

THE
INVESTMENT
ASSOCIATION

VALUE ASSESSMENT REPORTS – ANALYSIS AND INITIAL RECOMMENDATIONS

April 2021



ABOUT THE IA

The IA champions UK investment management, supporting British savers, investors and businesses. Our 250 members manage £8.5 trillion of assets and the investment management industry supports 113,000 jobs across the UK.

Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs.

The UK is the second largest investment management centre in the world, after the US and manages over a third (37%) of all assets managed in Europe.

SUMMARY AND RECOMMENDATIONS

THE REQUIREMENT FOR AUTHORISED FUND MANAGERS (AFMs) TO PERFORM AN ASSESSMENT OF VALUE ON THEIR FUNDS HAS BEEN IN PLACE SINCE 2019, AND ALL AFM BOARDS HAVE NOW UNDERTAKEN AND PUBLISHED THEIR FIRST REPORTS ON THEIR ASSESSMENTS OF VALUE. THIS IS THEREFORE AN OPPORTUNITY FOR THE INDUSTRY TO REVIEW THE FIRST YEAR OF ASSESSMENTS, CONSIDER THE DIVERSITY OF APPROACHES THAT HAVE BEEN SEEN IN THE MARKET PLACE AND DRAW SOME INITIAL CONCLUSIONS ON GOOD PRACTICE THAT MIGHT HELP IN FURTHER DEVELOPING PRACTICES AROUND THE ASSESSMENT OF VALUE.

The IA has undertaken a study of assessment of value reports published by a sample of AFMs, representing around 71% of UK funds by assets under management. This report outlines **what we have observed in industry practice in the first year, and based on this analysis highlight some of the approaches the IA believes have worked well in light of the FCA's objectives for the Value Assessment, and which firms may wish to consider when assessing their approach to future reports. This should by no means be considered a comprehensive list of recommendations, or a safe harbour standard. Such standards can only be issued by the FCA, should it choose to do so.**

The paper is divided into five sections:

1. Background and purpose

2. Methodology

3. General Findings are set out in the following areas, including recommendations for firms to consider:

- Accessibility and location
- Structure and layout
- Overall approach to value assessment reporting.

4. Specific Criteria Reporting considers each of the minimum criteria set by the FCA, reporting on how each of these has been addressed by the firms in the sample, and some recommendations around these.

5. Concluding Remarks

In terms of our substantive analysis, we find the following:

ACCESSIBILITY, STRUCTURE AND OVERALL APPROACH

The majority of firms have used composite reports for their assessment of value statements, rather than include these in annual reports. While the majority of reports in our sample were easily found, this was not universally the case and further work is needed to make all reports accessible.

There is significant variation across reports in terms of length, but most seek to explain the value assessment and a number include a statement from the Chair, a senior executive or the Board. Such statements, while not required by regulation, can be helpful in demonstrating ownership and accountability of the Board to investors in their considerations and conclusions on the assessment of value.

The FCA's rules require rules require the assessment of value to be performed at share class level with reporting at fund level and, where applicable, at share class level. Most AFMs have reported on their assessments at fund level rather than share class level, with some reporting some of the criteria at firm level. Around 21% reported that action was needed, with the most commonly cited reason being performance. We do not suggest a standardised reporting format at this stage, though we recommend the AFMs assume a broad audience in both language and presentation of the report, with recommendations on how to ensure that the content is both straightforward to understand and presented in a way that provides relevant data in an engaging format.

SPECIFIC REPORTING ON SEVEN MINIMUM CRITERIA

Our commentary focuses on the seven minimum criteria set out in regulation, providing an IA view on key aspects to help firms with the next iteration of reports, while recognising that the regulator is likely to offer a more detailed view during the course of 2021.

We find most AFMs have focused on the seven minimum criteria specified by the FCA, with only two AFMs in the sample choosing to specify additional criteria. We do not at this point offer a view about additional criteria that should be a standard part of the value assessment, though recognise the evolving landscape for sustainable finance/ESG disclosures in particular.

A broad range of approaches have been adopted for **Quality of Service**, with AFMs in many cases considering this at the level of the firm. This can include categories that could arguably be considered as separate criteria themselves. We suggest firms consider setting out and reporting on measurable factors where possible.

Performance is the criterion on which we saw the most issues on value being raised. Just over half of AFMs stated the investment objective the fund is seeking to achieve, and around half provide performance data either for all funds or those where performance has been identified as an issue. We suggest that it is helpful to investors for AFMs to set out the investment objective and to provide performance information or a clear signpost to where this can be found.

Most AFMs reported **AFM Costs** as a separate criterion, though a majority (62%) did this at firm level. This criterion can involve considerations that are commercially sensitive that would not be appropriate to disclose in a public report, but the process and conclusions of this criterion should be specified separately to other criteria in the assessment of value report.


Almost three quarters (71%) of AFMs considered **Economies of Scale** at a firm level, but only two gave a figure at which economies of scale are typically realised that can be passed onto investors. We anticipate the FCA offering further insight in this area as part of their firm-level supervision and broader signalling to the market during 2021-22.

The majority of AFMs (88%) reported good value on **Comparable Market Rates**, and 64% provided fee data for some or all of their fund range. Just over half of AFMs explicitly referenced the peer group against which they had compared their fees, and 40% reported fee data for the peer group. The IA view is that it is for AFM Boards to decide if it is appropriate to use an external firm or an internal process, but suggest AFMs set out the rationale or methodology for the selection of the peer group in their reports.

Approaches to reporting on **Comparable Services** were broad, with varying degrees of specificity being given on the services considered. 97% of funds covered in the sample were reported as representing good value against this criterion. While recognising the confidentiality issues and sensitivities that can arise with mandates, we suggest AFMs at least outline the assessment process undertaken for comparable services.

Around 10% of funds in our sample identified issues with investors being in more expensive **Classes of Units**, with AFMs taking action to move these to cheaper unit/share classes. Information and findings were usually presented at firm or fund level, with only a minority reporting at unit/share class level. The IA does not give a view on whether reporting should be at share class level, but suggests that AFMs consider including clear guidance to assist investors in identifying which share class they invest in.

We anticipate the process to be one of continuous learning and improvement over the next few years, as AFM Boards, in partnership with their independent directors, grow and refine their understanding and familiarity with the concepts and processes involved in the assessment of value. We hope that both the analysis and recommendations contained in this report will assist firms as they consider further development of their approach to the assessment of value.



**“WE ANTICIPATE
THE PROCESS TO BE
ONE OF CONTINUOUS
LEARNING AND
IMPROVEMENT.”**

RECOMMENDATIONS

Drawing on the analysis and discussion set out in the report, we summarise here the recommendations that firms may wish to consider when preparing their next value assessment reports.

General areas

ACCESSIBILITY AND LOCATION

- Publishing reports in an easily accessible location on firm websites, such as on individual fund pages.
- Making individual fund reports available to investors where there is a wide range of funds.

STRUCTURE AND LAYOUT

- A statement or summary comment about the year's value assessment can offer a way to connect with investors beyond the formality of the reporting process itself, conveying key wider messages about a firm's ethos alongside more specific material relating to the value assessment.

OVERALL APPROACH TO VALUE ASSESSMENT REPORTING

- Wider use of summaries and graphics to illustrate the information provided may be a helpful way of making reports easier to follow. Such an approach may also be helpful in addressing the varying information demands of different investors.

Specific criteria

QUALITY OF SERVICE

- Setting out any measurable factors against which quality of service has been assessed and supporting information, so readers can assess how the Board has reached its conclusions on quality of service.

