



FUNDS-AXIS

Funds-Axis TCF Briefing

Business as usual following the FSA's December deadline.

The Financial Services Authority (FSA)'s Treating Customers Fairly (TCF) December 2008 deadline requires that firms should now be able to demonstrate that they are consistently treating customers fairly.

What is Treating Customers Fairly?

Treating Customers Fairly is not the same thing as customer satisfaction – fairness and satisfaction are not one and the same. TCF is rooted in *Principle 6 of the FSA's Principles for Businesses* which provides that a firm must pay due regard to the interests of its customers and treat them fairly.

Whilst not a new concept, it is however now clear that TCF will be one of the FSA's major initiatives in the retail market for the future as it moves further towards a principles based regime. Indeed, the FSA's business plan for 2009/2010 outlines the strengthening of its supervisory focus on 'Treating Customers Fairly' (TCF) stating that it is critical to ensure that TCF is an enduring feature of its regulatory regime.

In essence, TCF applies to those firms that deal with retail customers. However, it is worth noting that TCF is broad enough to apply to firms that do not have a direct relationship with their end customers but have a material impact on them.

In this Paper, we provide an overview of TCF, a status check on where your organization should now be and then we conclude by focusing specifically on TCF for Asset Managers.



Funds-Axis has developed a TCF Toolkit which can effectively support the process of embedding TCF within the culture of your organisation and give efficiency to the process of developing meaningful Management Information to demonstrate improved outcomes for customers.

See Page 8 for more details

Status Check-Firms should now be able to demonstrate that:

- i. Senior management have instilled a culture whereby they (Senior Management) understand what the fair treatment of customers means; where they expect their staff to achieve this at all times; and where (a relatively small number of) errors are promptly found, put right and learned from;
- ii. There is appropriate and accurate measuring of performance against all customer fairness issues materially relevant to their business, and that results are acted upon;
- iii. Fair outcomes are being delivered; and
- iv. There are no serious failings, whether seen through Management Information or known to the FSA directly.

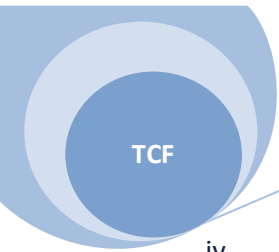
The FSA's Expectations:

The FSA expects firms:

- i. **To treat the customers fairly through the six stages of the product lifecycle;** The six stages of the product lifecycle identified by the FSA are:
 - a) Product design and governance;
 - b) Identifying target markets;
 - c) Marketing and promotion;
 - d) Sales and advice processes;
 - e) After sales information and service; and
 - f) Complaints handling.
- ii. **To embed TCF;** the FSA states that a firm can demonstrate that it has embedded TCF by showing that it has completed its implementation plans, resolved any outstanding issues relating to TCF practices, and put in place means of monitoring / measuring the fair treatment of customers and of ensuring that the impact on fair treatment is considered in strategic and business decisions. **Funds-Axis GRC™ can ensure that TCF is embedded within your organisation.**
- iii. **To thereby achieve better outcomes for customers;** the FSA has defined six consumer outcomes (the “TCF Outcomes”), which outline what it wants to achieve for consumers.

The six outcomes are:

1. Consumers are confident that they are dealing with firms where the fair treatment of customers is **central to their corporate culture**;
2. **Products and services should be designed and marketed to the correct consumers**;
3. Consumers should be provided with **clear information** and kept appropriately informed before, during and after the point of sale;
4. Where consumers receive advice, the **advice is suitable** and takes account of their current circumstances;
5. Consumers are provided with products **that perform as the firms have led them to expect**, and the associated service is both of an acceptable standard and as they have been led to expect; and
6. Consumers do not face **unreasonable post-sale barriers** imposed by firms to change product, switch provider, submit a claim or make a complaint.



- iv. **To be able to measure these improvements in consumer outcomes;** Senior management should by now have the appropriate Management Information (M.I) for them to be able to demonstrate to themselves and others that they are treating their customers fairly and that their aspirations for change are being realised throughout the business.

The importance of Management Information (M.I)

For many firms, the greatest TCF challenge has been to develop relevant Management Information to be able to demonstrate that they are their customers fairly. Yet, the importance of management information cannot be understated. Indeed the FSA set two deadlines for March 2008 and December 2008 specifically in respect of Management Information (of the sample of firms assessed, only 13% met the March deadline). The importance of M.I. is also made clear in the following FSA quotes:

“Until senior management can judge the firm’s performance against appropriate MI, it will not be possible for them to assess whether they are delivering fair outcomes. We will increasingly look at firms’ own MI to demonstrate this.”

