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No turning back now

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SRD II

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Aniel Mahabier

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Feature

No turning back now

Shiv Taneja argues that an absence of trust has long plagued the UK fund management industry and steps by the regulator to boost governance, transparency and value must be embraced.

In the spring of 2018, the Financial Conduct Authority (FCA) suggested that – as part of a wide-ranging review of governance, value and transparency of UK investment management – some 190 UK fund managers were going to need as many as 480 independent non-executive directors (iNEDs) to sit on their fund boards with effect from 30 September 2019. Palpable excitement was the prevailing sentiment as many industry worthies started burnishing their resumés in anticipation of the start of a 'plural' or 'portfolio' board career in fund management.

The inclusion of iNEDs on fund boards is part of an important set of measures and the result of the FCA's Asset Management Market Study (AMMS), which requires the production of the annual Assessment of Value report for UK mutual funds and the need for every fund board's Chair to come under the purview of the new Senior Managers & Certification Regime (see BOX for more information); yet the headlines, unsurprisingly, were largely focused on the need for a battalion-sized injection of senior industry talent on to fund boards.

That was then, and in the more than 12 months since, what has the experience been for the development of strong independent governance on fund boards? Well, the first thing to note is that the current requirement is for a minimum of two iNEDs, representing just 25% of the fund board; with a few honourable exceptions, most fund managers have done no more than meet the minimum requirement. But what has possibly proven to be a bigger disappointment, especially for the many aspirant iNEDs – particularly those from outside the industry who were hoping to instil a degree of much needed experiential (and other forms of) diversity on to fund boards – the number of roles offered into the public market were woefully few and far between, and in many instances the fees on offer were far below the FCA's indicative figure of £40,000 per directorship per annum.

As with many such things, demand appears to have fallen far short of supply, and I'd suggest this is largely due to the following factors:

1. Far more fund managers already had their required two iNEDs *in situ* than the marketplace believed to be the case, and therefore these firms didn't need to take any action. After all, the FCA never said these were going to be 480 *new* jobs!
2. Asset managers, especially the larger more internationally focused firms, have had the ability to call upon existing iNEDs on fund boards in other jurisdictions to join their UK fund board. A perfectly acceptable solution, even if it could potentially call into question the extent of directors' independence if they have multiple board roles with the same fund management firm;
3. Finally, and possibly the main reason for an absence of roles in the public market, is that a very large number of funds boards never did need to go external, as their own first- and second-degree contacts provided ample and rich pickings to fill the one or two roles they had on offer. Unfair you say, especially if you are not on the inside track, but perfectly legal, respond those fund boards who have chosen this friendlier, quicker and significantly less expensive option.

There is a temptation to suggest that whilst the FCA has had the right idea about instilling a degree of governance and transparency in asset managers in an effort to drive value for their investors, the industry has done what it has often done: seek to protect the *status quo* by doing as little as it possibly can get away with. On the face of it, and this would certainly have been true 12 months ago, there was quite a lot of feet-dragging, and I believe this was largely on account of just not being focused on something that had to be delivered 12 months out, and a rather ill-judged sense that if they didn't do anything about the 'problem' for long enough, it might just miraculously go away! Well, the FCA, if anything, is more determined than ever to ensure that the AMMS is implemented fully, and has also made it very clear that if it feels that the current rules are not having the desired effect, it will push harder and for more.

Through my work at Fund Boards Council (FBC) I have had the benefit of a ring-side seat of these early and tentative steps that the UK fund industry has taken in its effort to get to grips with greater transparency on its boards. For sure, this is just the start, and I am pretty optimistic that the UK fund industry will not just play catch-up on the governance and transparency front, which it must, but also has the ability to get ahead of the narrative, to coin a phrase.