PERFORMANCE

- Setting out the investment objective that the fund is aiming to achieve ahead of describing how the fund has performed.
- Providing information on how the fund has performed, or directing investors to where this can easily be found, and consider providing benchmark or comparator information alongside this – firms may wish to consider presenting this using a chart or other visual tools.

AFM COSTS

- Setting out a discussion in the report on AFM costs that is distinct from other criteria relating to charges.

ECONOMIES OF SCALE

- Providing a high-level description of how economies of scale are being assessed in the assessment of value report.

COMPARABLE MARKET RATES

- Setting out the ongoing charges for all of the funds in the assessment of value report.
- Setting out the rationale or methodology for how the peer group was selected.

COMPARABLE SERVICES

- Outlining the assessment process undertaken for comparable services, including the types of services assessed, and the outcome of the assessment.

CLASSES OF UNITS

- Including guidance to assist investors in identifying which share class they invest in.

1. BACKGROUND AND PURPOSE

The requirement to perform an annual assessment of value, alongside the requirement to appoint independent directors to the Boards of authorised fund managers (AFMs), represents the most significant reforms to the governance of UK authorised funds over the last few decades. These reforms are part of a drive by the regulator to power cultural change in the industry to a greater focus on delivering value to investors.

AFMs must prepare and publish annually a public statement on the assessment of value undertaken by the Board, either in the annual report and accounts or in a separate consolidated report including the assessment of value statements for a number of funds. This requirement has been in place since September 2019, meaning the first assessment of value reports were published from the end of January 2020.

The FCA set out a list of the minimum criteria that the Boards of AFMs should consider in their value assessments, together with minimum considerations on what the reports on the value assessments should offer. The FCA considers that the transparency created by such reports can play an important role in stimulating competition within the industry. As such, the precise shape of the process and reporting was left to the Boards of AFMs to determine. At the same time, competition law considerations limited the scope for collective discussion within the industry on how the new requirements should be approached, at least until reports were available in the public domain. AFMs have therefore had to determine for themselves the right approach to the value assessment for their firm, including the level of detail that should be given on their assessment, what data and measures to include, etc. In the case of those AFMs that were among the first to report, they had to do this without any precedent to follow in the UK.¹

The IA has always anticipated the value assessment process as being one of incremental development and improvement. The end of the first year of public reporting provides a valuable opportunity for the industry, its customers, regulators and wider stakeholders to consider the assessments performed in the first year. The IA, like a number of other organisations, has analysed a sample of the first cohort of value assessment reports, and in this report we set out our observations based on this analysis. Some of the observations, notably around accessibility, reiterate and expand on previous IA guidance to member firms. Other elements, particularly the need for clearer presentation of some aspects of reporting, are based on our report analysis and mirror themes that are being reflected in the work of other stakeholders.

While this paper focuses on the reports on the value assessment issued by AFMs, it is important to stress that this is not the sole, or even the primary purpose of the value assessment requirement. At its core, the value assessment requirement is a governance requirement, rather than a disclosure requirement. The purpose of the value assessment report is to provide external scrutiny and accountability on the value assessment undertaken, rather than an end in itself, and the primary focus of Boards is on this assessment, for which Board directors will consider a huge quantity of information. The internal approaches and detailed evaluation processes of individual firms, and the briefing packs presented to Boards are confidential and not in the public domain, with summaries of the conclusions being made publicly available.

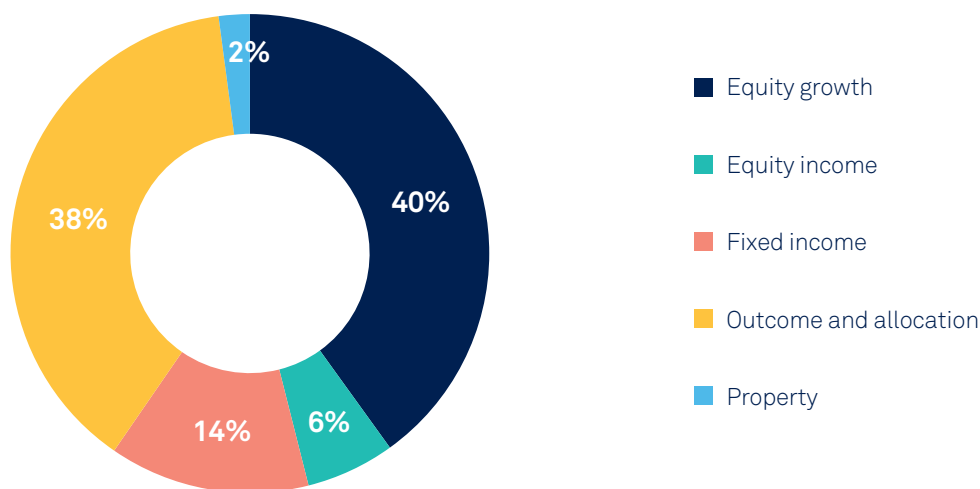
Nonetheless, we hope that the observations in this analysis will be useful to AFMs as they consider not just the report, but the key governance processes involved in the overall assessment. We intend to work further with firms, customer groups, the regulator and wider stakeholders to help the assessment and reporting process evolve successfully in the coming years.

¹ Only limited lessons could be drawn from the annual assessments carried out by the Boards of Trustees of US 1940 Act investment companies using the Gartenberg principles – a comparable, though not equivalent, process that has largely evolved through legal precedent rather than regulation.

2. METHODOLOGY

The analysis presented in the subsequent sections is based on the public reports of 45 IA member firms. These account for over £800 billion in UK domiciled funds on behalf of retail and institutional investors, representing 71% of total UK domiciled funds under management. The sample covers almost 1500 UK domiciled funds. We also use Morningstar fund data for the purposes of obtaining some descriptive statistics for the sample. The sample is designed to include all sizes of firm and all forms of business model. As Chart 1 shows, the sample offers a good mix of funds investing across asset classes with the majority being equity (46%) or outcome/allocation (38%) funds.

CHART 1: BREAKDOWN OF SAMPLE BY ASSET CLASS



3. GENERAL FINDINGS

The work and challenges involved in implementing the first year of value assessment have been significant, including: establishing a value assessment methodology; establishing new data channels to power that methodology; enhanced processes for collating and analysing data to be presented to the Board; and a process for reporting on the assessment made by the Board. The focus on year one has inevitably been on implementing a process that satisfies the regulatory requirements. Undoubtedly, firms will be seeking to build upon and refine the processes they established further in the second-year assessments and beyond, considering their value offering further and potentially extending and refining the data points used to consider each of the criteria.

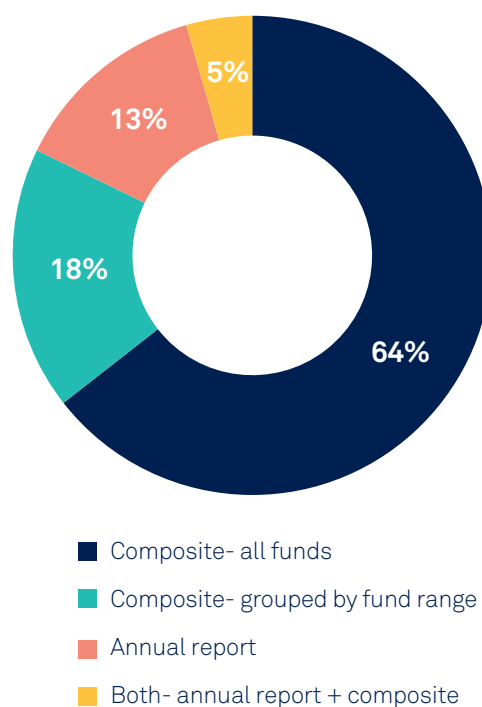
There has been a clear diversity of approaches and reports from AFMs on the value assessment, which suggests limited scope for standardisation. AFMs have also begun to develop their own house styles, and although we expect these to evolve, our sense is that a number of AFMs will prefer to work within the frameworks they have initially established. As such, the IA does not propose to produce or recommend an industry template for value assessment reports at this time. It is possible that we may see greater convergence in how value assessment reports are presented in the coming years. The IA will continue to monitor how the value assessment progresses over the coming years and will continue to assess whether there is scope for or benefits in encouraging greater standardisation.

