



MARKET TIMING
GUIDELINES FOR MANAGERS OF INVESTMENT FUNDS

July 2008

MARKET TIMING

GUIDELINES FOR MANAGERS OF INVESTMENT FUNDS

Introduction

Market Timing is not a precisely defined term, but generally refers to a trading strategy, often coupled with frequent purchases and sales of units/shares, in open-ended Funds with the intention of dealing on prices that do not fully reflect market information. This is distinct from trading strategies which may lead to frequent dealing (eg Constant Proportion Portfolio Insurance products) but which are not intended to benefit from anomalies in the fund pricing mechanism. The generic term Market Timing, used in these Guidelines, describes two distinct activities, arbitrage and short-term trading.

Arbitrage can occur when an investor is aware that the security prices upon which a fund's dealing price is calculated do not take account of the most recently available market information. An example would be when a fund is priced using end of day prices from a market which closed for trading for a material period prior to the fund valuation point, e.g. a UK unit trust which is invested into US stocks, valuing at 12 noon UK time and using US market closing prices from 9.00 p.m. the previous trading day. During this period arbitrageurs may have concluded that prices will change significantly when the market reopens, perhaps based on Wall Street results releases, some global event after market hours or on indications from the global futures markets. Alternatively they may have taken a view on correlation between markets in different time zones, e.g. in a Far East fund by anticipating that if Wall Street falls a certain percentage, then Far Eastern markets may follow suit by perhaps a smaller, or a larger, margin. In the UK CIS industry, trades placed with Funds by arbitrageurs are not illegal, but are generally regarded as being sharp practice.

Arbitrage can be distinguished from short-term trading, when investors take short-term trading positions, e.g. 5 to 10 days, based upon their own independent views, often resulting from quantitative analysis, as to future market directions.

Both arbitrage and short-term trading can be disruptive to fund management and can cause dilution in the fund to the detriment of long-term investors. The fund, and investors' interests, can be harmed by these activities, which can compel the Manager to retain a higher level of liquidity than would be ideal, or to buy and sell holdings more frequently than desirable, thereby incurring broker commissions, market spreads, market impact etc. The short-term trader adds to the friction of running the fund, the arbitrageur takes profits from the fund and actively picks the pockets of long-term investors.

Anecdotal evidence suggests that due to the UK's position in global time zones, what Market Timing has been detected in the UK has related to Funds invested in the US or Far East markets, or into an overseas market that happens to be closed for a particular day whilst the fund itself is still open for trading. Clearly, the recent trend towards lower front-end fees has also made Funds more attractive to investors with short time horizons. Approaches by Market Timers to Managers of dual priced Funds may include a request that trading is retained within the Manager's box, so that the Market Timer is not hit by the bid/offer spread.

Market Timing and UK Regulatory Principles

Whilst Market Timing is not explicitly a breach of UK regulations, Managers are subject to over-riding fiduciary responsibilities and should also take note of the FSA Principles, in

particular Principle 6, "A firm must pay due regard to the interests of its customers and treat them fairly" and Principle 8, "A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client". Principle 8 would become especially relevant if Managers were to contemplate offering privileged access to the Market Timer.

The potentially harmful impact of such Market Timing needs to be understood by Managers of UK Investment Funds. Clearly, high value Market Timing has a cost impact on Funds, and even if any transaction costs are recouped by operation of a dilution levy/adjustment, the Market Timer, especially the arbitrageur, will in all likelihood still be benefiting at the expense of long-term investors. Even if the Manager has not afforded any special treatment to the Market Timer, he still has a fiduciary obligation to take all reasonable steps to discourage such traders.

The Senior Management Arrangements, Systems and Controls ("SYSC") module of the FSA Handbook notes that the FSA introduced these particular rules to encourage firms' directors and senior managers to take appropriate practical responsibility for their firms' arrangements on matters likely to be of interest to the FSA because they impinge on the FSA's functions under the Act. The main matters of interest to the FSA are those which "relate to the fair treatment of the firm's customers, to the protection of consumers, to confidence in the financial system, and to the use of that system in connection with financial crime".

