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UK Financial Conduct Authority to Impose Remedies in Asset Management Sector

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On 18 November 2016, the ***UK's Financial Conduct Authority (FCA)*** published interim findings from its year-long study of the country's asset management sector—concluding that price competition is weak in several areas, and highlighting wider concerns about the way the investment consulting market operates.

The market study, commenced in November 2015, considers whether the UK's asset management sector is sufficiently competitive and whether institutional and retail investors are getting value for money when buying asset management services.

The terms of reference posed three main questions:

1. How asset managers compete to deliver value
2. Whether asset managers are willing and able to control costs and quality along the value chain
3. How investment consultants affect competition for institutional asset management

In addressing these questions, the FCA also considered whether there are any barriers to innovation and technological advances.

The study marks a notable feature of the FCA's expanded remit since 1 April 2015 in its ability to use information gathered through its powers under the Financial Services and Markets Act 2000 to enforce the competition rules.

Key Findings

The main finding of the interim report is that price competition is weak in a number of areas of the asset management sector, which has a material impact on the investment returns of investors through their payments for asset management services.

In particular, the FCA found the following:

- Charges are higher for actively managed funds but do not necessarily reflect better performance compared to charges for passive funds.

- While charges for passive funds have fallen over the last five years, charges for actively managed funds have stayed broadly the same.

- Very few asset management firms lower charges to attract investment, particularly for retail investors.

- There is considerable price clustering for active equity funds, particularly where Assets Under Management (AUM) are greater than around £100 million.

- Fund objectives are not always clear, and performance is not always reported against an appropriate benchmark.

- Fund governance bodies do not exert significant pricing pressure by scrutinising asset managers’ costs, and typically do not focus on value for money.

- As fund size increases, pricing does not appear to fall, suggesting that economies of scale are retained by the fund manager rather than being passed on to investors.

- While progress has been made in improving market transparency over charges, there are continuing concerns around how asset managers communicate costs to investors.

- It is often difficult for investors to know whether they would be better off switching share classes or funds, and investors may incur significant costs if they make such changes.

- Retail investors do not appear to benefit from economies of scale by pooling their money together through direct-to-consumer platforms. As such, there are concerns as to the value provided by platforms and advisers.

- The investment consultancy market is relatively concentrated, with the top three firms accounting for around 60% of the market.

Remedies

The interim report proposes a number of remedies:

- Placing a strengthened duty on asset managers to act in the best interests of investors including reforms that will hold asset managers accountable for how they deliver value for money as well as requiring greater independence on fund oversight committees.

- Introducing an “all-in fee” approach to quoting charges so that investors in funds can easily see what is being taken from a fund. This has the potential to also touch upon MiFID II’s approach to the payment of research by investment firms.

- Helping retail investors identify the best fund for them by (i) requiring asset managers to be clear about the objectives of the fund; (ii) reporting against objectives on an ongoing basis; (iii) clarifying and strengthening the appropriate use of benchmarks; and (iv) providing tools for investors to identify persistent underperformance.

- Exploring with government the potential benefits of greater pooling of pension scheme assets.

- Consulting on whether to make a market investigation reference to the Competition and Markets Authority (CMA) for in-depth investigation of the institutional investment advice market.

- Recommending that HM Treasury considers bringing the provision of institutional investment advice, such as that provided by investment consultants to pension schemes, within the FCA’s regulatory perimeter.

Many of the FCA’s proposals are investor protection related, despite the study’s emphasis on competition matters. These proposals will likely lead to different and more far-reaching outcomes. The FCA is now consulting on these proposed remedies, and responses should be submitted by 20 February 2017. The final report and proposed amendments to the FCA's rules are expected to be published in Q2 2017.

Conclusion

While this study is the first time the FCA has taken an in-depth look at competition in the asset management market, the interim report reflects the FCA’s strong and continuing focus on investor protection. Proposals to enhance governance, clarity of investment objectives/policies and cost transparency, for example, are issues that the FCA has been pursuing for some time. Notably, there is an emphasis on borrowing from the experience of overseas regulators in how to tackle these issues, such as the US approach to fund governance and cost scrutiny.

For the investment consultant industry, a referral by the FCA to the CMA may precipitate fundamental changes. If the reference proceeds, firms in the institutional investment advice sector—particularly the market leaders—can expect detailed analysis of their business and practices by the CMA, following which it would typically propose further remedies and regulation. This can present both risks and opportunities to market players as well as their customers and suppliers.

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