We outline what we have observed in industry practice in the first year, and based on this analysis highlight some of the approaches the IA believes have worked well, and which firms may wish to consider when assessing their approach to future reports. This should by no means be considered a comprehensive list of recommendations, or a safe harbour standard. Such standards can only be issued by the FCA, should it choose to do so.

1. ACCESSIBILITY AND LOCATION

FCA rules allowed firms to publish assessment of value reports either as part of each fund's annual long report or as a composite report covering two or more funds. As can be seen in Chart 2 below the majority (82%) of firms in the sample have published their statements as a composite report, either as a single report covering their entire funds range (64%) or through multiple composite reports (18%), grouping together funds investing in the same asset class or with similar investment strategies. Some firms in the sample have made it possible to download assessments for individual funds in addition to the composite report covering their entire fund range. A minority of firms (13%) have published their value assessments in the annual long report.

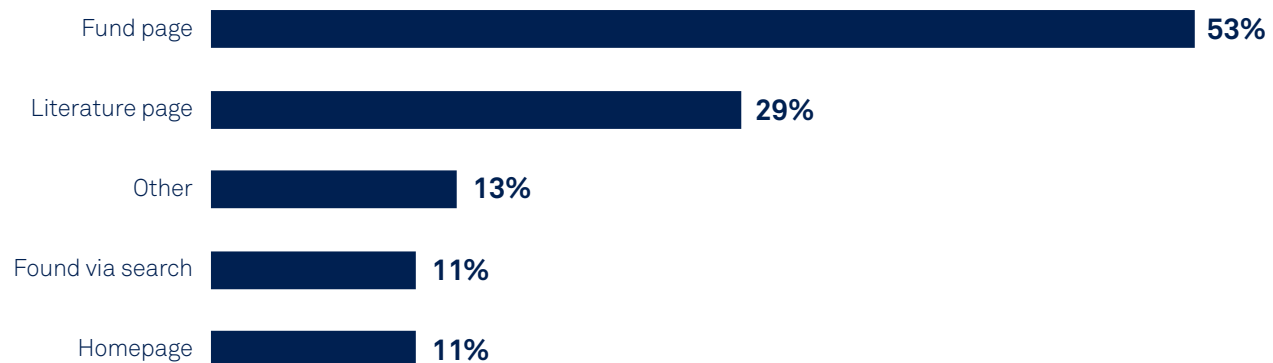
CHART 2: HOW VALUE ASSESSMENT REPORTS ARE PUBLISHED



Public reporting of the value assessment process was intended to bring in further transparency and scrutiny. IA guidance, published to help firms during the first year of the assessment and reporting process, highlighted the importance of accessibility of the reports to investors and other stakeholders. All firms in the sample have made reports available on their websites with varying degrees of visibility and accessibility. Just under one fifth (18%) of firms have made reports accessible from more than one page on the website.

The most common place to find the reports is on individual fund pages, with over half of firms in the sample including links somewhere on these pages (see Chart 3). Where reports are not found on individual fund pages, they can most commonly be found in literature libraries or directly on the homepage. The 'Other pages' category includes regulatory disclosure pages or dedicated assessment of value pages that can easily be accessed in the navigation panes of websites. However, some reports (11%) were not located in intuitive locations on the website, and were only found via external search engines or via the search function on firms' websites.

CHART 3: HOW TO LOCATE THE REPORTS



**IA Comment:
Making reports as accessible as possible**

Regardless of whether the assessment of value is published within the report and accounts, or within a composite report, we reiterate how important it is that these are easily accessible to the public. As illustrated in Chart 3 above, 11% of reports in our study were not available in intuitive locations of the website. Other bodies have noted similar findings: when completing its analysis, the CFA were unable to locate assessment of value reports for 25% of the funds it had intended to include in its sample². At a minimum, composite reports must be made available in the same manner as the report and accounts. However, it is critical for the industry to be open and transparent. We therefore suggest that AFMs should seek to make reports easily findable on their websites through simple navigation or straightforward search terms.

Where the statement on the assessment of value was included in the annual reports and accounts, in some cases this was not evident from the firm’s website. Even when looking in the reports and accounts, it was not always easy to find the assessment of value statement within these – in some cases these were not referenced in the contents. We recommend the location of the report is clearly signposted to investors on the firm’s website and is put in its own section of the report and accounts that can easily be found by readers.

Provided the statement on the assessment of value is provided in the manner required in COLL 4.5.7R(8) or (9), there is nothing preventing a firm from also making the report available in a separate format either reproduced in whole or in summary form to make it more accessible to investors, including in a digital or vlog format, provided that any summary is a fair representation of the full report and is not misleading. Where a firm chooses this approach, we recommend that firms include a signpost to where the full value assessment report can be found.

We recognise that broader awareness of the assessment of value reports needs to be promoted, in particular among intermediaries and distributors, who usually have a closer relationship with the end investors. Greater encouragement is needed for platforms to host or provide links to assessment of value reports. Meanwhile, it is important at this stage that AFMs themselves take the appropriate steps to make the reports straightforward for investors to access, as the industry seeks to broaden awareness and engagement in other parts of the market.

Have you considered?

- **Publishing reports in an easily accessible location on your website, such as on individual fund pages.**
- **Making individual fund reports available to investors where you have a wide range of funds.**



² <https://www.cfauk.org/professionalism/research-and-position-papers/review-of-uk-fund-assessment-of-value-reports#gsc.tab=0>
(Refer to Executive Summary, page 3)

2. STRUCTURE AND LAYOUT

The FCA rules around reporting have been deliberately non-prescriptive, giving firms flexibility to produce reports in a way that best suits them. As a result, we have seen first year reports that vary significantly in presentation, length, level of detail and use of quantitative and qualitative information. We have analysed our sample of reports to identify areas where firms have taken similar approaches and areas where there is notable variation in reporting approach.

Overall length

Firms' internal value assessment process goes into great detail and requires access to information that is commercially sensitive. The published reports are intended to be a high-level summary of a much more detailed internal assessment. The published reports range from 1 to over 400 pages, depending on how many funds are covered within them. However, we do find a difference in approach between the average number of pages per fund of value assessment in annual reports (3 pages per fund) compared with composite reports (6 pages per fund).

Opening statement

Almost 60% of firms have chosen to open their value assessments with a letter from the Board Chairperson, often introducing their approach to delivering value and an overview of their findings. Almost one quarter of these firms have also included additional statements from iNEDs, the CEO, the CIO or the Board. Firms publishing their value assessment statements only in the annual report tend not to include an opening statement from someone involved in the assessment process. This may be a reflection of the fact that annual reports have a different overall structure and usually include an opening statement to the report as a whole.

Explanation of the assessment of value

Since this is the first year of reporting, 69% of firms have included a brief 'What is an assessment of value?' section or similar early in the report. It is here where firms explain the context regarding the Asset Management Market Study and outline the seven criteria they are required to report against. Just over a quarter of firms (27%) also include a glossary to help customers navigate the value assessment report.