The FSA have seen this document and provided input to the production of these Guidelines.

The FSA carried out a review of Market Timing in winter 2003/04 and set out its findings and conclusions in a Press release on 18 March 2004, which is attached as an Appendix to this paper.

Purpose of these IMA Guidelines

The objective of the Guidelines is to provide Members with suggestions for a robust and demonstrably reasonable control framework that will give them, and the investors in their Funds, comfort that Managers are taking all reasonable steps to help ensure that Funds are being protected from the activities of Market Timers. Whilst these Guidelines have been prepared for the benefit of IMA's membership, they do not have the status of regulation and accordingly are neither binding nor evidential. Following these Guidelines may not demonstrate compliance with FSA rules and not following them, in itself, will not represent a breach of an FSA rule nor lead to regulatory action.

Each IMA Member should assess the risk represented to their Funds and the Funds' long-term investors by Market Timing activity and the extent to which the Member adopts these Guidelines will in large part be conditioned by that risk assessment. Not all the suggestions are appropriate to all business or operational models, but in aggregate, they represent a toolkit of policies and processes that could assist Members in protecting their Funds.

Clearly, several of the policies and processes suggested are complex and require costly and sophisticated structures in which to function. Members are entitled to consider the cost implications of adopting any of these Guidelines in the light of the risk represented to their Funds by Market Timing.

IMPORTANT NOTE

This document is intended to provide a helpful indication of some of the kinds of controls and procedures that may be adopted by Managers of Investment Funds to counter Market Timing.

The Guidelines do not purport to set out a minimum standard of conduct for Managers, neither would adoption of them necessarily represent any form of safe harbour under FSA Rules.

The Guidelines are in no way conclusive or exhaustive, and in many cases will need to be adapted to fit the operational and business model of the Manager, the expertise of the Manager's staff and any requirements that may be imposed upon the investment Funds and/or the Manager either contractually or by regulation.

Managers should consider seeking appropriate external professional advice as regards the procedures, practices and controls they wish to adopt to combat Market Timing.

Whilst these Guidelines are aimed at providing assistance in the context of UK regulated Funds, many of the policies and processes suggested could usefully be employed in respect of either unregulated or non-UK Funds. However, we would caution Members to ensure that they consider any local restrictions and conditions that might mean that certain of these Guidelines may not be followed as here set out.

Contents

Definitions	6
The Guidelines	7
1 Scope	7
2 Appropriate Supervisory Structure	8
3 Identifying Market Timing	9
4 Addressing Market Timing	10
5 Reducing the attractiveness of Funds for Market Timing.....	11
5.1 Dual Pricing	11
5.2 Review of valuation points	11
5.3 Dealing cut-off points	11
5.4 Fair value pricing.....	12
5.5 Dealing over local public holidays	12
5.6 Publication of fund portfolios.....	12
5.7 Dilution levy or dilution adjustment	13
5.8 Redemption fees	13
6 Deterring identified Market Timers.....	15
6.1 Refusing to deal with the Market Timer	15
6.2 Requiring settlement in advance of order.....	15
6.3 <i>In specie</i> transfers.....	15
6.4 Terms of Business (TOB)	15
APPENDIX	16
FSA Statement on Market Timing	16

Definitions

For sake of simplicity this document uses the following generic terms:

- *Board* – governing body of the Manager
- *Depository* – a unit trust trustee or a depository of an open-ended investment company
- *DATA* – the Depository and Trustee Association
- *Fund* - a UK authorised unit trust or a UK authorised open-ended investment company
- *FSA* – UK's Financial Services Authority
- *Manager* – a manager of a UK authorised unit trust or an authorised corporate director of a UK authorised open-ended investment company

The Guidelines

1 Scope

These Guidelines are designed for the Managers of all UK Authorised Investment Funds ("Funds"), i.e. authorised unit trusts or open-ended investment companies ("OEICs"), and will assist them in discharging their responsibilities. Firms may wish to consider applying these Guidelines more broadly, although they have been developed within the context of the UK regulatory regime and not all recommendations will be appropriate in all jurisdictions.

