Competition

Annual report 2016/17

Competition
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Foreword

Welcome to our second Annual Competition Report.

Promoting competition is one of our three operational objectives, together with protecting both consumers and the integrity of the UK's financial system. It is an intrinsic part of why we exist and how we regulate.

This report, published alongside our Annual Report and Accounts 2016/17, reflects how critical competition is to our work and across our operations. It also demonstrates how important effective competition is for every user of financial services in the UK.

Our work in 2016/17 has looked at the impact of asset management charges on the pensions and savings of millions of people. We introduced remedies to help the 96% of UK adults with a current account make informed decisions about their cash savings. And we launched a market study into how the £1.3tn mortgages market could help consumers better meet their needs.

To do this, we have a wide range of tools and powers. These range from making new rules, guidance and market studies to enforcement and investigations. We increasingly use behavioural economics to understand consumer choices and also champion innovation to help firms deliver better products, greater value and wider choice.

Christopher Woolard
Member of the FCA Board
and Executive Director of Strategy and Competition

1 Overview

Key points

- This is our second Annual Competition Report. It summarises our work to promote competition between April 2016 and March 2017. It covers work led by the Competition Division, as well as policy, supervisory and other work in which competition considerations have been a factor.
- Our objective is to make markets work better in the interests of consumers. In markets where competition is working effectively, consumers find competitively priced, good quality, innovative products. In this way a competitive market can also deliver improved service standards and increased access to products and services.
- During the year we completed market studies on credit cards and investment and corporate banking, published our interim findings on asset management, and launched a study on mortgages. These are all very significant markets for households and the economy – for example, 30 million people in the UK hold a credit card, and three-quarters of households have assets under management via a pension.[1]
- We have progressed and implemented remedies from earlier studies. For example, shining a light on low interest rates in cash savings accounts, and trialling ways to compare annuity offers.
- We have continued to progress our existing Competition Act 1998 investigation and launched a new case. We have used a number of other measures to increase awareness of and compliance with competition law.
- We are at the cutting-edge of using behavioural economics to help us understand and address competition concerns. This year we tested behavioural remedies to address under-repayment in the credit card market and the use of information prompts in the annuities market. Our proposals for new rules and guidance to address persistent credit card debt were based in part on the results of these trials.
- A focus on entry and innovation is central to our competition work. We have continued to support many innovative firms through our Innovate project – helping them obtain authorisation, test their ideas and facilitate relationships with overseas regulators. During the period covered in this report, we have received 371 requests for support from innovative businesses. 17 firms from the Innovation Hub have gone on to successfully become fully authorised firms.
- Competition considerations are an integral part of our broader regulatory activities, including our policy, supervisory, authorisation and enforcement work. Examples include our work to ensure that the Markets in Financial Instruments Directive II (MiFID II) open access requirements are effectively implemented in the UK.
- Our understanding of competition in financial markets has deepened in several areas, including the effects of product complexity on consumers, consumer engagement and long-standing customers.[2]

1 Oxera The contribution of asset management to the UK economy (July 2016): www.theinvestmentassociation.org/assets/components/ima_filesecurity/secure.php?f=press/2016/The%20contribution%20of%20asset%20management%20to%20the%20UK%20economy.pdf

2 We use the term 'long-standing customers' for customers who stay with the same provider and same product for a long time, in most cases holding products that are no longer on sale.

Introduction

When markets work well, consumers enjoy more choice and value for money as firms compete to win their business. Those firms offering the lowest prices, the highest quality or the most innovative products are the most successful.

Well-functioning, open and competitive markets are so important that promoting effective competition was made one of our operational objectives. The promotion of competition also informs how we pursue our other two operational objectives.[3] Our competition mandate (ie our competition objective and duty) is set out in the Financial Services and Markets Act 2000 (FSMA). Our Annual Report and Accounts 2016/17 details our objectives, obligations and reporting requirements in relation to FSMA.

