



Ongoing Monitoring of Marketing Intermediaries

RECOMMENDATIONS FOR A **COMMON APPROACH TO KPIS.**

Distributor Advisory Group

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Executive Summary

To address regulatory requirements for the ongoing monitoring of intermediaries involved in the marketing and distribution of funds, the working group proposes that AIFMs and IFMs adopt a standardised approach to measure relevant, well-defined KPIs.

KPIs for Complaints, Target Market Exceptions and Marketing Incidents are proposed, with the existence of alternative controls noted for other potential KPI measures that were also considered. It is proposed that Complaint, Target Market Exceptions and Marketing Incident KPIs be measured at a minimum of once per year, which will enhance the ability of AIFMs and IFMs to oversee the marketing and distribution activities undertaken by intermediaries, when used in conjunction with existing due diligence measures.

GLOSSARY OF TERMS

AIF(s)	Alternative Investment Fund(s)
AIFM(s)	Alternative Investment Fund Manager(s)
ALFI	Association of Luxembourg Fund Industry
CBD	Cross-border distribution
CBI	Central bank of Ireland
Circular 18/698	CSSF Circular 18/698 on the authorisation and organisation of IFMs incorporated under Luxembourg law
CP 86	Consultation Paper 86
CSSF	Commission de Surveillance du Secteur Financier, the Luxembourg financial regulator
DAG	FINDEL Distribution Advisory Working Group
DD	Due Diligence
DISTRIBUTOR DUE DILIGENCE QUESTIONNAIRE (DDQ)	A list of questions designed to collect relevant information about 1) the organisational set up and 2) activities undertaken by a firm appointed by the Manager to market and distribute its funds, to enable the Manager to assess the associated risks
ESMA	The European Securities and Markets Authority
IFM(s)	Investment Fund Manager(s) as defined by CSSF Circular 18/698
KPI	Key Performance Indicator
MI	Management Information

MiFID II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
UCITS	Undertaking for Collective Investment in Transferable Securities

REGULATORY BACKGROUND

Authorised Investment Fund Managers (AIFMs) and Undertaking for Collective Investment in Transferable Securities (UCITs) management companies, hereafter referred to as Managers, have to meet regulatory obligations to oversee the activities of entities that market and promote their funds, hereafter referred to as Marketing Intermediaries. These requirements differ by country.

In Luxembourg the Commission de Surveillance du Secteur Financier (CSSF) is prescriptive in its requirements for the oversight of Marketing Intermediaries as delegates of the Manager, specifying detailed requirements for initial and periodic due diligence plus ongoing monitoring. These requirements apply “mutatis mutandis” to relationships with sub-distributors, meaning that Luxembourgish Managers need to ensure that the CSSF’s requirements are met by the marketing function irrespective of whether Marketing Intermediaries are appointed directly by the Manager or indirectly, including where a non-Luxembourg Global Distributor is responsible for the appointment of local sub-distributors.

Meanwhile, in Ireland the Central Bank of Ireland has published Consultation Paper 86 (CP86) which makes clear that the regulator’s expectations in respect of the monitoring of delegates applies to distributors and details the importance of the ongoing exchange of information between the parties, but does not prescribe specific requirements for due diligence and ongoing monitoring. And in the UK the Financial Conduct Authority (FCA)’s requirements are more focused on product governance, and the regulator does not prescribe an obligation for Managers to perform due diligence checks on Marketing Intermediaries.

MARKETING INTERMEDIARIES

In the absence of a consistent definition of what constitutes marketing activity across the relevant legal acts, this proposal adopts the definition set out in the paper “**ALFI Considerations on Marketing and Distribution**”:

“Marketing” shall be read as the activity of offering or placement of investment funds at the initiative of the IFM/fund (in case of direct offering) or on behalf of the IFM/fund (in case of indirect offering)

This proposal also notes the types of Marketing Intermediary defined in the ALFI paper:

Various types of intermediaries can be involved in the marketing function (distribution and/or private placement). We may refer in particular to the following intermediaries:

- *Distributors, including distribution to retail investors;*

- *Independent financial advisors;*
- *Dealing/order routing platforms;*
- *Nominees (i) appearing in the register as acting on behalf of underlying investors (e.g. banks investing on behalf of their clients) and (ii) bound by a distribution agreement;*
- *Insurance – unit-linked, where the policy holders can select the underlying funds/ sign the application form/are in the register;*
- *Structured products/pension plan where the policy holder can select the fund;*
- *General partner/fund board of directors acting as global distributor.*

DUE DILIGENCE

Despite the regulatory differences, common approaches for initial and periodic due diligence have evolved since the requirements first came into force, with the majority of Managers utilising due diligence questionnaires (DDQs) for the collection of relevant information from Marketing Intermediaries to enable Managers to perform a risk assessment of the marketing & distribution activities.

