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Financial Conduct Authority
25, the North Colonnade
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20th February 2017

Dear Becky,

FCA PRACTITIONER PANEL RESPONSE TO ASSET MANAGEMENT MARKET STUDY INTERIM FINDINGS

The Panel welcomes the fact that the FCA has produced an interim report to which interested parties have been able to respond. We support the objectives of the FCA's Asset Management Market Study, as both consumers and firms benefit when financial services function better. This is an extensive analysis of the funds market and institutional distribution.

We welcome the recognition of the need not just to focus on the product providers and manufacturers, but also to look at the full value chain and total cost experienced by the investor. This is a welcome move away from a piecemeal approach to the investment market, but we encourage the FCA to consider any remedies and their impact on separate parts of the market which are proportionate to avoid unintended consequences.

We have the following comments in response to the findings of the interim report.

1. **Comments on the findings of the interim review**

    a. *Governance and value for money*

The proposals around governance and value for money need to be properly thought through and, if changes are required, the purpose behind such change needs to be clearly articulated. For example, at some points reference is made to enhanced requirements to "act in the best interests of investors" and at other points the focus seems to be on value for money – the two are not the same. The FCA needs to be clear that this does not just equate to the lowest cost.

In relation to the case for more independent oversight of funds, we note alternative governance structures, such as the Irish model, which promote greater independence between the Authorised Fund Manager (AFM) and the asset manager and with the majority of AFM members and the chair independent. However, if changes are to be made this needs to be on the basis of a proper review of governance so that any new regime ensures accountabilities are very clear, that any changes are compatible with company and trust law, and they do not create ineffective governance while adding bureaucracy or expense. For example, given the different structures of insurance companies, pension funds and authorised funds, bolting on Independent Governance Committees (IGCs) is unlikely to be the right answer, although it is true for workplace pensions that IGCs have carried out important work on defining value for money in its broader sense (including service, communications, choice and security).

Any proposed changes to the governance structures must support the clear lines of accountability of the Senior Managers and Certification Regime (SMCR) if there is not to be inconsistency of governance rules. Similarly, we understand that one of the objectives of the

governance remedies is to protect the interests of existing customers, and encourage the FCA to ensure this is aligned with the principle of Treating Customers Fairly.

b. Costs and pricing

It is disappointing that the FCA has focused so heavily on costs and has, in a number of cases, been quite selective in its interpretation of the evidence. The apparent bias towards passive investment, for example, seems to ignore evidence around the real value of active management and the alpha that has been created for clients in many strategies. Asset management needs to be judged on outcomes, not just costs. We agree consideration needs to be given to helping investors choose between active and passive funds and in delivering value for money in each. For those without an adviser or who are not actively engaging, for example under auto-enrolment, passives have appeal but savers should also be given choices, including active funds, even if these have higher charges.

Our view is that the FCA should be mindful of a longer term approach to asset management, such as that taken by customers who are planning for retirement. Any action which may encourage such investors to move investments from active to passive solely on the grounds of cost may result in their being significantly disadvantaged in the longer term, once it is too late to do anything about it. The FCA must be careful that its remedies do not inadvertently encourage such decisions. It is important that customers should be aware of their options, but are not pushed to switch without being aware of the potential downside.

The study does not seem to take account of the fact that a significant reduction in active management would have serious implications for the efficiency, effectiveness and disciplines of primary and secondary capital markets. The industry contributes enormously to the success of UK plc and to continue to do so it needs to be able to compete on the world stage - something that regulators should be encouraging.

c. Fund performance and fund flows

We suggest the FCA considers further its findings around the link between fund performance and fund flows. Experience generally shows a much closer and clearer link between performance and flows than that which the interim study observed; this is particularly the case for larger firms who witness consequential swings from intermediaries once performance begins to lag.

d. Pensions-specific considerations

We believe the funds within workplace pensions, both trust-based DC and Group Personal Pensions, should be considered primarily as institutional. Workplace personal pensions now have IGCs to drive Value for Money as well as a charge cap. Our experience is that this is working well and we need to avoid duplication of VFM governance at both fund and pension scheme level. Within pensions, savers already receive extensive disclosure at 'product' level. For charges, this often combines investment related and scheme administration charges. We'd be concerned if scheme members in future received extensive additional or separate 'fund' disclosures.

2. Remedies – general principles

The Panel strongly suggests that the FCA adheres to a number of key principles when determining which remedies to apply:

1. Consumer testing should play a major role in all measures designed to increase investor awareness (e.g. disclosure). It is more important that investors receive the correct information than ever-increasing amounts of data.

2. Several major changes to the regulatory environment for asset managers are currently underway (e.g. PRIIPs and MiFID II) and more will follow later in 2017 (e.g.

the extension of the Senior Managers & Certification Regime under Accountability 2). Providers, platforms and advisers have already responded to interventions such as RDR, TCF and charge caps on workplace pensions and the AMMS needs to avoid applying new remedies to parts of the market which have already addressed underlying issues. Whether or not the changes already underway achieve the FCA's desired policy outcomes should be analysed in the first instance prior to agreeing additional measures.

