



Equity Income Sectors – Reinstatement of Yield Monitoring Tests and Enforcement

How The IA Monitors Funds in the Equity Income Sectors

The IA sector definitions (see Appendix 1) are intended to ensure that funds within the Equity Income sectors - UK Equity Income (UKEI) and Global Equity Income (GEI) - have a specific focus on delivering income, whilst not being unduly inflexible or prescriptive.

We require funds to meet a yield hurdle over 1 and 3 years in order to remain in the equity income sectors in recognition of the importance of the income objective to investors. The IA publishes these yield figures for all funds within the equity income sectors on its website so retail savers, advisers and users of the sectors have access to up-to-date information about fund performance.

The yield monitoring tests are based on the historic yield at each fund's year end. Annually a fund's yield must meet 90% of the FTSE All Share (UKEI) or MSCI World (GEI) yield, and across any rolling 3-year cycle, the fund's average yield must exceed 100% of the relevant index average yield over the same period.

The Impact of the Pandemic and The IA's Decision to Suspend Enforcement

In recognition of the exceptional market environment for managers of equity income funds caused by the pandemic, the enforcement of the yield rules was suspended in April 2020. This decision was taken both to avoid the necessity of managers adjusting their portfolios to meet IA sector yield hurdles and to prevent a situation where the composition of the Equity Income sectors was disrupted unnecessarily, thereby making it harder for customers to easily identify equity income funds.

The IA continued to publish the yield data collected at each fund's accounting year end on its website. These guidelines were intended to minimise short-term disruption to the equity income sectors where fund distributions and yields were likely to be impacted by company dividend suspensions and postponements as a result of the pandemic.

The suspension has been reviewed periodically by the IA's Sectors Committee, with the first formal review taking place in September 2020 and subsequently on a quarterly basis. The Sectors Committee has now chosen to reintroduce the enforcement of the yield tests from 24 September 2021. Enforcement is being re-introduced in September in order to give firms three months' notice of the change.



The Reinstatement of the Yield Tests & The Implications for Firms with Funds Classified to The Equity Income Sectors

The annual 90% yield hurdle test will be applied as it was before the moratorium. However, the 3-year rolling average yield test will be adjusted to allow firms to exclude one fund accounting year from the calculation. In this way, a fund may not necessarily be removed from the sector based on one unprecedentedly bad year for income payments experienced as a result of the pandemic conditions.

If a fund fails either the 1-year test or the modified 3-year test, the fund will move out of the equity income sectors. Funds in the UK Equity Income sector that fail will be moved into the UK All Companies sector subject to meeting the 80% UK equity requirements. Funds in the Global Equity Income sector will be moved to the IA Global sector subject to meeting the 80% global equity requirements.

Yield Tests

The moratorium is being withdrawn on 24 September 2021, so the yield tests will be applied to funds with a year-end date in September 2021 and to all funds thereafter. The tests will be applied as follows:

- **1-Year Test**
Annually, at the fund's year-end, each fund in the sector must achieve a yield of not less than 90% of the FTSE All Share \ MSCI World yield. Funds that fail to do so will be removed from the sector.

- **Modified 3-Year Test**
 - Taking a simple average of each year end yield figure over the previous 3-year rolling period, a fund must exceed the 100% average yield of the FTSE All Share/MSCI World Index for the same period.
 - All funds will be able to elect one fund accounting year (with a year-end of either 2020 or 2021) to be excluded from the calculation of the 3-year yield test. See below a worked example.
 - This election is a one-off decision that can only be made at the fund's next accounting year end following the reintroduction of enforcement on 24 September 2021.
 - The Sectors Committee will operate an appeals process in exceptional circumstances and only if a manager can demonstrate that the case merits the right to appeal. For example, if a manager can demonstrate that a fund's yield was impacted by factors related to COVID 19 for two of the fund accounting years, the firm may wish to appeal being removed from the sector. In the event of an appeals process, each fund's case will be judged on its own merits. The Sectors Committee decision will be final.