“We see the receipt and challenge of that MI as key to the Board’s (and wider senior management’s) oversight of the treatment of customers.”



Funds-Axis has worked with clients to develop a complete range of TCF Management Information.

TCF – Management Information deadlines

FSA Expectations	<i>All firms were expected to have reached the ‘implementation’ stage of TCF in a substantial part of their business.</i>	<i>All firms were expected to have appropriate MI in place to test whether they are treating their customers fairly</i>	<i>All firms are expected to be able to demonstrate to themselves and the FSA that they are consistently treating their customers fairly</i>
FSA Deadlines	End of March 2007	End of March 2008	End of December 2008
FSA Findings	<i>An average of 85% of those surveyed met the deadline.</i>	<i>Only 13 % of those surveyed met the deadline</i>	

The FSA's Mode of Assessment

The FSA were proposing that TCF implementation would be reviewed through a one-off structured sampling of 100 firms. However, in November 2008 the FSA announced that assessment will now be integrated into firms' regular ARROW (FSA's Risk-Responsive Framework) visits as of January 2009.

The Assessment will use the TCF Culture Framework to identify where there are risks that might prevent good performance from being sustained or to explain or to identify poor performance where it exists. The November 2008 Update outlines a four staged process which will be used:

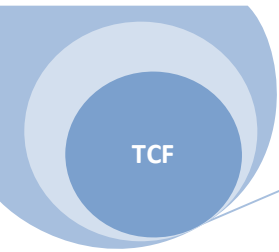
- i. **Request for information prior to ARROW visits:** For TCF this may include a short pre-assessment questionnaire which allows a firm to summarise and provide examples of its delivery of fair outcomes and relevant M.I demonstrating the fair treatment of customers;
- ii. **Determining scope and nature of the assessment:** Supervisors will use the information gathered through the initial planning request, as well as their current knowledge of the firm, to determine the scope of the TCF element of the ARROW assessment, including how outcomes will be assessed;
- iii. **Assessment validation:** The scope of the TCF review and the assessment of a firm's performance will be subject to challenge by the ARROW validation panels; and
- iv. **Feedback to the firm:** TCF will be specifically reflected in the risk scores provided to firms at the end of their ARROW assessments.

TCF and Asset Managers

Whilst principles based, the FSA has issued more than 50 publications on TCF, including Policy Statements, good practice illustrations, case studies, cluster reports and speeches covering all TCF areas.

These provide us with significant guidance as to what the FSA expects of firms. For example, as regards the Product Development stage of the product lifecycle, we know from the FSA publications that the product provider needs to:

- a. Identify the target market, namely which types of customer the product is likely to be suitable for and which types are not;



- b. Consider stress-testing the product to identify how it might perform in a range of market environments and how the customer could be affected;
- c. Consider which systems and controls it will need to manage adequately the risks posed by product design; and
- d. Consider how to ensure the information it produces for consumers is clear, fair and not misleading, and apply due skill, care and diligence when preparing information for distributor use.

We can find additional guidance in respect of each of the above four points from the FSA's TCF publications. There are also a number of notable FSA TCF publications and speeches which relate specifically to asset management, including:

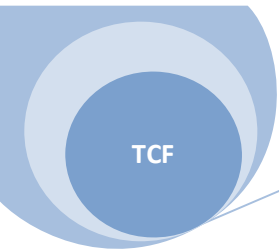
- September 2007, FSA Asset Management Conference, Keynote speech by Clive Briault, Managing Director, Retail Markets, FSA, *"Some challenges for the Asset Management Industry"*.

