



FEATURE ARTICLE

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What's In A Name (2)

Regular readers of Lighthouse Group Feature Articles will recall that at the beginning of November 2011 I penned an article entitled "What's In A Name?" discussing the IMA sector classifications and in particular the "pickle" that the IMA had got itself into over the reclassification of the Managed Sectors.

The IMA Managed Sector definitions had been brought into the spotlight due to, in particular, Arch Cru and also Barclays selling of Aviva's Global Balanced Income Fund (the Balanced Fund) and Global Cautious Income Fund (the Cautious Fund) and subsequent £7.7m fine by the FSA. In the case of Arch Cru the Arch Cru Investment Portfolio qualified for and was listed in the IMA Cautious Managed sector but when this investment failed the IMA said that the sector classification related to the sorts of assets held in the funds listed in their sectors rather than their risk levels – in fact an IMA spokesperson specifically commented at the time that: "The word cautious should not be taken literally. It's actually asset-based rather than risk based. None of our sectors are risk based."

The fact was that the Arch Cru investment qualified for the Cautious Managed sector on asset allocation grounds and at the same time it demonstrated a low volatility figure and this was seen by some investors as further evidence that this was indeed a cautious investment. The low volatility figure should however have been questioned. In the case of Arch Cru it turned out that the low volatility figure was achieved at the "risk" of reduced liquidity and that was ultimately the undoing of the fund.

Now as I explained in my article at the beginning of November the IMA are not the only organisation to provide sector classifications and as a result of the broad criticism of sector classifications the ABI announced in February 2011 that for their classifications sector names including "Cautious" and "Balanced" were to be replaced with "Mixed Investment" plus a clear statement of how much each type of fund can hold in equities.



In response to this in May 2011 the IMA announced that after reviewing their sector classifications they planned, from July 2011, to rename the Managed sectors A, B and C and to introduce a new Managed D sector. The IMA explained that: "The names are intended deliberately to provide no other information about the sector, thereby encouraging users of the sectors to do more due diligence to understand the nature of funds that would fall into the underlying sectors. The use of A, B, C and D does not even indicate the order of the risk/ reward hierarchy across the four sectors, and to access this information the user would have to access the definition." There was however such a large negative response to this proposed new classification system from the investment industry that the IMA was forced to withdraw it.

Then most recently on the 30th November 2011 the IMA and ABI announced that they are going to harmonise their Managed/Mixed Investment sectors to provide; ".....greater clarity to consumers, creating consistency and comparability across insurance and investment funds."

As a result from the 1st January the IMA and ABI have agreed upon a single set of sector names and definitions as per the table:

NEW IMA & ABI NAMES	OLD IMA NAMES	OLD ABI NAMES
Mixed Investment 0-35% Shares	N/A	Mixed Investment 0-35% Shares
Mixed Investment 20-60% Shares	Cautious Managed	Mixed Investment 20-60% Shares
Mixed Investment 40-85% Shares	Balanced Managed	Mixed Investment 40-85% Shares
Flexible Investment	Active Managed	Mixed Investment 60%-100% Shares

Firms will have until the end of April 2012 to make the necessary changes to their funds.

Considering this new classification system I can certainly see the advantage of a single set of names and definitions for the mixed investment sectors across insurance and investment funds. It is however perhaps disappointing that despite various industry feedback and suggestions (see my previous article of the 10th November) the IMA has decided to define sectors by asset mix rather than risk-ratings. After all a fund may have a higher equity weighting than its peers but this is not in itself necessarily an indication of the "risk" of the fund.

Now in its defence on this point I understand that the Investment Management Association is setting up a fund comparison website for consumers and is considering developing risk ratings for funds in



the managed sectors. Apparently the IMA is looking at ways you can measure risk for funds in the managed sectors; but if the IMA feels it is not able to develop a suitable risk-rating process for the managed sector it will rely on the European Securities and Markets Authority's Synthetic Risk Reward Indicators (SRRIs) which will be added to the website in the summer. (SRRIs are based on volatility using weekly or monthly returns covering the previous five years. All funds will be required to publish these on their Key Investor Information documents by July 2012.)

Moving in the Right Direction?

My view is that the IMA are moving in the right direction but have some way to go before they reach what may be termed a final destination. I say this because, for example, the sector definitions still appear remarkably broad with the Cautious Managed becoming Mixed Investment 20-60% shares. This could mean huge disparities between the funds in this sector in terms of their make-up and the question must be asked as to whether you will be comparing like with like in such a broad sector?

There is also the issue that it is the fund manager's responsibility to decide on the name of their fund. Ultimately if fund manager's don't have to change their funds' names this almost makes the new sector definitions meaningless. We should however perhaps understand that with reference to this fund management groups are faced with the challenge of changing their "Cautious Managed" fund to what? The "Mixed Investment 20-60% Shares" fund?

Conclusion

The question remains as to how many potential investors will really take the sector definitions as merely a starting point and take the time to drill down using various additional information that may be available?

In the Press Release announcing this "harmonisation" it explained that the IMA's consumer research had found that when presented with sector definitions, investors focused on the percentage exposure to asset classes and the majority of UK active investors said the sector name was not the most important factor in deciding what to invest in, but that 28% have used the sectors to help them reach their final investment decision. In light of this the IMA said that: "..... the sector names need to act as a useful signpost."

It is important to remember that a signpost may only give you a general direction rather than a specific destination and as long as investors understand this then fine but will this in fact be the case? The IMA have a hard task in pleasing everybody and as I have already said they are moving in the right direction and lets hope they continue to do so.

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