Good ground has been covered in standardising due diligence information requested by Managers, driven by the efforts of Industry working groups to publish standardised DDQ templates, including FINDEL template and more recently the ICI's Investment Funds Distributor Due Diligence Questionnaire. Also, the launch of a number due diligence tools by service providers acting as a go-between for the exchange of information between Managers and Intermediaries involved in the marketing and distribution. The majority of Marketing Intermediaries now have established processes for responding to DDQs or providing alternative formats of due diligence information.

APPROACHES TO ONGOING MONITORING

Unlike the initial and periodic due diligence, the industry has not yet adopted a standardised approach for the ongoing monitoring of Marketing Intermediaries by Managers. Some due diligence tool providers have launched (or are in the process of launching) functionality intended to support Managers by requesting Key Performance Indicators (KPIs) from Marketing Intermediaries. However, at present there are no established solutions and the reporting of KPIs by Marketing Intermediaries is uncommon, & often limited to information relating to the assets and sales, with few Managers having negotiated a contractual requirement for KPIs into their Distribution Agreements.

CONSTRAINTS

Ongoing monitoring requires the exchange of information and Managers and Marketing Intermediaries face a number of constraints in the provision and receipt of suitable information required to facilitate the ongoing, as described in the following sections.

REGULATION

At present there is no consensus amongst Managers (or due diligence tool providers) about the best KPIs to measure in monitoring Marketing Intermediaries. Regulatory requirements are high level with potential differences in managers' interpretation also contributed to by a shortage of industry definitions. Luxembourg

AIFMs and UCITs management companies will refer to section 522 of CSSF Circular 18/698 (Figure 1) whereas other Managers are subject to rules that are less prescriptive. Marketing Intermediaries find it difficult to respond to multiple requests for different measures.

Figure 1: Extract from CSSF Circular 18/698

522. In addition to the elements referred to in Sub-section 6.2.3.4. (*Details on the ongoing monitoring*), the IFM must carry out an ongoing monitoring of the marketing intermediaries in compliance with Section 5.4.2. (*Obligations applicable to the IFM according to the manner in which the relationship with marketing intermediaries and the function of registrar agent is organised*) of this circular and include the following elements (non-exhaustive list):

- the monitoring of marketing incidents (for example, Market Timing, non-compliance with the legal and regulatory provisions in force in the marketing country, etc.);
- the monitoring of the marketing countries;
- the monitoring of the compliance by the delegates with the provisions of the MiFID II Regulation with respect to the reception of benefits, the arrangements for the exchange of information between the IFM and the marketing intermediaries, particularly regarding the target market;
- the analysis of the complaint records;
- the monitoring of the collection of subscriptions and redemptions, broken down by UCI.

RESOURCE CONSTRAINTS

Distributors and platforms have shared concerns that requests for new reporting requests may be met with resource constraints. Similarly, Managers, particularly those with large distribution networks, are conscious of the resource implications for analysing KPIs and ensuring any resulting actions receive the attention they deserve.

AVAILABILITY OF INFORMATION

Marketing Intermediaries have also flagged that they may not be able to support the roll out of certain a KPI if they do not measure the indicator themselves or, where relevant, receive the required reporting from their sub-distributors so cannot pass information up the chain. There may also be KPIs that Marketing Intermediaries are not able to support because they are not willing to share the requested information outside of their organisation or feel that local regulations do not permit them to do so.

CONTRACTUAL OBLIGATIONS

Many Managers are wary that they do not have contractual requirements for Marketing Intermediaries to report KPIs, although some firms have made headway in introducing this into their legal agreements. Repapering or amending legacy distribution agreements can be a huge task and Managers' success with agreeing this requirement largely depends on how engaged and willing Marketing Intermediaries are to renegotiate terms.

SUCCESS CRITERIA

Success in rolling out KPIs is most likely to be achieved if Managers select a number of well-defined KPIs that are within the Marketing Intermediaries' capacity to measure. Feedback from Marketing Intermediaries has been consistent in explaining the need for any proposed KPI measures to be standardised, well-defined and relevant. Standardisation is key for streamlining the reporting of KPIs by Marketing Intermediaries and they are more likely to respond to the same request from multiple Managers. Clear definitions are needed to avoid any potential misinterpretation of the request and KPIs should avoid duplication with risk measures already captured in the DDQs, with consideration given to utilising information already made available by the Marketing Intermediary.

Marketing Intermediaries are most likely to be able to support the reporting of statistics rather than detailed responses. Such statistics would also be easier for due diligence tool providers to capture, and adoption by these firms would help to streamline the roll out of KPIs and encourage a standardised approach by Managers. However, it is acknowledged that the reporting of statistics is more likely to result in a need for Managers to request additional information where issues are indicated, and it is therefore essential that KPIs are well defined to ensure that they are correctly interpreted by Managers, as well as being understood by Marketing Intermediaries.

