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# Primary Market Technical Note

## Investment management agreements and independence of the board

The information in this note is designed to help issuers and practitioners interpret our UK Listing Rules, Prospectus Regulation Rules, Disclosure Guidance and Transparency Rules, and related legislation. The guidance notes provide answers to the most common queries we receive and represent FCA guidance as defined in section 139A FSMA

### Rules

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UKLR 15.2.1911.2.16R; UKLR 15.4.711.4.13AR

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UKLR 11.2.16R and UKLR 11.4.13R require the board of directors or equivalent body to be in a position to effectively monitor and manage the performance of its key services providers, including any investment manager of the applicant at admission and on an ongoing basis. The rules reflect our belief that it is important that the board acts as an important counterbalance to the investment manager. In CP12/25, we consulted on amending LR 15 and subsequently introduced rules which state that the board of a premium listed closed-ended investment fund must be able to effectively monitor and manage the performance of its key service providers, such as the investment manager, both at admission and on an ongoing basis (LR 15.2.19R and LR 15.4.7AR).

~~In CP12/25, we highlighted our continued belief that it is important that the board acts as an important counterbalance to the investment manager (paragraphs 8.5 and 8.6). Specifically, we stated that we expect boards to ensure that appropriate contracts with key service providers are in place at admission, and to ensure that they are in a position to take action if the contractual provisions are breached or they are no longer in the best interests of shareholders. (see paragraphs 1.34 and 8.14 of CP12/25 and Handbook Notice No 4, July 2013). While this issue was highlighted in the context of the AIFMD, the new rules built on an existing concept articulated as part of previous FSA policy work (the Investment Entities Listing Review).~~

The purpose of an independent board is to offer challenge, including to key service providers such as the investment manager, and to safeguard shareholders' interests. Traditionally, the board ultimately had the ability to terminate the management agreement and appoint a new manager if the performance of the existing manager was found to be unacceptable. Of course, such a termination may be at a cost, and, depending on the nature of the fund's investments, there may commonly be a period of initial investment, during which the ability to cancel an agreement would be very limited.

However, we have seen new applicants with investment management agreements that either:

- only allow the fund's board to terminate the agreement if the fund is wound up at the same time
- continue in perpetuity or for a period of time that is unusually long compared to other funds with similar investment policies, or
- have termination fees or other significant termination penalties that are essentially prohibitive

Clearly, the challenge provided by an independent board will only lead to the dismissal of an investment manager in the most extreme cases. In addition, an investment manager will normally be subject to a number of regulatory and fiduciary duties that will govern its relationship with the fund. It is unclear to what extent the ultimate ability to cancel an agreement affects discussions between the fund's board and its investment manager.

~~LR 15~~UKLR 11 does not prescribe specific provisions for investment management agreements; generally, we would not seek to involve ourselves in what we regard as essentially a commercial contract that needs to be appropriate for a particular fund.

However, boards should be mindful of whether the terms of an agreement are such that their ability to act independently and provide appropriate challenge could be fettered. In the case of a new applicant, we would expect the fund's sponsor to be able to articulate how the board is able to meet the requirements of UKLR 15.2.19~~11.2.16~~R (and, in due course, UKLR 15.4.7A~~11.4.13~~R) in light of termination provisions in the investment management agreement that are particularly onerous or unusual in the context of the fund's investment policy. We may question a new applicant's ability to comply with these rules where the terms of an investment management agreement are such that they could prevent a board from terminating an investment management agreement or contain terminations provisions which are particularly onerous or unusual when compared to funds with similar investment policies. We expect that this will be an issue only in the most exceptional cases. We encourage sponsors to engage with us at an early stage if there is a concern that this may apply to a new applicant.

As a separate matter, the prospectus should describe any onerous or unusual provisions relating to termination of the investment management agreement, including the potential impact on the fund. However, we emphasise that disclosure is not of itself sufficient to satisfy any concern about eligibility.