IA Comment: Potential for demonstrating ownership and accountability

As observed in our findings, a majority of reports, especially those published later in the year, included a statement from the Chair of the Board, and around a quarter of reports included statements from the CEO or independent directors. There is no requirement for such a statement in the assessment of value report, and it is therefore a decision for each firm whether they decide to include it. That said, including a statement or forward from the Chair and/or giving information on the individuals who are on the Board may help with demonstrating ownership and accountability of the assessment of value process by individual Board members. It may also offer an opportunity to articulate the firm's values and ethos, and what it seeks to deliver for investors.

Ultimately, the report is intended to describe the assessment of value process, and the outcomes of the Board's decisions based on its' assessment of the funds, rather than be used as a marketing document. We suggest that any statements given by the Chair or Board should be given in that spirit.

.....

Have you considered?

- **A statement or summary comment about the year's value assessment can offer a way to connect with investors beyond the formality of the reporting process itself, conveying key wider messages about a firm's ethos alongside more specific material relating to the value assessment.**

.....

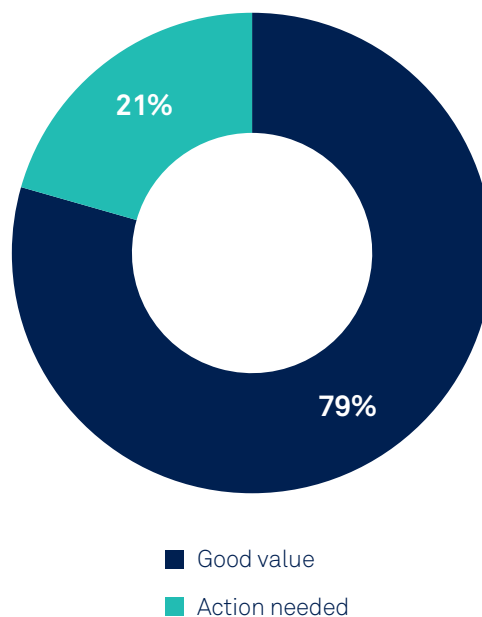
3. OVERALL APPROACH TO VALUE ASSESSMENT REPORTING

The rules outlined by the FCA require firms to carry out value assessments at a share class level for each fund. In terms of reporting, since firms are required to report for each fund, the IA guidance suggests the public facing reporting be at a fund level with share class level issues being identified where necessary. Over four-fifths (82%) of firms in the sample have reported at the fund level with the remainder reporting either for each share class (7%) or providing a firm level (11%) summary of their assessment with little or no fund specific information. We discuss the level of reporting further under *Classes of Units*.

In terms of overall conclusions, we analyse this at both firm and fund level:

- At the firm level, 62% of the 45 firms in the sample have identified at least one of their funds requires further action, with the remaining 38% reporting their entire fund range delivers value.
- Looking at the funds administered by the firms (almost 1500 in total), Chart 4 shows that some 79% of the funds were assessed by their AFM boards as having delivered good value, with 21% requiring further monitoring or action to be taken.

CHART 4: PROPORTION OF FIRMS IDENTIFYING ACTION NEEDED



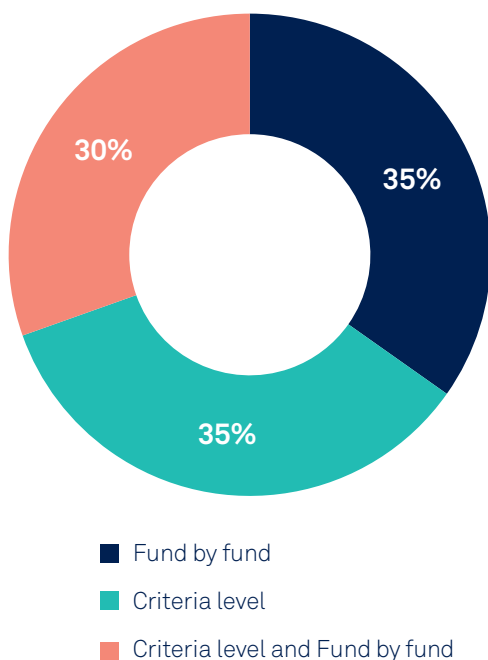
We make five observations here about presentation of the results:

1. Approach to presentation of assessment criteria.

As Chart 5 shows, the firms in the sample have taken three broad approaches in presenting their assessments:

- **Fund by fund:** Following a brief introduction to the seven criteria, firms go through their findings against each of the criteria, fund by fund (35%).
- **Criteria level:** Firms go through each criterion and present a summary of their findings, going into fund specific detail for all or some of their funds within each criterion (35%).
- **Combined approach:** Firms use a combination of criteria and fund levels above, such that they present a summary of some or all of the criteria at firm level (most commonly quality of service and economies of scale) and present fund by fund findings for the criteria not covered at a firm level (30%).

CHART 5: OVERALL APPROACH TO PRESENTATION OF FINDINGS



2. Positioning of conclusions. Almost half the firms (49%) have presented the conclusions of their process at the front end of the report prior to discussing the assessment and criteria in any detail, so investors do not have to dive into long reports to determine overall conclusions. The upfront conclusions are either presented in summary tables or in narrative text form.

3. Summary tables. Just under half (49%) of firms have used tables somewhere in their reports summarising their overall conclusions for each fund. Over a third (35%) of the firms that do not use summary tables either publish their statements in the annual long report or are assessing just one fund.

4. Tiered ratings. Over half (58%) of firms in the sample have used a tiered rating system to present conclusions overall and for each of the assessment criteria. The remaining firms presented a binary overall conclusion regarding whether a fund has delivered good value to investors or not. For those using a tiered rating system, this is usually in the form of a three-tiered traffic light system where firms assign funds a green, amber or red rating. A very small number of firms in the sample have used a four or five-tiered rating system for their funds.

5. Areas for improvement. One third of reports include a 'what can we improve' section regardless of the outcome of the value assessment process itself. These can be specific action points that firms intend to implement or commitment to further monitoring.

**IA Comment:
Assuming a broad audience in both
language and presentation**

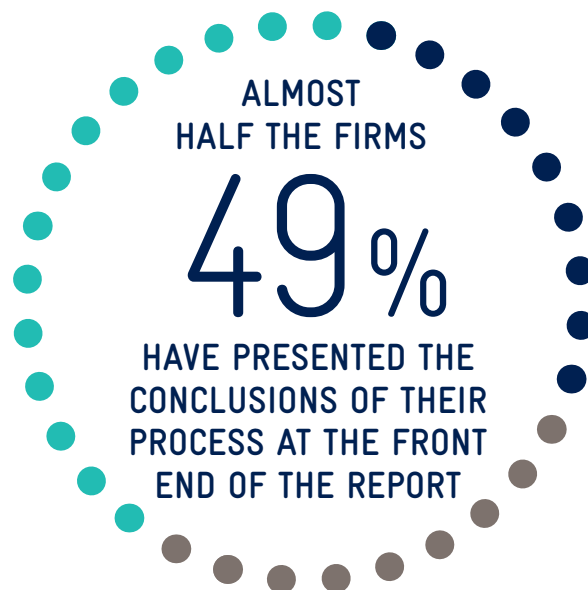
One of the issues that many firms have reported to the IA in year one is the difficulty of identifying who the main audience is for this report. This clearly affects how the report is structured, the language and terminology used, the type and quantity of information that is included, and how this information is presented. Determining the right balance of information to include in the report has proved challenging to managers in the first year. There is a fine line with giving enough information, and overwhelming investors by giving too much. Getting the balance of information disclosure right is likely to take a few further iterations of the report.