2 Appropriate Supervisory Structure

Managers need to have a robust structure in place to defend against, identify and deal with Market Timing. This structure should include the following:

- Assigned responsibility of a member of senior management or appropriate committee to have oversight of the policy, procedures and processes for ensuring effective controls are in place against Market Timing
- Formal acknowledgement of responsibility of all relevant staff (e.g. client facing staff and fund managers) to escalate potential or suspected abuses/suspicious approaches, to the above or another nominated member of senior management.
- A formal and approved policy on special dealing terms and procedures under which only nominated members of senior management may give approval for granting such terms
- Robust identification and escalation procedures, including notification to senior management of issues identified via deal analyses or by the Manager's dealing desk of investor deals falling within certain parameters designed to filter out inappropriate trading patterns
- A formal and approved policy on the provision of detailed portfolio positions
- Comprehensive staff awareness and procedural training
- A clearly set out internal staff dealing policy/code of ethics in relation to dealing in Funds by members of staff. This could include a fixed holding period of sufficient length to prevent short-term trading, or a pre-approval process that would effectively prohibit arbitrage or short-term trading except in specified cases such as financial emergencies
- A clear policy stating that the Manager's own investment strategies will not include Market Timing of investment Funds, whether or not they are managed by the Manager or Associates
- A formal policy in relation to box management, to ensure that any box management does not intentionally take advantage of time zone arbitrage variances or unintentionally afford greater facility to Market Timers.

In most cases the appropriate body for approving the relevant policy will be the Board of the Manager. References to senior management should be read as requiring someone of sufficient seniority and experience to be able to discharge the role competently.

3 Identifying Market Timing

Managers may wish to monitor trading patterns in the Funds based upon parameters such as deal size and frequency. What measures are taken should be based on the Manager's assessment of the risk of the occurrence of Market Timing and the likely effect on the Funds. Whatever steps are agreed upon, the details should remain confidential to the Manager to avoid Market Timers operating just outside the limits set.

As well as looking at individual trading patterns Managers should also consider the following high-level analytical tools:

- monitoring the level of deals in and out of the fund as a percentage of Total Net Assets. Funds vulnerable to Market Timers will often have higher than usual fund turnover rates;
- monitoring the ratio of sales to redemptions. Consistent 1:1 ratios might be indicative of a Market Timer dipping in and out of the fund.

The nature, investor profile and investment objective of the fund should be taken into account in setting the benchmarks for such monitoring.

One of the difficulties facing Managers is the omnibus nature of many of the accounts that supply them with deal instructions. Overwhelmingly such accounts are for legitimate purposes and add to the cost-effectiveness of fund distribution. However, the US experience shows that Market Timers will use such accounts to camouflage and offset their dealing, making their dealing patterns more difficult to detect.

While Managers will not be able to look through to the underlying accounts, they should consider having a policy that:

- their terms of business with such holders of omnibus and nominee account holders set out the Manager's policy on Market Timing and the consequences of that account holder undertaking any activity designed to circumvent them;
- omnibus accounts are subjected to an appropriate monitoring process.

There is no golden rule as to how such accounts may be analysed. For the purposes of any redemption or short-term trading fee it may be appropriate to use a FIFO (first in first out) methodology so that charges are not levied on assets redeemed that have in fact been held for some time. However, it is also arguable that LIFO (last in first out) might be a better identification methodology for picking up round trips done from within an omnibus account, and provide a basis for further investigation.