For full transparency, all the yield figures will continue to be displayed on the equity income yield spreadsheets on the IA website. The results are displayed alongside the average FTSE or MSCI yield. From September 2021, the excluded year nominated by firms will be highlighted.



Standard Test - Fund fails 3-year average 100% test and is removed from the sector

Fund Name	Fund Year End Date	FTSE All Share Yield	Fund Year End Yield
Income Fund	30-Sep-18	3.8	4.4
Income Fund	30-Sep-19	4.2	4.2
Income Fund	30-Sep-20	4.6	4.1
Income Fund	30-Sep-21	3.0	3.1
3 Year Average		3.9	3.8

Modified Test - Chosen year is removed from 3-year average calculation

Fund Name	Fund Year End Date	FTSE All Share Yield	Fund Year End Yield	
Income Fund	30-Sep-18	3.8	4.4	
Income Fund	30-Sep-19	4.2	4.2	
Income Fund	30-Sep-20	4.6	4.1	Remove Covid-19 Year
Income Fund	30-Sep-21	3.0	3.1	
3 Year Average		3.7	3.9	



Appendix 1: The UK Equity Income and Global Equity Income sector definitions

UK Equity Income

Funds which invest at least 80% in UK equities and which intend to achieve a historic yield on the distributable income in excess of 100% of the FTSE All Share yield at the fund's year end on a 3-year rolling basis and 90% on an annual basis.

Notes:

1. To ensure compliance with the sector criteria, funds should supply data for monitoring to enable the calculation of historic yield based on The Investment Association guidelines set out in "Authorised Funds: Yield Calculation and Disclosure Guidelines - 2012".
2. Funds are required to submit yield data at the fund's year end to the sectors team at The Investment Association and to the monitoring company.
3. To ensure compliance with the intended 100% yield, funds in the sector will be tested over 3-year rolling periods by taking a simple average of the yield figure achieved for each fund at its year end. Funds that fail to exceed the 100% average yield for each 3-year rolling period will be removed from the sector. (As an illustration, this would require a fund that delivered 90% in the first year and 100% in the second year to deliver a yield in excess of 110% in the third year, if it were to be allowed to remain in the sector).
4. Annually, at the fund's year-end, each fund in the sector must achieve a yield of not less than 90% of the FTSE All Share yield. Funds that fail to do so will be removed from the sector.
5. The Investment Association will measure yield to one decimal place.
6. To assist users of the sectors and aid comparison, The Investment Association will publish the annual yield achieved by each fund in the sector.

Global Equity Income

Funds which invest at least 80% of their assets globally in equities. Funds must be diversified by geographic region and intend to achieve a historic yield on the distributable income in excess of 100% of the MSCI World Index yield at the fund's year end on a 3-year rolling basis and 90% on an annual basis.

Notes:

1. Funds must be diversified by geographic region.
2. Funds which qualify for the Global Emerging Markets equity sector but also have an income bias will be excluded.
3. To ensure compliance with the sector criteria, funds should supply data for monitoring to enable the calculation of historic yield based on The Investment Association guidelines set out in "Authorised Funds: Yield Calculation and Disclosure Guidelines - 2012".
4. Funds are required to submit yield data at the fund's year end to the sector team at The Investment Association and to the monitoring company, Morningstar.
5. To ensure compliance with the intended 100% yield, funds in the sector will be tested over 3-year rolling periods by taking a simple average of the yield figure achieved for each fund at its year end. Funds that fail to exceed the 100% average yield for each 3-year rolling period will be removed from the sector. (As an illustration, this would require a fund that delivered 90% in the first year and 100% in the second year to deliver a yield in excess of 110% in the third year, if it were to be allowed to remain in the sector.)



6. Annually, at the fund's year-end, each fund in the sector must achieve a yield of not less than 90% of the MSCI World Index yield. Funds that fail to do so will be removed from the sector.
7. The Investment Association will measure yield to one decimal place.
8. To assist users of the sectors and aid comparison, The Investment Association will publish the annual yield achieved by each fund in the sector.