Feedback from IA members suggest that engagement by retail investors in the assessment of value reports is limited, with some members having reported very low click-throughs by website visitors to these reports, according to their website analytics. The IA hopes to do further work on the audience for the reports during 2021 and it is also likely to evolve as the value assessment process itself beds in as part of the UK fund landscape.

Nonetheless, the IA and member firms recognise that reports should be drafted and presented in a clear, informative and useable format, such that a retail investor would find the report helpful should they seek it out. The IA does not propose to produce further detailed guidance on language and terminology used in the assessment of value reports at this stage, but suggests the *Guidance on Fund Communications*, issued by the IA in February 2019 in partnership with the Wisdom Council may be a useful reference for firms in this context.

Have you considered?

- **Wider use of summaries and graphics to illustrate the information provided may be a helpful way of making reports easier to follow. Such an approach may also be helpful in addressing the varying information demands of different investors.**



4. SPECIFIC REPORTING OF THE SEVEN MINIMUM CRITERIA

The rules set out by the FCA require AFMs to consider “at least” seven criteria and provide a summary of how each of the criteria was assessed and what actions were taken, if any. The seven criteria are:

1. Quality of service
2. Performance
3. AFM costs – general
4. Economies of scale
5. Comparable market rates
6. Comparable services
7. Classes of units

We set out below some considerations with respect to the seven criteria set out by the FCA. We note in particular two key general points.

First, that **the FCA will be continuing its own analysis in line with its expectations of firms and that the commentary below is necessarily limited therefore to the IA’s own view of where firms could take further steps in the development of their reporting process.**

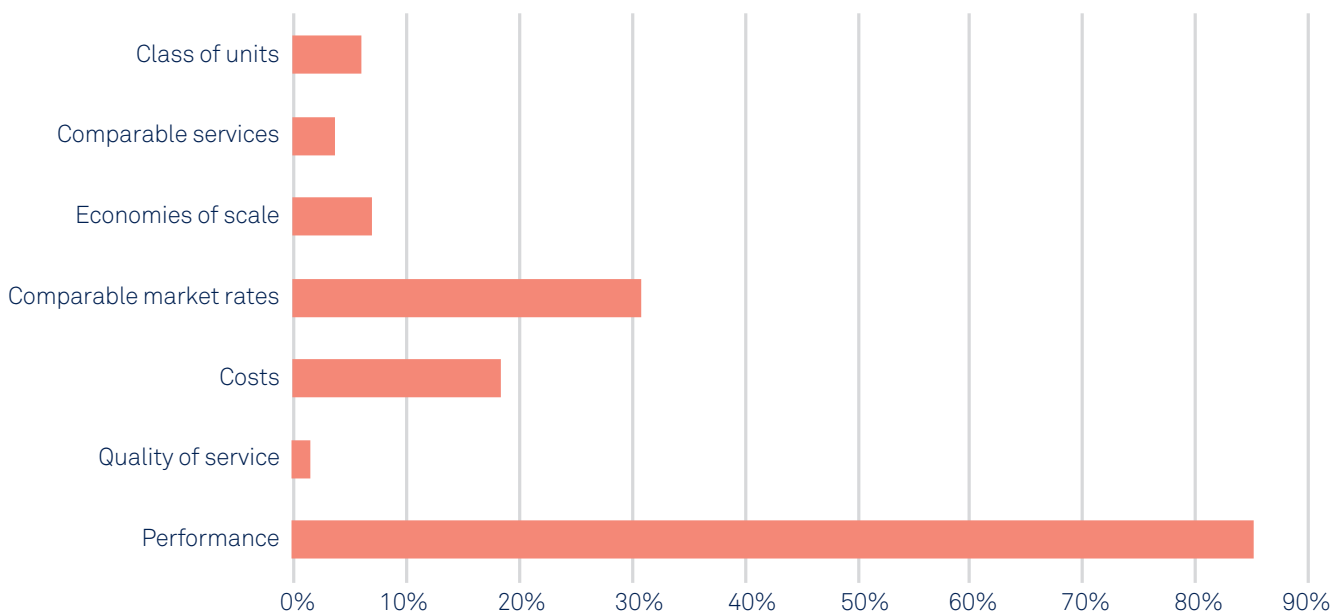
Secondly, **the seven criteria set by the FCA are minimum criteria, with firms required to perform the assessment of value on and report against “at least” these criteria.** This clearly allows AFMs to consider and report against other criteria if and where they believe this is applicable to their value proposition, provided this is in addition to, and not in place of, the seven criteria specified by the FCA.

OVERALL COVERAGE OF CRITERIA

Firms have discussed all seven factors at a firm level to varying degrees of detail. Within the sample, we observe just two examples of additional criteria used; one firm which considers responsible investment criteria and another which has looked at corporate culture as an additional data point outside of Quality of Service.

Chart 6 provides a summary of areas where issues arise with value at fund level. Of the almost 300 funds reporting issues, the primary driver is issues related to performance. Very few of these funds have reported issues with quality of service, economies of scale and comparable services.

CHART 6: CRITERIA FOR IDENTIFYING AN ISSUE WITH CUSTOMER VALUE



IA Comment:
Considering other criteria?

The AFMs in the sample elected overwhelmingly to consider only the seven criteria specified by the FCA, with only two AFMs choosing to consider further criteria. It should be noted, however, that under quality of service in particular, a broad range of approaches were taken by AFMs, and they have tended to consider a range of factors as sub-criteria under quality of service rather than as distinct criteria. It is possible this approach may evolve in future years as approaches to assessments of value are further developed.

Some industry commentary has recommended going further than the seven criteria, for example: incorporation of both responsible and sustainable investment approaches and liquidity as part of the value assessment. Such factors are clearly increasingly important for customers as well as policymakers and regulators. The industry is also deploying very significant resource in these areas, both on the measurement/management and reporting side.

For now, our view is that it should be left to firms to determine whether it is appropriate, having regard to their value proposition, to consider such factors in their assessments of value. This could be on a case-by-case basis. For example, where firms operate funds with specific responsible and sustainable investment approaches or invest in illiquid assets, there may be greater need for consideration than where a fund is operating a conventional value investing strategy in very liquid markets. Equally, where firms take a more systematic or integrated approach to responsible and sustainable investment, there may be scope for a broader set of comments as part of the value assessment report.

We will review these points carefully in future guidance, particularly given rapidly-evolving expectations around responsible and sustainable investment, which are likely to see a mainstreaming of such considerations – both in the investment and reporting process – in the coming years.

QUALITY OF SERVICE

The quality of service criterion requires firms to look at services directly related to the operation of the fund as well as additional services that relate to the broader investor experience. Different services would be subject to assessment with varying weight and degrees of materiality.

Although reporting on this has been broad, there are some commonly reported aspects of service that include investor feedback, complaints, quality and timeliness of communication and information provision, ESG integration, external ratings and awards, quality of personnel, quality of investment processes.

This criterion is either presented at the firm level, or if reported for each fund, the same text is used across the entire fund range. There have been only eight funds reporting issues with quality of service related to suspensions and income delivery.

IA Comment:
Approaching Quality of Service

There were a variety of approaches we observed firms taking in their report. This is to be expected, as the factors that each firm deems relevant to the quality of service very much depend on the value proposition of the firm. This is a very broad criterion, and can capture a range of items that could potentially be considered criteria in and of themselves. We do not consider it helpful at this stage to direct or recommend all firms to consider particular factors within the quality of service where not mandated in the FCA rules. We do, however, suggest that the factors chosen as far as possible should be objectively measurable, and that the report should outline the factors that have been considered and how those factors have been assessed, including providing supporting information where appropriate, so readers are clear on how the Board reached its conclusions.

