FCA's Letter: Our Alternatives Supervision Strategy

https://www.fca.org.uk/publication/correspondence/portfolio-letter-alternatives-2022.pdf

A Summary of the FCA's Alternatives Supervisory Strategy

The Financial Conduct Authority (FCA) published a letter on the 9th of August to the Chief Executives of Asset Managers and Alternative Investment firms (Dear CEO Letter). The Dear CEO Letter details the strategic view the FCA wish to take towards sectors and the 'portfolios' of firms that have similarities within their permissions and business models.

The Dear CEO Letter impacts "alternative investment firms" which include firms managing or advising on alternative assets and investment vehicles (such as private equity and hedge funds). Asset managers include FCA authorised firms which directly manage or advise on mainstream investments, particularly retail investments.

As mentioned in their previous letter in **January 2020**, the FCA continues to drive their objective, that firms should act in the best interests of their customers and in doing so have highlighted the failings of Asset Managers and Alternative Investment firms and their lack of consumer protection.

Since the FCA's last letter, significant world events have greatly impacted the Asset Management industry, for example, BREXIT, the cessation of LIBOR and the recent COVID pandemic. Considering the above, the sector has shown resilience with market integrity mostly maintained. The FCA admits that during the period of 2020, industry resources were shifted as a COVID response, however, they now aim to focus their efforts on addressing risks, by encouraging firms to review current practices and procedures.

FCA's supervisory priorities

Part of the Regulator's supervisory focus is to assess the firms' Main Risks of Harm which are consistent with the commitments set out in their 2022 Business Plan.

1. Investment strategies that carry inappropriate levels of risk for their target client

Firms should identify the needs of investments and their client types, when offering products or managing investments, to avoid poor marketing practices and inappropriate distribution, largely targeted at mainstream investors.

To minimise risks to Consumers, firms should:

- ensure that alternative investments are only offered to appropriate investor types, and that the investment needs of the clients are met
- consider restrictions when communicating and approving financial promotions for alternative products
- carry out suitability assessments of alternative investments for retail investors
- outline clearly, the target markets in their distribution channels
- under COBS 3.5, include quantitative and qualitative tests to assess elective professional investors meet the requirements

In the next few months, the FCA is looking to issue a questionnaire, requesting firms for information on their Business Model, Investor Categories, Framework and Products.

2. Conflicts of Interest

Firm's Board or Executive Committees have been asked to review their procedures, in order to prevent conflicts, managed or disclosed, that have a potential to cause harm to the financial markets and investors. The FCA asks firms to consider the effect of their shareholder structure and the possible implications it can have on the effective governance of their organisation.

3. Market integrity and disruption

The FCA warns that robust risk and liquidity management is important at any given time, but especially as there is an increase in market instability and rising interest rates, which is leading to various new coexistent risks for Alternative Asset managers. This urges firms' and their Boards to ensure that risk functions have the correct resources, systems, and controls to be able to deal with the high levels of risk which funds and investors are exposed to. This is of particular interest to Large Hedge Fund.

4. Market abuse

Firms are expected to have strong prevention cultures, effective systems, and controls to enable them to discharge their obligations under the UK Market Abuse Regulation (UK MAR). Firms must ensure UK MAR controls are tailored to their individual business models, and warns that supervisory sanctions, civil and criminal actions will be taken if firms are not compliant and this will further act as a deterrent.

5. Culture

The FCA will look at how Senior managers and firm policies influence an organisation's culture. The FCA are interested to know how strong cultures are embedded in firms where founders or other senior individuals have a dominant role. Later this year the FCA will publish a Consultation Paper which will follow up on its earlier Discussion Paper in July of 2021. Firms that are subject to the MIFIDPRU Remuneration Code are required to apply the relevant rules from the performance period on or after 1 January 2022. If staff at firms are poorly incentivised this can lead to increased conflicts of interests and potential for harm.

6. Environmental, Social and Governance (ESG)

The FCA explains that:

- Firms are required to ensure that ESG-labelled products are clear, not misleading and that firms' actions match the stated aims.
- Marketing materials pertaining to ESG-labelled products are to be accurately described, with funds offering clear and consistent disclosure, which are subject to review.
- Asset Managers and Alternative Investment Fund Managers that are in-scope of the FCA's December 2021 rules, need to make disclosures in line with those recommended by the Taskforce on Climate-related Financial Disclosures, should consider what steps they will need to take to be able to make these disclosures from 2023 as required.

How we can help

Boards of firms impacted by this Dear CEO Letter should consider which of the areas identified are applicable to their business and to take the actions considered necessary to meet the FCA requirements. Newgate Compliance have extensive experience in advising Asset Managers and

Alternative Investment firms on the topics contained in the FCA's letter. Contact us to see how we can help you.

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Newgate has an unrivalled combination of experienced professionals, many of whom are ex-regulators.

Our customer focused approach seeks to provide appropriate, pragmatic and flexible solutions to our clients helping them to meet both the regulator's rules but also the spirit, principles and culture of the regulatory regime.

We look to build long-term relationships with our customers helping to encourage business growth, productivity and innovation. Our proactive approach is tailored to each customer's needs changing to meet those needs as the customer progresses and develops.