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Client Alert
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Latham & Watkins Financial Regulatory and Investment Funds Practices

29 June 2017 | Number 2168

FCA Seeks to Reform UK Asset Management Sector

FCA publishes final report in its asset management market study and announces package of remedies.

The FCA published the final report in its asset management market study on 28 June 2017. The terms of reference for the study were published back in November 2015, and an interim report setting out initial findings and proposed remedies was published in November 2016.

The interim report was very critical of the industry, indicating that the FCA had found weak price competition and that it held concerns about the investment consultant market. Market participants were given the opportunity to comment on the FCA's interim findings until February 2017. The FCA received high engagement from the industry on its sweeping proposals, stating that it received over 150 written responses and held discussions with almost 200 stakeholders.

The FCA is proposing a package of remedies designed to improve competition in the asset management sector. Some of these do not require further consultation and are being taken forward; these are explained in the final report. Other remedies do require further consultation and so proposals are set out in a separate Consultation Paper (CP17/18). Responses to the consultation are due by 28 September 2017.

This consultation also includes some additional areas for discussion: whether the FCA should consider ending the payment of trail commission, and whether proposed governance-related remedies in the consultation should be applied to providers of other retail investment products.

The FCA also sets out initial views regarding further proposals. It plans to publish detailed consultations on these proposals later in the year. This staged approach is partly due to the regulatory reform agenda, with MiFID II and PRIIPs go-live dates on the horizon, and the upcoming consultation on the extension of the Senior Managers and Certification Regime (SMCR). Therefore, the FCA feels that existing initiatives will address at least some of its concerns, and so it may be better to wait and consider those concerns once all of the relevant details of those initiatives have been clarified.

Key findings

The FCA's final findings largely reflect those in the interim report:

- Price competition is not working as effectively as it could be. The FCA has found that firms do not typically compete on price, there is considerable price clustering on asset management charges for retail funds, and firms have high levels of profitability.

- On average, both actively managed and passively managed funds do not outperform their own benchmarks after fees. The FCA's work also suggests that there is no clear relationship between charges and the gross performance of retail active funds in the UK.

- The FCA has concerns about how asset managers communicate their objectives and how useful these are for retail investors. It is also concerned that investors' awareness of and focus on charges is mixed and, for retail investors, often poor.

- The FCA has concerns in relation to the investment consulting market. These include the relatively high and stable market shares for the three largest providers, a weak demand side, relatively low switching levels, and conflicts of interest. These concerns are most relevant in relation to smaller institutional investors, such as pension funds, which rely more heavily on investment consultants than larger investors do.

Remedies

The FCA divides its package of remedies into three groups, based on their overall aim.

Remedies to enhance investor protection for those who are not well placed to find better value for money

- **Fund governance: SMCR**. The FCA sets out its intention to consult on introducing a new Prescribed Responsibility under the SMCR to act in the best interests of investors, including a consideration of value for money. This responsibility would need to be allocated to the chairman of the fund manager. This proposal will be consulted on in due course as part of the wider consultation on the extension of the SMCR. The FCA has decided not to go ahead with one of its controversial suggestions — recommending the introduction of a statutory fiduciary duty. *Initial views only*.

- **Fund governance: value for money**. The FCA is proposing to introduce a new rule requiring fund managers to assess whether value for money has been provided to fund investors. This assessment would need to take place on an ongoing basis and be formally documented at least once a year. It would need to cover certain prescribed areas, such as fees and charges, and quality of services. *Addressed in CP17/18*.

- **Fund governance: directors**. The FCA is proposing that asset managers should include a minimum of two independent directors on their boards, or have independent directors make up at least 25% of the total board membership. These independent directors would need to meet certain criteria and could only be appointed for a set length of time. The proposals would apply regardless of the size of the fund manager. *Addressed in CP17/18*.

- **Risk-free box profits**. The FCA proposes to prohibit fund managers from retaining risk-free box profits (requiring these profits to be passed to the fund) and to require fund managers to disclose their approach to box management in the fund prospectus, in order to increase transparency for investors. *Addressed in CP17/18*.

- **Switching investors to better value share classes**. The FCA is consulting on proposals to facilitate switching, by clarifying in its guidance that a fund manager can undertake mandatory conversion in certain circumstances, when dealing with an unresponsive unitholder. *Addressed in CP17/18*.

Remedies to drive competitive pressure on asset managers

- **All-in fee**. The FCA states that it still supports the introduction of a single all-in fee disclosure, but is considering how costs and charges can be communicated more clearly to investors. Noting the changes that MiFID II and PRIIPs will introduce — which the FCA believes will go some but not all of the way towards providing clear disclosure — for now the FCA will be testing ways to improve the effectiveness of these new disclosures and how changes to the presentation of these disclosures might encourage investors to make effective price comparisons. The FCA states that this work will inform the development of any future remedies in this area. *Initial views only*.

- **Consistent and standardised disclosure of costs and charges**. The FCA is recommending that industry and investor representatives agree a standardised template of costs and charges for institutional investors, put together with independent oversight. *Initial views only*.

- **Clearer objectives**. The FCA will chair a working group to consider how to make fund objectives clearer and more useful for investors. It plans to complete this work before considering whether any rule changes are required. *Initial views only*.

- **Benchmarks**. At present, the FCA has concluded that it is not necessary for all funds to have a benchmark, comparator, or numerical target return. It intends to consult on requiring fund managers that do set a benchmark, comparator, or numerical target return for a fund to be clear about why they use that particular benchmark, and to use the benchmark consistently across marketing materials. For fund managers that do not set a benchmark, the FCA proposes to require them to explain why they do not do so and prevent them from using any other benchmark, comparator, or target in marketing materials. *Initial views only*.

- **Past performance presentation**. The FCA is considering introducing rules or guidance to clarify that, where past performance is presented, this is done against the most ambitious target held out to investors. The FCA is also intending to consult on rules preventing a fund manager presenting past performance against any benchmark, comparator, or target where one has not been set for the fund. *Initial views only*.

- **Performance fees**. The FCA is considering consulting on rules to ensure that performance fees are only permitted when the fund has achieved a level of return above the most ambitious target communicated to investors. The FCA will also consider whether additional policy action is required to make UK domiciled funds' performance fee structures more equitable. *Initial views only*.

Remedies to improve the effectiveness of intermediaries

- **Extension of the regulatory perimeter**. The FCA intends to ask HM Treasury to bring "all aspects of investment consultancy services", including asset allocation advice, into the regulatory perimeter. *Final remedy*.

- **Market study into investment platforms**. The FCA will launch a market study to consider how investment platforms and firms offering similar services in adjacent markets compete to win new customers and retain existing customers. It plans to publish a terms of reference document shortly. *Final remedy*.

- **Investment consultants**. In its interim report, the FCA proposed to make a market investigation reference to the Competition and Markets Authority to address the FCA's concerns in relation to investment consultancy services. This would enable the competition regulator to carry out an in-depth investigation of this part of the sector and potentially impose competition law remedies such as structural remedies (for example, requiring firms to sell parts of their business) or behavioural remedies (for example, changing the way information is made available to customers). The FCA can accept undertakings in lieu of making a market investigation reference and has a duty to consult on any proposed undertakings. As the three largest investment consultants have submitted undertakings in lieu to the FCA, which are designed to address the FCA's concerns about the market, the FCA must consult on its proposed action. In this case, the FCA is proposing to reject the undertakings in lieu and continue with its proposal to make a market investigation reference. It expects to make a final decision in September 2017. *Addressed under separate consultation; responses due by 26 July 2017*.

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