.....

Have you considered?

- **Setting out any measurable factors against which quality of service has been assessed and supporting information, so readers can assess how the Board has reached its conclusions on quality of service.**

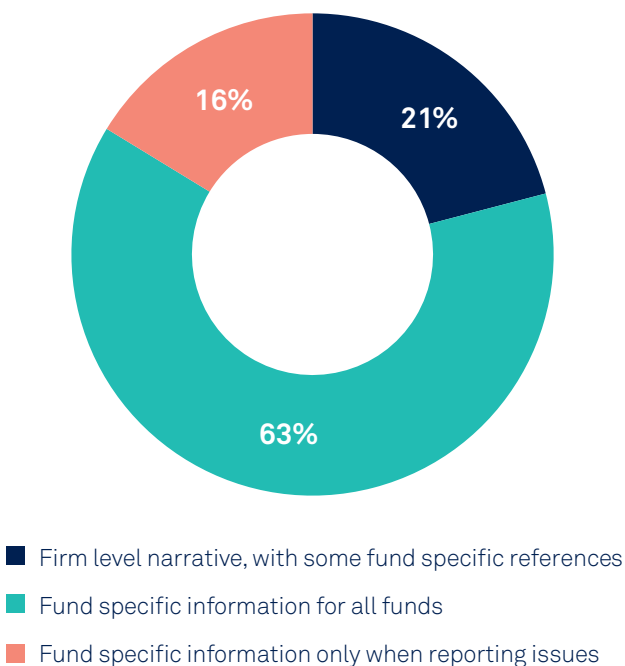
.....

PERFORMANCE

The performance criterion requires firms to assess returns, net of all charges, and should be viewed in the context of the fund objective and investment policy. Where appropriate, performance relative to a benchmark should be considered. In cases where the objective includes specific outcomes such as risk management or providing income, it is appropriate to look beyond return to assess whether these outcomes have been delivered. Over half (56%) of firms in the sample open the discussion on performance by first explicitly setting out the fund objective against which they have assessed performance.

Reporting on performance has been mostly fund specific, with just one fifth of firms reporting firm-level summaries in which they highlight issues identified in specific funds. As Chart 7 shows, the majority (63%) of firms have reported their assessment of performance for their entire fund range while 16% have reported the details of their underperforming funds only.

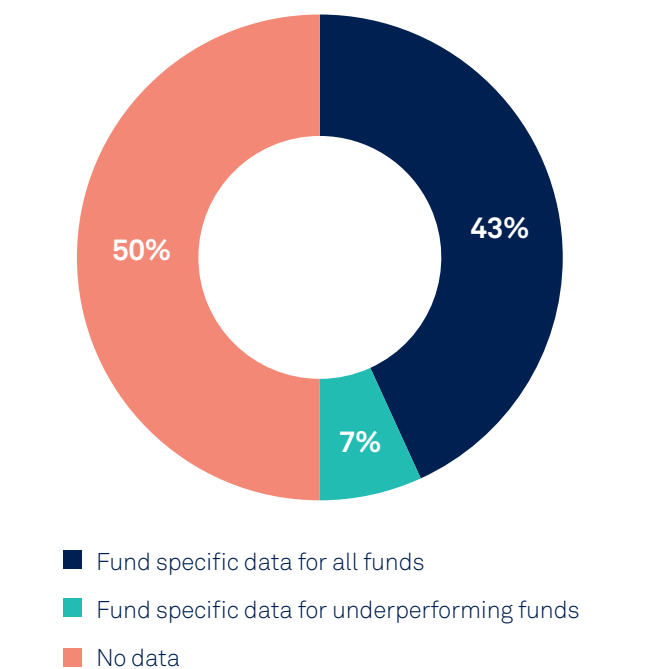
CHART 7: APPROACH TO REPORTING THE PERFORMANCE CRITERION



All firms have considered fund performance over the recommended holding period as outlined in the fund objective, most typically five years. Over one third (36%) of firms in the sample have made explicit reference to further performance analysis looking over multiple timescales, half of which have assessed near term performance over one, three and five years, with the other half looking at longer term performance over seven or ten years.

AFMs have the discretion to choose whether or not to include qualitative or quantitative information on performance, and this is an area where we observe variation amongst firms. As Chart 8 shows, half of firms have not included any data at all in their performance assessments. Those publishing their statements in the annual report who have not included data in the value assessment section have made references to performance data that can be found elsewhere within reports.

CHART 8: USE OF DATA WHEN REPORTING PERFORMANCE FINDINGS



The majority (77%) of those who do include fund performance data also include benchmark performance data. A very small number of firms have also used sector percentile as an additional performance metric.

Over three fifths (64%) of firms who have included performance data in their assessments present the information in table or chart form.

**IA Comment:
Setting context for performance**

This has clearly been a strong area of scrutiny for Boards, and the most common criteria by far where concerns over value were identified. Performance net of charges is undoubtedly also a key area of focus for investors – after all, ultimately net returns, whether as capital growth or income, are what investors who choose to invest in funds are seeking.

Just over half of firms chose to provide the investment objective that the fund was trying to achieve when discussing the performance. This context is important in any discussion on how the fund has performed, and we suggest that it is helpful to set out the objective before discussing how the fund has performed against this.

Half of the reports we viewed provided no data showing how the fund had actually performed. While there is no requirement to provide performance data in the report, a purely narrative description of how the fund performed does not necessarily help the investor to draw their own conclusions as to whether the fund has delivered returns in the way that they had hoped.

It is ultimately for the Board of each firm to decide whether and how much information on the performance of the fund to include, and whether to include benchmark figures or other comparators. However, we suggest it is helpful for investors not to have to look up figures being referred to in the description of the Board’s assessment elsewhere. Firms may wish to consider including at least the NAV performance of the fund for the representative share class over the period being assessed. As we suggest in the section on audience above, consideration should also be given to presenting data using charts and other visual tools.

.....
Have you considered?

- **Setting out the investment objective that the fund is aiming to achieve ahead of describing how the fund has performed.**
- **Providing information on how the fund has performed, or directing investors to where this can easily be found, and consider providing benchmark or comparator information alongside this – you may wish to consider presenting this using a chart or other visual tools.**

AFM COSTS

The AFM costs criterion requires Boards to identify and review each charge the fund is paying for and for each of these, the cost of providing the service to which the charge relates or the amount paid to an associate or an external party. In addition to the fund’s cost base, AFMs must consider all fees including the AMC as well as additional fees such as performance and entry fees.

Most firms (80%) reported on AFM costs as a standalone criteria. The remaining 20% of firms discussed their findings on AFM costs within a broader ‘Cost’ section which grouped together two or more of the seven criteria, most commonly comparable market rates.

While the majority of firms focused the discussion on the reasonableness of fees relative to the funds cost base and the cost of services provided, a minority (11%) of firms focused the discussion on the OCF and looking at how the fund compared with a peer group.

IA guidance highlighted that firms may wish to consider whether to comment explicitly on transaction costs, given the increasing focus on reporting the aggregation of charges and transaction costs under PRIIPs and MIFID II. Just under a fifth (18%) of firms in the sample have reported that transaction costs have been included in their assessment of AFM costs.

At the fund level, there have been very few reported issues with AFM costs with 94% of funds in the sample concluding good value. The majority of firms (62%) report this criterion at the firm level, or at the fund level but using the same text across the fund range.