On Product Design, Mr. Briault stated that *"Our perception is that investment products and services seem too often fashioned to meet the needs of providers and distributors, with consumer needs taking a back seat."* Quoting a McKinsey Report on the state of US asset management industry in 2010 he continued: *"existing "style-based" investment strategies (... such as growth, cautious balances, etc) are bad for investors, producing narrowly focused funds that typically under-perform broader based strategies. ... the industry would be better advised to focus more on fashioning outcome-based [products] (such as retirement provision, tax minimization and income generation)."*

Mr. Briault also commented on derivatives usage under UCITS III and TCF, commenting that we have seen some innovation in the market on the back of UCITS III and the wider investment powers therein *"with several 130/30 funds and other variations on hedge-fund like long/short strategies but in general the response seems to have been surprisingly muted."* *"This .. [lack of product innovation using derivatives under UCITS III] leads us to wonder about the degree to which fund managers have thought through consumer needs in designing new ranges of funds."*

- September 2007, FSA Paper on Good and Poor Practices in Key Features Documentation (KFDs)

In their KFD sample checking, the FSA found that only 15% of KFDs met their requirement, plus that collective investment schemes generally seem to have poorer KFDs. The FSA noted that complexity is introduced where UCITS firms include both KFD and Simplified Prospectus information in one



document. According to the FSA, significant improvements can be made to KFD whether or not combined with the Simplified Prospectus. The FSA commented:

“Firms could do more to satisfy themselves that product information for customers is clear, fair and not misleading. And we thought they could do more to ensure due skill, care and diligence was applied when producing information for distributors.”

- A series of Discussion Papers (including DP07/2 Responsibilities of Product Providers and Platforms), speeches and Guides, in respect of the thorny issue of the respective responsibilities of Product Providers and Distributors for the fair treatment of customers, including when a Platform is included in the distribution process. The controversy focused on the level of management information that Product Providers would have to obtain from Distributors and Platforms in order to be able to demonstrate TCF.
- FSA Publication, TCF: measuring outcomes, November 2007, comment on TCF and Property Funds. The FSA commented that they had on-going concerns in respect of a tendency for product design to be driven by benchmarking of competitors’ products rather than by identifying needs of the target market. The FSA then commented:

“As an example of this issue, during 2006, the Investment Management Association reported that around 23% of retail product net sales were of property fund ... at a time when many commentators were arguing that property prices were unsustainably high and the best of the performance was over. it is unclear whether firms always launched these products to serve identified consumer needs or whether the motivation was to provide funds firms could encourage consumers to buy.”

- January 2008, the FSA Good Practice Illustrations for Managers of UK Authorised Collective investment Schemes

The Good Practice Illustrations deal with a number of TCF issues. In particular, as regards “identifying the target market”, the Illustrations acknowledge that TCF need not require that a fund be targeted to a particular demographic profile, but that further factors which can contribute to identifying the target market include:

- What the fund is for, the nature and scale of risks (e.g. liquidity, volatility, risk of capital loss) and a realistic typical investment-time horizon; and
- Whether the fund would best be incorporated as part of a portfolio of investments.

TCF

The Illustrations also state that the FSA expects firms to:

- Consider whether the nature of the fund is such that it might be necessary to limit or otherwise restrict the active distribution of the fund;
 - Consider the information needs of distributors;
 - Assess the accuracy of the characterisation of the fund and its generic suitability on an ongoing basis; and
 - Collect evidence that enables the monitoring of sales volumes and trends against projections, including through and any data available from intermediaries.
- February 2008, A speech by Dan Waters, FSA Director of Retail Policy and Themes & Asset Management Sector Leader which provided the following additional comments in respect of the Product Provider / Distributor discussion:
 - In general, the FSA would not expect CIS operators to obtain the personal details of investors in their funds, unless that was relevant to the nature of the product (e.g. for a CIS which is designed specifically for and marketed to 65 year olds); and
 - Platform providers have a responsibility to ensure that product providers are able to carry out all the distributor identification and analysis of sales volumes that they need to be able to do to ensure that retail customers who end up with their products are being treated fairly. The FSA believe that platform providers should be able to provide them with the wherewithal to meet their responsibilities.

Funds-Axis TCF Toolkit

Funds-Axis has developed a TCF Module within the **FUNDS-AXIS GRC™** automated Governance, Risk and Compliance Solution. This Module can effectively support the process of embedding TCF within the culture of your organisation and give efficiency to the process of developing meaningful Management Information to demonstrate improved outcomes for customers.

Other services which Funds-Axis provides in respect of TCF include:

- ✓ Role-specific TCF Training
- ✓ TCF Best Practice Consultancy
- ✓ TCF Library – Obligations, Recommended Controls & M.I.
- ✓ Independent external TCF Reviews
- ✓ KFD and literature reviews
- ✓ Dashboards & Reporting solutions for development of M.I.

