Technical Briefing: The FCA Assessment of Value 2023 review

The UK FCA has published the results of its 2023 review on Assessment of Value (AoV) which highlighted continued failings, alongside examples of good and poor practice, and a reminder of the alignment to the 'now live' FCA Consumer Duty.

Since inception, in 2019, the industry has been trying to align to FCA expectations as the drive toward better outcomes, in this case value, for end investors. The latest review considered 14 firms of different sizes, reviewing their AoV process, inputs and governance. Findings were compared to the output of the 2021 review, alongside the FCA Handbook rules and guidance.

In section 2 of this technical briefing note, the Devlin Mambo team have considered the latest FCA review, summarised the key points, provided our view, and highlighted suggested actions for firms.

High level summary of findings

In general, the review highlighted a better understanding of FCA expectations and improved AoV processes. Firms were less reliant on assumptions and provide a better quality of MI to AFM Boards and AoV committees. The FCA make the following key points:

- Firms must substantiate any claims they make
- Remedial action is evident to address poor value, with a reduction in fund fees for end investors - a big win for the FCA in highlighting the effectiveness of AoV!
- Despite better justification of fees, the FCA did not see remedial action to cut fees and any which were, were generally driven by comparable market rates
- Any cut fees aligned to comparable market rates resulted in 'price clustering, which has been previously highlighted by the FCA as a market failing
- Tensions between fund profitability and value for money appear to influence AoV decision-making
- Decision-making that failed to link to reasonable outcomes was highlighted as a failure of rule compliance for the AFM board and senior managers accountable

How can we help?

Since 2019, Devlin Mambo have been closely involved with helping our clients with Assessment of Value, and more recently with Consumer Duty implementation. We have a detailed knowledge of FCA expectations, and a practical approach to ensuring compliance aligned to your business model.

At Devlin Mambo we are continually monitoring, considering, and providing thought leadership and advice to our clients to help with their ongoing regulatory strategy, and implementation. If you would like to discuss the impact of this paper further, please get in touch with your relationship contact, or a member of the Devlin Mambo team.

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Section 2: Key findings of the FCA 2023 AoV review in detail

Area	FCA Feedback	Devlin Mambo View	Actions Required
Gap Analysis The FCA reviewed all firms gap analysis against the 2021 review findings	• Some AFMs had not fully addressed FCA findings from the 2021 review. Some had not considered the FCA feedback, where Directors at other firms hadn't considered the quality of gap analysis.	• Given this is the second review, the FCA are keen that the industry get AoV right – especially given the renewed focus from Consumer Duty. • It is important that firms reassess their adherence both to COLL Rules and FCA expectations from both this review, and that from 2021. • It is likely that asset managers and specifically the Price & Value outcome under Consumer Duty will be a particular area of focus for the FCA as a possible "first order of business" when it comes to the regulators stated plan to supervise and enforce under the Duty.	All firms that complete a Value Assessment should: • Conduct a gap analysis • Create an action plan • Present findings to the product Board and iNEDs.
AoV Integration The FCA considered how firms integrated AoV into their BAU process.	• Leading managers embedded value assessments into the product lifecycle (product development, management, and governance), whereas others treated it as a separate annual exercise. The latter presents issues in demonstrating a strong AoV process.	• Considering the Products and Services outcome of Consumer Duty, all firms should consider the impact to investors as an ongoing exercise. • AoV encapsulates how value is delivered to an investor in a product, therefore consideration to the impact of AoV process should be an ongoing exercise. • Again, the FCA's stated intention to supervise and enforce under Consumer Duty should focus the minds of asset managers here. Not, only has AoV been in place since 2019, but the broader PROD provisions have been in place since MIFID II came into force. The regulator is likely to have little tolerance for laggers here.	• Consider the stages of your product lifecycle, the oversight and governance applied, and how this interacts with the relevant pillars of the AoV. This should be a focus area of the gap analysis.

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AoV report The FCA reviewed the quality of reporting	• There is a noted improvement in quality of reporting since the 2021 review, including actions to deal with poor value. The FCA has listened to firms concerns about production costs, and reiterated that the rules permit disclosures in the funds annual reports.	• Reporting has certainly improved in terms of quality however from our experience, improvements can still be made to the content. A good example is the focus of the Consumer Understanding Outcome in the Consumer Duty. AoV reports should be written for the intended average retail investor of the firm, and complexity, jargon, and signposting should be considered.	• A review of the AoV reports should be conducted through a Consumer Duty lens.
Decision-Making **T**he FCA considered the information and analysis undertaken in the decision-making process	• Despite better data inputs, some boards still reached fee justification conclusions that appeared unreasonable. A specific example is highlighted where the Board were unable to influence pricing, as this is set by a more senior group entity or committee.	• The FCA do highlight improvements in the data that is used for decision-making, which is positive. The concern, however, is that it is the Boards responsibility to conclude whether fees are justified for that product in isolation. • Conflicts of interest need to be managed carefully, and influence from the wider group entities or committees must not impact decision-making on the appropriateness of fees.	• Firms should consider an independent review of the AoV process, focusing on the Board ToR and conflicts of interest in relation to AoV methodology and decision-making. • iNED training is provided by the Investment Association and firms like the Fund Boards Council. • Additional training should be provided to Boards with an emphasis on relevant case studies providing examples of good and bad practice.
Independent Challenge The FCA considered the level of challenge from iNEDs	• Most independent directors did not sufficiently critique assessment methodologies and conclusions. Some were too involved in the collection and analysis of information to be able to challenge effectively, whereas others did not understand the methodology.	• The role of the iNED should be to provide effective challenge. To be able to do so, there must be a detailed enough understanding of the process and methodology, alongside the operation of the product.. • Ensuring independence is key and there must be balance. Firms should also consider whether sufficient challenge was in fact taking place, but the evidencing of this was poor.	• It is important to ensure that your iNEDs, or as an iNED, that ongoing training is provided on this topic as well as ensuring corporate secretariat functions understand the importance of effective minute taking. • The chair should play an active role in ensuring there is an effective record of challenge.