4 Addressing Market Timing

In the event that a Manager has identified Market Timing, or has been approached with proposals to facilitate such activity, e.g. by way of a guaranteed waiver of dilution levy/adjustment or regular provision of detailed portfolio listings, doing nothing is not a supportable option. In the case of an approach, this should be rebutted and consideration given as to whether there is a case for reporting the approach. Managers should be aware that short-term trading patterns may be linked to certain money-laundering methodologies and typologies and should bear in mind their obligations under the general law, the JMLSG Guidance Notes and the FSA's Money Laundering Sourcebook.

Fortunately there are existing rules that Managers can call upon to assist with one of two strategies, i.e. firstly, reducing the attractiveness of the Fund for Market Timing and, secondly, if a Market Timer is identified and does not amend their behaviour, turning them away.

A complication in dealing with such activities is that, as noted in 3 above, Market Timers may attempt to conceal their transactions within omnibus accounts operated by intermediaries. If the Manager applies some of the options described below in too draconian a manner, an unfortunate side effect can be that other innocent investors will also be impacted. The Manager has to strike a balance between making the Funds unpalatable for Market Timers and continuing to offer the hallmark virtues of Funds - access and liquidity - to all legitimate investors.

5 Reducing the attractiveness of Funds for Market Timing

5.1 Dual Pricing

As Market Timing is primarily, but not exclusively, targeted at single priced Funds, Managers of dual priced Funds may readily be able to confirm that their investors are not suffering such detriment. If this is the case, these Managers should not need to apply the additional controls suggested in this paper. To gain this comfort, Managers will need to monitor fund activity and ensure that their spread setting process is sufficiently robust to address the risk that Market Timers, particularly arbitrageurs, may try to take advantage of an insufficient spread or where the level of staleness renders the defence of dual-pricing inadequate.

Managers contemplating conversion from dual to single pricing should, before they make a decision and, most importantly, before they implement any such change, review what additional safeguards might need to be put in place to address potential Market Timing.

5.2 Review of valuation points

Whilst it may be administratively convenient for Managers to set the same valuation points for all its authorised unit trusts and OEIC Funds and sub-Funds, there is no regulatory requirement for them to be the same. To limit opportunities for time zone arbitrage, Managers should review the valuation points for Funds invested into overseas markets and consider the benefits, costs and practicalities of setting valuation points at times when the relevant securities markets are open.

Before making changes to valuation points Managers need to consider the cost and operational impact of changes weighed against the risks, any volume constraints on third party providers coping with amended valuation points, management of investor switches between Funds/sub-Funds on different valuation points and notification to investors of any change in valuation points. It should be noted that having differing valuation points does not necessitate different dealing cut-off points and it is possible to mitigate the complexity of varying valuation points on clients and client administration (see 5.3 below).

It is recognised that such an approach may not always fit with the Manager's operational model, and its scope is limited in respect of Funds that invest, or might invest, in markets in more than one time zone (e.g. a sector or industry fund). In such cases Managers should consider Fair Value Pricing (see 5.4 below).

5.3 Dealing cut-off points

The COLL Rules give Managers flexibility to determine the interaction between the dealing day and the valuation point by enabling them to set a cut-off point before the relevant fund valuation point for deals. Such a process can be used to ensure that investors are unable to place a trade during all or part of the period when underlying markets are closed. It introduces more uncertainty into the Market Timer's model and would help preclude the type of arbitrage where the Market Timer buys the fund and sells the relevant index by way of a future at the dealing/valuation point. It will not of itself deter the short-term trader.

The rules permit Managers to set a dealing cut-off point at or before the time of the relevant market close, as far back as the close of the Manager's previous business day. This could effectively close the time zone arbitrage opportunities described above. However, before introducing dealing cut-off points, Managers should consider whether this would unduly inconvenience significant legitimate investors, e.g. fund-supermarkets and Funds of Funds, and carefully evaluate the operational implications of doing so.