PROPOSED KPIS

FINDEL DAG working group members were surveyed about their preferred KPI measures. Analysis and discussion of the responses has led to the proposal that the 3 KPIs described below be adopted as an industry standard approach to the ongoing monitoring of Marketing Intermediaries.

COMPLAINTS

Managers shared feedback in the survey that a KPI on complaints is preferred by the majority of firms.

The reporting of complaints by Marketing Intermediaries to Managers is generally a regulatory requirement irrespective of jurisdiction and it is typically also a contractual obligation. Firms have established complaint handling processes and DDQs typically ask Marketing Intermediaries to confirm that they have processes in place to report complaints to Managers.

The scope of the KPI measure needs to be well defined to ensure consistency in its interpretation. It was discussed that caution should be exercised when assessing a KPI capturing all types of complaints, to ensure that the information provided by Marketing Intermediaries is interpreted correctly by Managers. For example, reporting of product-related complaints, such as about a fund's performance or investment objective, should not necessarily be interpreted as reflecting badly on the performance of a Marketing Intermediary and might instead favourably demonstrate that the Marketing Intermediary has strong processes in place to report complaints to Managers. Meanwhile, reporting of distribution-related complaints, such as about incorrect information contained in Marketing Intermediary-produced marketing materials, could cause a Manager to query whether the Marketing Intermediary has the right processes and controls in place to distribute its funds.

Managers can reconcile KPI reporting against their complaint logs to check that complaints have previously been reported by Marketing Intermediaries, in that way checking that the Marketing Intermediary has an appropriate process for reporting complaints, and also ensuring that individual complaints have appropriately considered by the manager, with any product-related complaints being fed into the product reviews and any distribution-related complaints being fed into the Marketing Intermediary risk assessment.

KPI 1: Number of Complaints in the period.

Complaint: Any expression of dissatisfaction, whether justified or not, received from a client or underlying investor that relates to a fund or product, advice provided, information contained in marketing materials or the service provided by Marketing Intermediary.

TARGET MARKET REPORTING

Managers typically do not systematically receive target market management information as most Marketing Intermediaries report by exception and do not issue nil returns in periods when there have been no sales outside of the defined target market. Many Managers responded to the survey that they wished to receive KPI reporting about sales outside of the defined target market (“Target Market Exceptions”) as a method of validating the exception reports they receive.

Discussion of this KPI by the working group touched on the fact that although the existence of target market exceptions does not necessarily indicate poor Marketing Intermediary performance, as an investment outside of the defined target market may be suitable for a client as part of a diversified portfolio, the reporting of exceptions is key to enable to Manager to analyse cases, trends and review its target market definition. Reporting of target market exception numbers as a KPI would allow Managers to assess not just the number of exceptions, but also reconcile against their logs to check that all exceptions have previously been reported and the Marketing Intermediary is meeting its reporting obligations.

KPI 2: Number of Target Market Exceptions in the period.

Target Market Exceptions: Sales to an end client(s) who falls outside of the category(ies) of clients that the Manager has specified to be the identified target market of a product or fund, having taken into consideration criteria such as clients’ knowledge and experience, financial situation, risk-bearing capacity, risk tolerance, investment objectives and needs.

MARKETING INCIDENTS

Managers shared feedback in the survey that a KPI on Marketing Incidents should be implemented to indicate to Managers any instances of non-compliance with local marketing requirements by Marketing Intermediaries, and also errors in Marketing Intermediary-produced marketing materials. It was discussed that the reporting of this KPI as a statistic would likely mean that a Manager would need to follow up with a Marketing Intermediary

for additional information when an incident is reported, but nonetheless the KPI would be a useful trigger to ensure that any such incidents are properly investigated by Managers.

KPI 3: Number of Marketing Incidents in the period.

Marketing Incident: for example, Market Timing, non-compliance with the legal and regulatory provisions in force in the marketing country requirements, errors in Marketing Intermediary-produced marketing materials, non-compliance with ESMA marketing communication guidelines and failure of the Marketing Intermediary to ensure the dissemination of mandatory documents to end investors.

OTHER CONTROLS

If adopted, the proposed KPIs would work to complement and strengthen existing controls for the ongoing oversight of Marketing Intermediaries, including sanctions screening and adverse media checks, amongst others.

In Circular 18/698 the CSSF prescribes other elements of the ongoing monitoring that Luxembourg Managers are required to perform. The working group has considered these elements, along with alternative KPIs proposed by due diligence tool providers and noted below existing controls that negate the need for additional standardised KPIs than what has been proposed in this paper.