IA Comment: **AFM Costs as a separate criterion**

When reporting on their assessments of value, some firms reported on AFM costs alongside comparable market rates and, in some cases, comparable services and economies of scale. We do not see anything in the rules that necessarily prevents firms from presenting these criteria under a grouped heading such as “Charges”. But even if organised this way, COLL 4.5.7R(8)(a) states that the report should include a “separate discussion and conclusion” for each of the seven criteria, and any other criteria assessed by the AFM Board. Therefore, we suggest AFMs are careful when setting out the report to make sure there is a distinct discussion and conclusion on AFM Costs, separate from the discussion on other criteria such as comparable market rates.

This section requires the AFM to consider the costs to it of providing a service for which it charges, or the cost paid to an external supplier for the performance of the service. We recognise that this assessment may require the consideration of information that is confidential, e.g. the costs paid by the AFM, rather than the fund, to some external suppliers, and may be subject to commercial confidentiality between the two parties. Nonetheless, the assessment carried out on these costs (both the AFM’s own and those of external suppliers), as well as the outcome, should feature as a distinct discussion in the report.

.....

Have you considered?

- **Setting out a discussion in the report on AFM costs that is distinct from other criteria relating to charges.**

.....

ECONOMIES OF SCALE

Reporting of the economies of scale criterion has mainly focused on the outcomes around whether scale savings had been achieved and passed on to investors, and if not, an explanation around why savings have not been passed on. Two firms in the sample have explicitly stated the level of assets required for scale benefits to materialise.

Firms have focused on various aspects when explaining their assessment of economies of scale, including:

- Discussing the greater negotiating power that comes with scale (almost 40% of the sample)
- Lowering of fees over time as evidence of scale benefits (20% of sample)
- Use of fee caps and waivers as tools (16%)
- Position on use of tiers or breakpoints (16%, half of whom have used tiering and the other half who are opposed to it)

For almost three quarters (71%) of firms in the sample, economies of scale is reported at the firm level, or for each fund with the same text across all funds. Otherwise, specific detail for each fund is reported only for funds where an issue is identified. There have been very few reported issues for economies of scale with 96% of funds in the sample reporting good value.

IA Comment: **Challenges of Economies of Scale**

A significant proportion of costs arise at a firm level rather than at a fund level. Contracts and terms with service providers, such as depositaries, fund accountants and transfer agents, are typically negotiated by firms across a range, and firms will use their overall funds under management to increase their commercial leverage when negotiating their terms. AFMs will hire personnel, e.g. risk and compliance teams, to oversee and operate a range of funds, and investment teams will often manage an investment strategy across a range of products and mandates. There is debate on how accurately some of these costs can be broken down to the level of an individual fund.

We do not offer a view on whether it is appropriate to consider economies of scale at the level of the firm, the fund range or the fund. The appropriate level at which economies of scale should be considered is for the Board of the AFM to determine. We expect that the FCA will offer further insight in this area as part of their firm-level supervision and broader signalling to the market during 2021-22.

We recognise this is an area that continues to be challenging for firms. Given the relationship with price setting, this is an area where collective guidance would be inappropriate at the present time, although we encourage firms to ensure the framework and methodology for determining the level of economies of scale is clearly documented, even if the scale of the existing funds is some way away from specific action.

.....

Have you considered?

- **Providing a high-level description of how economies of scale are being assessed in the assessment of value report.**

.....

COMPARABLE MARKET RATES

Whereas the ‘AFM costs’ criterion requires an internal review of the fund’s cost base, the comparable market rates criterion requires firms to look internally and compare the charges of the fund with the ‘market rate’ of comparable services.

Comparability as defined by the rules is related to the size, investment objectives, management type (active or passive), charge structure (bundled vs unbundled) and policies of the funds. Over half (58%) of firms in the sample have explicitly referenced the peer group against which the fund’s fees were compared to, most commonly the IA sector or the Morningstar sector. The majority of the remaining firms reference comparison to a ‘relevant peer group’ though it is unclear how this is defined internally.

We observe that the majority of firms (64%) have provided fee data for some or all of their fund range (see Chart 9). The remaining firms have outlined the conclusions of their value assessment on comparable market rates but have not explicitly stated the fees of each fund. Two fifths of firms have provided peer group fee data as a comparison, either in the form of an average or sector percentile rank.

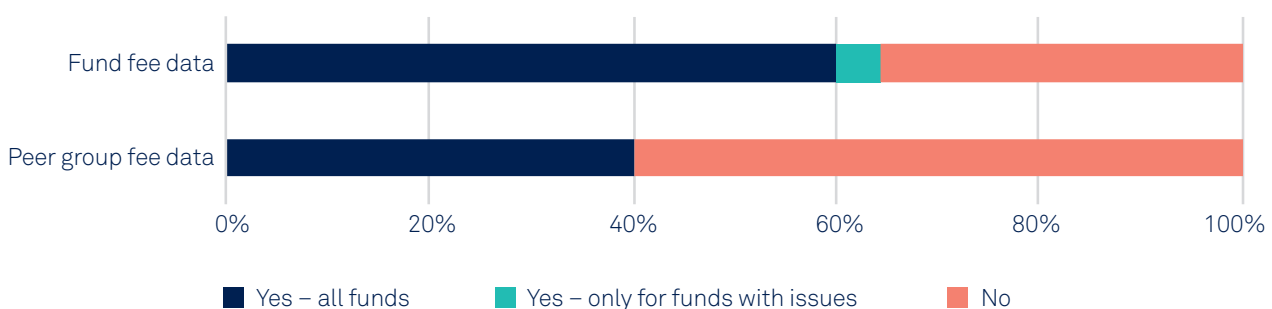
At the fund level, the majority (88%) of funds in the sample have reported good value on the comparable market rates criteria.

IA Comment: Importance of Peer Selection

Comparable market rates were the next highest criteria after performance where concerns over value were identified, resulting in firms taking action. The selection of a relevant peer group is key to the integrity of this assessment. Some commentators have suggested that only the use of an external firm to select the appropriate peer group can provide this assurance. We do not share this view – there is no requirement in the FCA rules for firms to use external consultants, and nor has the FCA communicated any such expectation to date. It is for each firm to decide how it selects its peers, and whether it is appropriate to use an external firm to assist them in the process, or do this internally.

Regardless of whether an internal process is used to select the peer group, or whether an external firm is used to assist this process, it is ultimately the responsibility of the Board to ensure that the peer group selected is appropriate, and we therefore recommend the Board considers and approves the selection. We understand that there are sensitivities to disclosing the competitor funds selected for the peer group, and we therefore leave it to the discretion of each firm whether to disclose the peer group. We do suggest that firms may wish to consider outlining the methodology of how the peer group has been selected in the assessment of value report.

CHART 9: USE OF FEE DATA WHEN REPORTING COMPARABLE MARKET RATES FINDINGS



Over half of funds provided data on their fees, a small number only where issues were identified with fees, and around half also provided an aggregated figure for the average fees across the peer group. There is no explicit requirement for firms to state their fees in the assessment of value report, but a narrative description on the assessment of fees, without giving any figures on what fees are being charged, limits the ability of investors to draw their own conclusion on whether the fees they are being charged represent good value. Although this information will be available to investors in other documents, as a general principle we do not think it is helpful to investors to expect them to look up information elsewhere. We therefore suggest that firms may wish to consider including the charges figures in their assessment of value reports to make the description of the assessment of charges more meaningful. In line with both FCA and IA guidance, we suggest the ongoing charges figure is given, which includes all operating costs of managing the fund, rather than providing only the annual management charge.

.....

Have you considered?