Managers should further not enter into arrangements with third parties – unless they are agents of the Manager, such as its third party fund administrator – permitting them to submit deals late, even if they are prepared to certificate the deals as having been received prior to the valuation point, or dealing cut-off point if earlier. Processing of late deals by the third party administrator should also be prohibited except where the Manager has satisfied itself as to the cut-off procedures in place and there is clear documented evidence that the order was received prior to the valuation point, or dealing cut-off point if earlier.

5.4 Fair value pricing

Where a fund is valued either using previous day prices for a market which is closed for a particular day, or, due to time zone differences, closed for normal trading materially prior to the fund valuation point, and where subsequent events indicate that prices have moved by the valuation point, Managers are permitted to make an appropriate adjustment to the valuation to reflect more accurately the current value of the portfolio. Managers are also permitted to make adjustments if they believe that the quoted prices for a particular stock are unrealistic, e.g. because it is suspended, illiquid and/or infrequently traded.

IMA, jointly with the Depositary and Trustee Association (“DATA”), have issued Fair Value Pricing Guidelines for Managers of UK domiciled Investment Funds. These Guidelines can be found on the IMA and DATA web-sites under Industry Standards.

5.5 Dealing over local public holidays

Managers of Funds that are invested overseas will frequently find that stock markets on which the fund investments are quoted are closed for local public holidays, e.g. Thanksgiving Day in the USA, Golden Week in Japan etc. To avoid the risk of valuing such Funds on stale prices, Managers could consider noting in the fund prospectus that the fund will not be valued on such specified days, (particularly if fair valuing is problematic because there is no proxy or well-correlated index to use) and that any investor deals received by the Manager during those days will be carried forward to the next valuation point.

5.6 Publication of fund portfolios

Managers may on occasion receive requests for fund portfolio positions, particularly from multi-managers, who use the detail to enable them to match their target asset allocations or assess portfolio risk and have no intention to cause detriment to fund investors. However, up to date portfolio details provide invaluable information for potential Market Timers, and Managers need to be careful about providing portfolio details. Managers should consider the essential obligation to treat all investors equally and, as noted in Appropriate Supervisory Structure above, a formal company policy should be established and adherence to it monitored.

The policy will need to strike a balance between an appropriate level of transparency and prompting dealing of an inappropriate frequency. The policy should cover full portfolio positions and also summary information, e.g. top ten holdings, geographical/industrial sector analysis or in the case of bond Funds, duration or currency analysis. The policy should establish a set publication frequency, together with a set time lag that will limit the value of the information to potential Market Timers whilst still being useful to genuine investors.

5.7 Dilution levy or dilution adjustment

A further option that is available to Managers, probably will not be effective on its own in deterring Market Timers, but may make their activities less profitable and consequently make the fund concerned a less attractive target, is a dilution levy or adjustment.

Under the COLL rules Managers may charge a dilution levy or move a swinging price by way of dilution adjustment, only in so far as it is necessary to protect a Fund from the effects of dilution. The Manager's policy on when to apply, or to not apply, dilution levies/adjustments, has to be set out in the Fund Prospectus. Typically the Prospectus will also set a trigger level of net sales or redemptions, above which the dilution levy/adjustment will be applied, and consequently Market Timing of sufficient size to hit this trigger level will be made less profitable and attractive.

As the trigger level will be publicly disclosed, Market Timers may of course ensure their transactions fall below this trigger level. However, in the event that the Manager starts to receive frequent sales and repurchases below this trigger level, the assumptions and calculations upon which the dilution levy/adjustment policy has been based may need to be revisited, rather than simply left until the next periodic review. A substantial increase in turnover may make a significant difference to fund dilution and consequently to the future growth of the Fund, which could influence the Manager to change his policy, not just on the frequency/circumstances of imposing a levy, but potentially to commence imposing a levy for the first time.