3. The competitiveness of the UK regulatory environment, and its impact on the UK asset management industry, should be taken into consideration when developing remedies. UK funds will increasingly be competing against EU funds in Europe and worldwide; any changes to the domestic fund regime will need to appropriately balance investor protection / competition and a continued ability to successfully market UK funds to investors worldwide.

3. Specific remedies

The Panel has the following comments on proposed remedies:

1. *A strengthened duty on asset managers to act in the best interest of investors*

All parts of the financial services industry should be acting in the best interests of their customers. The key here is to define the respective roles and responsibilities. There are already specific provisions in a range of legislation including AIFMD, MiFID and UCITS which cover this area, therefore we recommend reviewing what already exists to ensure it is fit for purpose before developing any additional proposals.

2. *To improve fund governance*

We recommend that any solutions maintain clear lines of accountability, which are in line with the SMCR and other existing rules.

3. *Simplifying fund charging structures.*

The idea of an 'all in' charge has surface appeal, but the FCA is right to highlight possible unintended consequences of certain of the options, particularly under Option D. But if transaction costs are included, there are knock-on implications for default funds in workplace pensions.

One option could be to require open-ended funds to adopt a single charge and provide investors with an estimate of transaction costs (Option B). However, if there are to be new charging structures, in particular in relation to the single fee, the FCA needs to be clear that this leads to benefits for the investor and creates the right incentives for managers. There is potential tension between simplicity for the investor which a single charge may bring and scrutiny that investors and commentators can apply to the fees. Transaction costs are a very different type of cost from the annual management charge and other administrative fees and including them in any single fee, and thus capping them, could create conflicts of interest for managers in keeping fees down and therefore possibly not dealing when it is in the best interests of investors to do so. It also does not recognise existing mechanisms that are in place for funds which are designed to ensure that incoming and outgoing investors who may provoke transactions in the underlying securities do not do so at the expense of continuing investors.

Although we do not consider a single charge would be impossible to calculate, there are therefore significant difficulties in doing so, and so we would encourage the development of a standardised methodology.

4. *Improving fund disclosure to investors*

One option would be to harmonise charging disclosure according to investor type. Where a fund is within a product wrapper which also has charges (for example pensions), the FCA needs to avoid making disclosure even more complex. We are not convinced consumers would benefit from seeing the impact of fund charges separate from the impact of other charges.

5. *Measures to help retail investors identify which fund is right for them*

We support the development of a single factsheet per fund including performance against the fund's objective and against an appropriate fund sector benchmark. There is, however, a trade-off between making the objectives and performance benchmarking helpful (and understandable) to consumers without being unduly constraining on the fund manager.

6. *Requiring increased transparency and standardisation of costs and charges information for institutional investors*

We see less need to intervene in the institutional space as investors there are more likely to have experts involved or to seek advice. The focus should first be on retail and then consider the extent to which remedies there are appropriate for the institutional market.

7. *Measures to improve the usefulness and comparability of performance information used by trustees*

The starting point should be a core set of consistent performance information. Any additional information required by one party, such as trustees, can then be built on to this.

8. *Exploring the potential benefits of greater pooling of pension scheme assets*

Group Personal Pensions, insured trust-based schemes and mastertrusts already pool assets by investing in funds open to a range of schemes and members. We see no scope for pooling Defined Benefit assets although there is no barrier to such schemes investing in pooled funds.

9. *Requiring greater and clearer disclosure of fiduciary management fees and performance*

The Panel view is that in terms of pensions is this might be best addressed through guidance from the Pensions Regulator, rather than by FCA regulation.

10. *Facilitating moves into better-value share classes*

There are a number of options which could help achieve this.

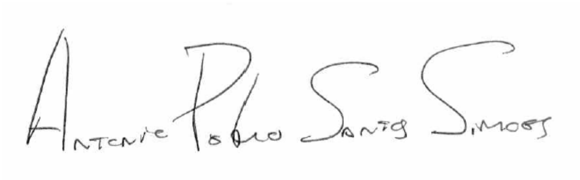
- One option would be to impose a sunset clause on pre-RDR share classes (rather than putting the onus on the investor to become aware of the trail commission payment and then decide to switch) and make it easier for asset managers to bulk transfer investors to alternative share classes where it is in the investors best interest.
- Alternatively, Irish domiciled funds allow certain powers to be given to AFMs so long as investors' interests are not prejudiced. They can compulsorily switch investors into cheaper share classes. This is a model the FCA could consider further.
- A further option would be to enabling bulk movement on a negative affirmation basis and without an advice requirement. Of course, this needs to be handled with great care to ensure no client is disadvantaged and to avoid unintended consequences such as unwillingness to introduce lower charging share classes.

11. *Consultation on whether to make a market investigation reference to the CMA on the institutional advice market and bring the provision of this advice with the FCA's regulatory perimeter.*

Before advancing this, the costs versus benefits need to be clear and these could be affected by the implementation of remedies elsewhere.

We would be happy to discuss any of these points further if required,

Yours sincerely,



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