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Service Quality The FCA considered the manner in which firms considered service quality, including ESG approach	• Stronger managers used metrics to assess investment expertise and service quality. Weaker firms relied on manager attestations about the quality of operations. • On ESG, good practice was highlighted where firms did not apply positive ESG scores for firms that are not marketed as sustainable funds under the forthcoming FCA Sustainable Disclosure Requirements (SDR).	• The FCA continue to look for evidence and feedback, rather than reliance on statements in relation to quality of service. • Where firms are able to track quality through meaningful process, MI and feedback, they will be in a stronger position. Firms should consider additional metrics that should become available through Consumer Duty outcomes monitoring and ensure these are fed into the annual AoV process. • For ESG, firms should be cautious about how they discuss sustainability credentials where the product does not promote sustainability.	• Firms should revisit the AoV methodology for quality of service to ensure that meaningful process, MI and feedback are incorporated into the decision-making process.
Performance The FCA consider the approach to performance, the metrics for assessment, and benchmarking	• Good practice involved rigorous hurdles aligned to strategies, including delivering poor ratings to fund performance, even though capital growth had been achieved. Poor practice saw easily achieved targets through capital growth or asymmetric ratings. The FCA gave an example of a product that had 'good performance' despite underperforming the market benchmark by 10% for 5 years.	• The FCA highlight the requirement to set reasonable thresholds to determine whether performance is good or bad, and that only a few firms considered lowering fees in cases of poor performance. • There is a balance between performance and fees – they are linked, but fees are not necessarily a direct indicator of value. • Consideration of performance should also take into account competitor benchmarks, performance over the holding period, and the impact investment style. If investment style is impacting performance, then this should be disclosed as a risk in the Key Investor Information Document (KIID).	• Firms should revisit their AoV methodology to consider the thresholds that define good or poor performance, and the proposed actions for when these thresholds are not met. • Additional emphasis should be placed on investment style related disclosures where relevant.
AFM Costs and Economies of Scale The FCA considered whether firms are able to justify their fees	• Firms with good practice considered cost allocation at both fund and share class level, highlighting variation in profitability between smaller and larger products. This allowed for economies of scale to be recognised, and best practice highlighted the negotiation of better fees as funds grew. • The FCA raise concerns over firms that do not have a detailed costing model. In addition, those firms that 'reinvest economies of scale	• Whilst it may be difficult to assess costs at a fund and share class level, this allows a better understanding of profitability and the potential economies of scale benefit. • Increasingly, firm are turning to data and technology solutions to enable fund and share class level costing models that can be leveraged across the business, including to measure fund/share class level profitability.	• Firms should revisit their methodology for AFM costs and Economies of Scale. • AFM costs should be broken down to fund and share class level, where appropriate. Firms should consider upgrading their FP&A systems and data to enable effective fund/share class level profitability measurement.

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	benefits back into the business' do not directly benefit those investors where the largest economies are generated, rather all clients in general.	• Where AFM costs are compared to competitors, firms have been confusing this activity with comparable market rates – this does not meet the regulatory requirements for AFM costs. Economies of scale should be considered carefully. Any reinvestment must be accounted for, which may be difficult for firms to calculate.	• The product lifecycle process should be enhanced to consider economies of scale.
Comparable Market Rates The FCA consider the charge of the AFM's fund and the "market rate" of comparable services.	• The FCA highlight concern that over-reliance on peer comparisons to justify any potential overcharging. A key point was that some firms considered cutting fees if they were out of alignment with competitors – which is seen by the FCA as firms not applying AoV appropriately or being compliant.	• Tread carefully with comparable market rates! • Consideration should be given to what a comparable service is when comparing the charge of the fund and other similar funds – are your services actually comparable? • Care should also be given to ensure this is a consideration of value, and analysis should be undertaken on both the AMC and the OCF. When drawing conclusions around price and value comparable market rates must be only one input and undue reliance on this metric must be avoided.	• Firms should revisit their methodology for comparable market rates, and consider any contagion when assessing any other pillars in the AoV.
Comparable services The FCA reviewed the charges levied by firms for similar internal services	• The FCA highlighted good practice where a firm plotted the fees paid by segregated mandate clients of different sizes to provide a best fit – the fees were then compared to those of different sized funds to identify divergence. • Poorer practice highlighted by the FCA referenced discounts for segregated mandate clients due to the wider relationship with the affiliate, justifying the lower fees. • The FCA noted that the firm did not quantity the size of discount and, as an AFM with many funds managed by the asset manager, whether it could do similar for its fund activities.	• There is a strong requirement to assess and document any potential divergence between fees levied for similar strategies managed by each firm. • Focus should be given to any segregated mandate against a similar fund, and evidence why any discount or divergence is appropriate.	• Firms should revisit their methodology for comparable services, and ensure a robust rationale for any divergence in fees for provision of similar services.