Those Managers that have an element of discretion in their fund dilution policies may need to emphasise to their staff that any pressure to waive a dilution levy/adjustment to close a potential deal should be questioned, as this may be detrimental to ongoing investors. Such decisions should be taken only at an appropriately senior level.

Managers may be requested by fund supermarkets, or other aggregators, to agree that dilution levies will never be applied to their transactions, on the basis that these are a bundling of a number of smaller individual deals, each of which on their own would not trigger the dilution levy. If they wish to enter into such arrangements, Managers should ensure that this is formalised by legally enforceable agreement, under which the aggregator commits to place separate orders for any individual transactions, or string of transactions, that would cumulatively trigger the dilution levy threshold. As part of this agreement Managers should obtain the right to inspect the aggregator's records to confirm that the agreement is being adhered to, although the Manager should confirm that this is permitted under relevant data protection legislation.

5.8 Redemption fees

As noted above, a dilution levy is designed only to recoup for the Fund the additional transaction costs generated by certain large deals. It does not seek to remove the arbitrageur's profit and it tends not to penalise the less large, but frequent, pattern of trading that Market Timers can adopt to avoid such levies. A Manager may choose to take the power

to levy a redemption fee on redemptions in respect of positions that have been in the Fund only for a brief period of time.

Managers may wish to consider the use of a redemption fee (on either a strict or a discretionary basis). However, without a clear regulatory mandate as to the level of the fee, the methodology to be used, the time scale over which it might apply, and that, unlike dilution levies, which are paid into the Fund, redemption fees can be paid to the Manager, there is the danger that this could expose the Manager to complaints from legitimate clients who happen to have needed to redeem early.

6 Deterring identified Market Timers

6.1 Refusing to deal with the Market Timer

Despite the fundamental principle that Funds should be available to investors at all times during the dealing day, Managers are permitted to turn away business from investors that they know, or suspect, are Market Timers. Anecdotal evidence suggests that this particular rule is the one that Managers most frequently apply when deterring such practices.

This rule states that the Manager's obligation to sell units at all times during the dealing day does not apply if the Manager has reasonable grounds for refusing to sell units to the person concerned. The rule has a wide interpretation, and includes not just the circumstances of the potential investor, but also their intentions.

Managers should nevertheless be sensible in recording and communicating the justification for rebutting an investor or potential investor, as terms such as "market timer" are increasingly pejorative and possibly defamatory if communicated or published. Refusal to deal should be framed in the context of the products being long-term investments and not appropriate for short-term trading.

6.2 Requiring settlement in advance of order

Any person identified as a Market Timer, or potentially as a Market Timer, should not be offered any non-standard credit dealing privileges, and any non-standard credit privileges previously accorded should be withdrawn. Managers may be exposed if they have afforded special credit terms to an investor they know or suspect is damaging the fund.

If an identified Market Timer periodically switches within the Manager's fund family the Manager may require that the reinvestment side of that switch is settled in advance of the order being processed. At the very least this would be an inconvenience to the Market Timer.

6.3 *In specie* transfers

A further option available to some Managers is the threat of settling redemptions by *in specie* transfers rather than cash, although, as *in specie* transfers represent a significant operational burden for the Manager, this option probably would be used only as a last resort. Clearly, for this to be a thoroughly effective deterrent, the trigger level disclosed in the Fund Prospectus, above which the Manager may impose *in specie* redemption, will need to be quite low, as anecdotal evidence suggest that Market Timers may deal at low, but frequent volumes.

6.4 Terms of Business (TOB)

Managers may enter into TOB setting out legally binding arrangements with certain clients and distributors (such as fund supermarkets). It will be necessary to ensure that any TOB allow for Managers to implement any required measures to protect the Fund. They should not, for example, compel the Manager to pay commission or offer discounts on loads in respect of transactions or assets that the Manager has identified as related to Market Timing. One way of doing this would be to insert a clause into all TOB that states that in the event of a conflict between the TOB and the Prospectus, the Prospectus would prevail. This would permit the Manager to keep its Market Timing "toolkit" up to date without having to revisit all TOB on each occasion.