MARKET TIMING

Working group members discussed that market timing risk is relevant to a sub-section of funds and this topic therefore wouldn't be useful as a standardised KPI to be rolled out across the Marketing Intermediary network. Firms instead rely on controls through the Transfer Agent such as dealing cut off times, large deal alerts & periodic due diligence.

BREACHES

It was discussed that this measure is likely to receive pushback from Marketing Intermediaries, particularly as there are inconsistent interpretations of the scope and requests for reporting on breaches of any relevant regulation are likely to be refused. It was concluded that a KPI on Marketing Incidents reporting any breaches of local regulation should be most effective, as proposed above.

AML/CTF breaches

It was discussed with several Marketing Intermediaries and the feedback was that they have their own legal and regulatory requirements relating to AML and would not be willing to provide this information externally. Any material issues would be highlighted as part of the periodic due diligence process.

SUB-DISTRIBUTOR CHANGES

Whether a Marketing Intermediary has entered into any new sub-distributor relationships in the period, whether the Marketing Intermediary has terminated any relationships and whether the Marketing Intermediary granted broader authority to an existing sub-distributor are useful facts to help a Manager understand the global footprint of its fund(s). However, many Managers have implemented alternative controls that negate the need

for these factors to be measured as a KPI. Many firms are comfortable relying on contractual obligations for Marketing Intermediaries to notify/seek prior approval for changes and find this reporting/approval process to be robust.

SUSPICIOUS TRANSACTIONS

Feedback was discussed that at least that one due diligence platform provider is in the process of rolling out a KPI asking Marketing Intermediaries about suspicious transactions. It was discussed that firms don't typically have a reporting mechanism in place and that to be an informative measure the details of any suspicious transactions would need to be captured. However, a request for confirmation that Marketing Intermediaries have policies covering the reporting of suspicious transactions is already captured in DDQs. Firms may not be willing/able to share more detailed information, particularly as the sharing of information about suspicious activity could result in concerns about tipping off.

LATE TRADES

Whereas at least one due diligence platform provider has considered the roll out of a KPI on late trades, the working group concluded that existing controls negate the need for this reporting. Managers already have controls in place to prevent late trading through dealing cut off times and Marketing Intermediaries are typically asked to confirm that they have a Market timing policy in the DDQ. Firms' Transfer Agents are required to escalate any request to accept a late trade and as such the Manager will be aware of and have approved any such deal by a Marketing Intermediary.

BUSINESS CONTINUITY INCIDENTS

The reporting of business continuity incidents could help Managers to understand a Marketing Intermediary's on-going ability to service its clients. However, Managers already seek confirmation in the DDQ that Marketing Intermediaries have Business Continuity Plans that are tested, and it was concluded that Marketing Intermediaries are unlikely to be willing to share details of any incidents that are not already in the public domain, and Managers' adverse media checks are a more useful control for identifying such cases.

MARKETING COUNTRIES

DDQ templates adopted by some Managers for periodic due diligence ask Marketing Intermediaries to list countries in scope for their marketing activity. Additionally, fund platforms and certain intermediaries provide access to sales flows via MI or access to proprietary web interfaces. Trade capture platforms such as NSCC can also be used for the provision of marketing country information.

COLLECTION OF SUBSCRIPTIONS & REDEMPTIONS

Managers have a complete view of subscriptions and redemptions via the Transfer Agency transaction flows. Additionally, fund platforms & certain marketing intermediaries do provide access to sales flows via MI or access to proprietary web interfaces.

IMPLEMENTATION OF KPIS

Engagement with Marketing Intermediaries is essential, and support from industry service providers such as DD tools in engaging with Marketing Intermediaries is likely to be key for the large number of Managers that rely on the tool for due diligence.

Managers' approaches should have the flexibility to support alternative formats of information provided by Marketing Intermediaries as KPIS become embedded and should take into account other information received (such as sales MI and target market exception reporting).

The working group proposes that KPIS should be measured at a frequency which considers a risk-based approach and at a minimum of once per year. Managers may require KPIS on a more frequent basis. Successful implementation of the KPIS in this way will enhance the ability of Managers to oversee the activities undertaken by Marketing Intermediaries, when used in conjunction with existing due diligence measures.

CONCLUSION

In light of the discussions with managers and marketing intermediaries the FINDEL DAG propose these standard KPIS to supplement the ongoing due diligence. This position paper has not been discussed with regulators and managers should themselves ensure they are compliant with applicable legal requirements and regulations.

The view of the DAG is that these guidelines enhance the clarity for the industry and is for the benefit for both managers and marketing intermediaries.

REFERENCES

- CSSF Circular 18/698
- CP 86
- FCA PROD
- MIFID II
- CSSF Circular 04/146 Late trading and market timing
- Regulation (EU) 2019/1156 of 20 June 2019 on facilitating cross-border distribution

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