- **Setting out the ongoing charges for all of the funds in the assessment of value report.**
- **Setting out the rationale or methodology for how the peer group was selected.**

.....

COMPARABLE SERVICES

The comparable services criterion is an internal comparison requiring firms to look at how each charge compares with charges of another service offered by the firm with a similar size, objective or policy. The approach to reporting of this criterion has been broad, with firms outlining the definition of comparability of service or, in some cases explicitly stating whether the fees of the fund were compared to a similar mandate or overseas fund and then presenting their overall conclusion. Comparable services is the criterion with the second lowest number of reported issues after quality of services with 97% of funds in the sample reporting good value.

IA Comment: Comparable Services

The information typically given in this section was often light. This may reflect the difficulty of identifying to what extent other services, such as institutional mandates of a similar size being managed to a similar strategy are comparable, given differences in the applicable regulatory requirements and operating conditions.

The FCA has, however, made it clear that it expects firms to compare the costs of funds against those of institutional mandates of a comparable size and strategy that are managed by the firm or its associates. We understand confidentiality issues and sensitivities can arise with client mandates, and it may not be appropriate to disclose details of these. The report should however outline the assessment process undertaken by the Board, including the types of services assessed, as well as the outcome of the assessment.

Again, we expect that the FCA will give a further view on this as part of its supervisory process and broader signalling to the market.

.....

Have you considered?

- **Outlining the assessment process undertaken for comparable services, including the types of services assessed, and the outcome of the assessment.**

.....

CLASSES OF UNITS

The criterion requires AFMs to compare the price of different unit classes within the same fund and why are they different. Where unit classes are similar but with different prices, the criterion requires AFMs to consider whether it is appropriate for investors to be in a more expensive unit class where they are eligible for a unit class with lower charges. Where this is the case, AFMs may wish to consider either moving investors into cheaper unit classes or reducing fees on more expensive classes where moving investors is not possible or practical.

Over 140 funds (10%) across 14 fund groups in the sample have identified issues around whether investors are in correct share classes. A number of actions have been taken to ensure investors are in the right share class moving forward:

- Moving investors to cheaper share classes where possible
- Writing to unitholders to notify them of the availability of cheaper share classes and to review whether they are in the best share class based on their needs
- Engaging with platforms to encourage them to move investors to cheaper share classes

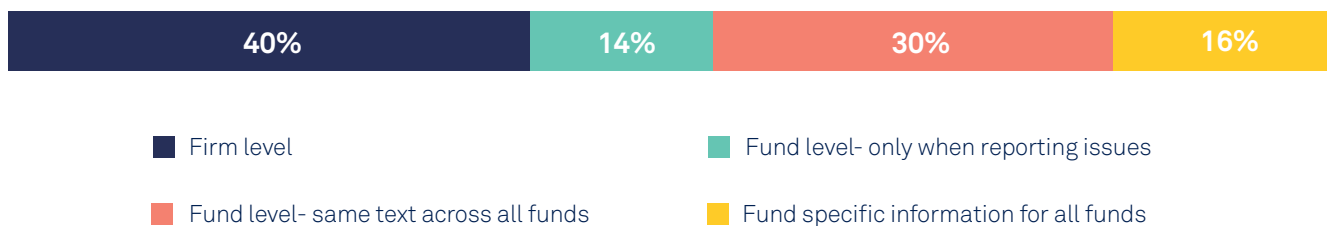
- Increasing minimum investment amounts on more expensive share classes and reduced minimum investments on cheaper ones
- Reducing fees on some share classes

Over half of the firms in the sample are reporting summaries of assessments at a firm level or reporting at the fund level but using the same text across all funds (see Chart 10). Less than one third (30%) of firms are reporting their fund-by-fund conclusions on classes of units for their entire fund range with 14% reporting only fund specific information for the funds where they have identified investors in incorrect share classes.

IA Comment: Navigating unit/share classes

A number of firms have indicated that they have moved a number of investors who are not on trail terms into lower fee share classes. While the bulk of investors will have been identified and moved in the first year of the assessments of value, some ongoing assessment is likely to be needed on identifying further investors who potentially become eligible for a lower share class, e.g. because they change their adviser arrangements. There are also a number of ongoing regulatory and legal obstacles in this area that the IA is discussing with the FCA with a view to facilitating the ability of firms to move between share classes.

CHART 10: FIRM VERSUS FUND LEVEL REPORTING OF CLASSES OF UNITS CRITERION



COLL 6.6.20R requires the assessment of value to be performed at the level of each share class. Apart from COLL 4.5.7R(8)(c), there is no specific mention of a requirement to report at share class level. As such, it is a decision for AFM Boards whether it is appropriate to report against all criteria at fund or share class level. (We do not consider that reporting only at the level of the firm is compatible with COLL 4.5.R(8)). We suggest that, as a minimum, where a concern over value has arisen in respect of a particular share class, rather than at the level of the fund, then this issue should be reported at the share class level. It is possible the FCA will give a further view on this as part of its supervisory process.

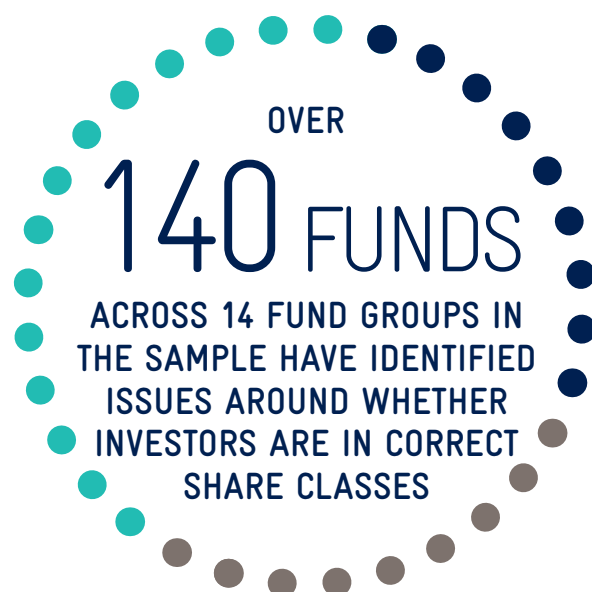
It is important to consider that investors will typically be offered only one share class at the point of sale, depending on the distribution channel they use. If findings or information is presented for a number of share classes, this information will need to be set out in a way that allows investors to identify the information that is relevant to their share class. Some guidance on explaining the share classes, and indicating to investors how they can identify which is their share class, may be helpful in these cases.

.....

Have you considered?

- **Including guidance to assist investors in identifying which share class they invest in.**

.....



5. CONCLUDING REMARKS

The value assessment process – and the associated public reporting of conclusions – is both an important step for the UK funds industry and one that will take some time fully to bed in. We expect the process to be one of continuous learning and improvement over the next few years, as AFM Boards, in partnership with their independent directors, grow and refine their understanding and familiarity with the concepts and processes involved in the assessment of value. While FCA supervisors look at both the assessment and reporting mechanisms established, it is premature for the IA to offer a definitive framework as to how the reports could be further standardised or enhanced. More research is also needed about the expectations of key stakeholders in the market, including those of retail investors themselves.

Nonetheless, there are clearly areas for improvement, building on emerging good practice from the first year. We are also encouraged by parallels in the areas we identify and the recommendations of wider stakeholders working in this area. We hope that both the analysis and recommendations contained in this report will assist firms across the industry, while recognising that individual firms will inevitably wish to determine the precise approach that they use.



The Investment Association

Camomile Court, 23 Camomile Street, London, EC3A 7LL

www.theia.org

 [@InvAssoc](https://twitter.com/InvAssoc)

April 2021