APPENDIX

FSA Statement on Market Timing

18 March 2004

The Financial Services Authority's investigation into market timing has found no evidence of illegal, late trading but has found some evidence of market timing in UK authorised collective investment schemes (CIS). Market timing does not appear to have been a major source of detriment to long-term investors.

Most occurrences have been short-lived with fund managers taking swift action to terminate relationships where clients have attempted to time Funds. The FSA has asked fund managers to calculate the effect of market timing and it is expected that this will form the basis for compensating payments to be made to the Funds in some cases.

Total amounts involved are still being calculated but are likely to be less than £5 million.

Michael Foot, FSA Managing Director, said:

"The picture we have uncovered is generally quite an encouraging one. Although there is evidence of market timing having occurred within our authorised Funds, looking at all the evidence we have amassed, we can find no sign either that market timing is widespread or that it has been a major source of detriment to long term investors."

Key Findings

While some evidence of limited market timing activity was uncovered, the relationships between the UK CIS fund managers concerned and the market timing clients appear to be of a different nature to those uncovered in the US, where there has been evidence of significant financial benefit to fund managers as a result of their relationships. In the UK, we examined 9,620 transactions as part of our investigation. In fact, only 118 eventually required follow up during on site visits.

The FSA's work found no evidence of late trading in the UK authorised CIS. It appears this is due in large part to the industry framework: where deals are placed directly with the fund manager before valuation points, and the important control function provided by the trustee in UK Funds. The FSA will be undertaking further work to confirm its view of trustee oversight.

We believe that our Principles and Rules provide sufficient tools to enable firms to manage the conflicts of interests posed by market timers. Among these tools are the ability to price underlying assets at a fair value and the ability to refuse to sell units to suspected market timers, as well as a number of measures to reduce dilution and to otherwise increase the cost (and so decrease the attractiveness) of market timing activity.

Mr Foot went on to say:

"We have amassed a considerable amount of evidence which leads us to this broadly reassuring conclusion and in doing so it would not be surprising if we have sensitised fund managers to the risks they run with respect to market timing and to the need for robust controls and active monitoring. But we will also undoubtedly have alerted some potential market timers. Doing nothing more in this area is therefore not an option for us."

Next steps

The FSA is undertaking further work on a number of issues: The FSA will continue to look to fund managers to demonstrate management of conflicts of interest in accordance with the FSA's Principles-based regime. Potential conflicts arise whenever market professionals are permitted to invest in Funds at the potential expense of long term investors. Steps to manage conflicts could include not dealing with market professionals if there are any questions about their motives or the potential impact on long term investors.

The FSA will be pushing ahead with the package of reforms to the regulation of Funds in the UK (CP 185) that were published last year. This included amendments to the rules that would clarify the measures available to deter market timing. These measures include the use of fair value pricing (use of a best estimate where underlying prices are likely to have moved materially) and clarification of the scope for declining to deal. We have been particularly encouraged by the willingness of industry participants to embrace fair value pricing and we are looking to them to work up concrete proposals for this. The firms asked that we implement the proposals on fair value pricing that we made in CP185 for existing Funds and this, subject to the approval of the FSA's board, is something we intend to do.

The FSA is encouraging managers of unit linked Funds that are not covered by the more detailed CIS regime to adopt the tools in the CIS regime to allow them to avoid potential detriment to investors from market timing. Firms are reminded that the FSA Principles apply.

Firms have pointed out the problem caused by order aggregators who place combined deals for several customers, which may hide the activities of market timers. While recognising these difficulties, we remind firms of their obligations. If fund managers are unable to satisfy themselves that potentially suspicious deals are not on behalf of market timers, we suggest they use the range of tools at their disposal and do not allow any unduly preferential dealing arrangements.