And here's why. The industry *zeitgeist* has changed. Yes, I know, we have said this before, but this time around it has to be different. A small, but important, example of this is the pleasing number of FBC's corporate members (boards of fund managers that includes the Chairs, the iNEDs, as well as the executive directors) are not just limiting their engagement on the topic of governance to their board members but are keen

Feature

to involve their internal senior teams. We think this bodes very well, not just for the development of good fund governance principles more widely throughout organisations but also for the development of a strong pipeline of future fund board directors for whom transparency, value and governance are firmly entrenched in their day-to-day business practices.

This change in attitude is especially important as historically UK fund manager boards (not counting those listed PLCs) have tended to be more internal management committees with few of the processes that most 'normal' boards will be used to. Via the new AMMS rules, this is set to change, even if the change is likely to be more evolutionary in nature. But that may be no bad thing, as the changes will then be far more enduring, one hopes.

And finally, and this is equally important, as fund boards grow in confidence of their role, they will be more ambitious for themselves both in terms of the number of iNEDs they bring on, but also the range of experiences these iNEDs bring to bear. This has happened elsewhere, and will almost certainly happen in the fund industry, and driven by a changing profile of fund board Chairs, as they move from largely executive-led to independent.

The FCA is far from perfect, but in the AMMS, and more generally, it has set in motion a course for greater transparency and better governance which seeks better outcomes for investors – and this is something the industry has got put its back into. It's a long overdue, and fund management has no options for turning back.

Shiv Taneja is the Founder, CEO of Fund Boards Council, a professional members organisation established for the support, promotion and development of sound fund board governance. He can be contacted at staneja@fundboards.org, and if you'd like to get involved, please visit https://fundboards.org

The Financial Conduct Authority
The FCA regulates financial services firms in the UK, and is the conduct regulator for 59,000 financial services firms and financial markets in the UK and the prudential regulator for over 18,000 of those firms. Basically, it is their job to make sure that investors generally get a fair deal, and that the markets work well for them.

Asset Management Market Study
An exhaustive study undertaken by the FCA to establish if UK fund managers were providing value to their mutual fund investors. Work on this study began as far back in 2015, with an interim report in 2016, and a final report in the summer of 2017, and a final policy statement in April 2018.

In essence, the FCA said in no uncertain terms that it found that price competition is weak in a number of areas of the industry. It added that, despite a large number of firms operating in the market, based on their sample they found evidence of sustained, high profits over a number of years. The FCA also found that investors are not always clear what the objectives of funds are, and fund performance is not always reported against an appropriate benchmark.

Assessment of Value
Every UK fund manager covered by the AMMS has to produce an annual statement for its UK mutual funds explaining why it feels that the fund in question provides value to investors. It is about performance, yes, and a lot more. This statement has to be signed off by the Chair and the iNEDs, and also made available to investors.

Senior Manager & Certification Regime
In the simplest of terms, it is an effort on the part of the FCA to ensure that the financial services firms operate to a high 'conduct' standard in the UK, resulting in the reduction of harm to consumer, and the strengthening of market integrity on the part of the industry. It has already been set in motion for the banks and insurers and from the end of 2019 will also cover the asset management industry.

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Firms will equally need greater insight of the companies within their portfolio, ensuring that proper and thorough governance is being exercised, and meeting investment aims. Forewarned is forearmed, and in the increasing drive to secure alpha through an ESG lens, data is the key meeting this challenge.

Bringing it together

Ultimately, SRD II aims to prevent the mistakes made in the past. Governance and oversight are only possible if the information and data being used to make the judgements is full and accurate and is available at the same level of detail to all players equally. Knowledge therefore is key to ensuring accountability. Issuers, institutional investors and proxy advisors all have a part to play in bringing about the behavioural changes needed to ensure businesses, and ultimately economies, run in a sustainable way.

Aniel Mahabier is CEO of CGLytics, the world's largest corporate governance data analytics provider. https://cglytics.com/

What our subscribers say

'*Governance* is a useful means of keeping up to date on developments in a field which is assuming greater importance by the day.'

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