In July 2015 the Government asked us to publish an Annual Competition Report to set out the steps we are taking to drive competition and innovation. This is our second Annual Competition Report, covering the period from 1 April 2016 to 31 March 2017. We published our first Annual Competition Report in July 2016[4], which covered our activities from 1 April 2013 to 31 March 2016.

3 The FCA's operational objectives are to:
- secure an appropriate degree of protection for consumers
- protect and enhance the integrity of the UK financial system
- promote effective competition in the interests of consumers

4 FCA Competition Report 2013-2016 (July 2016) www.fca.org.uk/publication/corporate/competition-report-2013-16.pdf

Background

What do we mean by effective competition?

Effective competition means firms striving to win business on the basis of service, quality, price and innovation. Consumers have the information they need to choose the product that offers the best outcome for them. If consumers are not satisfied, they can take their business to another firm.

As a result, the firms that thrive are efficient and innovative, offering products that meet real consumer needs at good value for money. Markets are open to new firms who can offer consumers a better deal, and unsuccessful firms must change or exit the market.

Promoting competition

When competition is not working effectively, these benefits can be lost. To promote effective competition we investigate markets where we have concerns about the competitive process. If we identify market features that are inhibiting competition, we take steps to address the problem.

We use a wide range of tools to investigate and remedy competition concerns and continue to develop new and innovative measures to make markets work better. These include, for instance, providing clear information to consumers at a crucial time or putting pressure on firms to compete more vigorously by raising public awareness of their pricing practices.

Effective competition means that more efficient firms are successful and less efficient firms are driven out of the market. As such, promoting competition also helps to enhance the competitiveness of UK financial markets. However, while we aim to promote competition within a sector, our objective is not to increase the competitiveness of any firm or group of firms directly.

Setting priorities

We continuously monitor financial sectors using a wide range of data and intelligence. We publish our collective intelligence in our Sector Views.[5]

While there may be competition issues in many of the markets we regulate, some raise bigger concerns than others. As our resources are finite, we need to prioritise certain concerns over others when deciding what to investigate.

The Sector Views bring together the expertise of the entire organisation to provide a strategic view of the sectors we regulate, and therefore help us set priorities in line with our wider objectives.

Our work

Broader regulatory work

Proportionate regulation is vital for competition in financial services to thrive. Consumers need to know they can trust the firms they buy from, and that they have appropriate protection if something goes wrong.

Competition is central to the way we think about regulation. Our aim is to ensure our rules protect consumers and the financial system in the most pro-competitive way. For example, the MiFID II open access regime sets out provisions that enable access on a non-discriminatory and transparent basis between central counterparties and trading venues in respect of all financial instruments. The central purpose of these provisions is to promote competition by giving fair and open access in the financial markets. We have been working to ensure the MiFID II open access requirements are effectively implemented in the UK.

In all competition work, we encourage the development of market conditions under which small and innovative firms can enter and challenge existing firms. During our assessments of proposed rules we take into account the impact on firms' ability to compete by offering innovative products. We also have a number of ongoing projects that aim to ensure that regulation does not unduly impede entry and innovation.

5 FCA Sector Views 2017 (April 2017) www.fca.org.uk/publication/corporate/sector-views-2017.pdf

Innovate

Our recent work to promote innovation included:

- Over the past year we have received 371 requests for support (compared to 319 in 2015/16). Over the course of the last year we have increased the overall satisfaction of the firms who have engaged with the Innovation Hub. Prior to 2016/17, 73% of firms rated their overall experience of the Innovation Hub as good or excellent. This has increased to 79% including the year 2016/17.
- Making it easier for firms to trial innovative ideas through our regulatory sandbox. In the first cohort of the regulatory sandbox, 24 applications (out of 69) were deemed to meet the sandbox eligibility criteria, with 17 firms undertaking testing. In the second cohort 77 firms applied, with 31 meeting the eligibility criteria. 17 firms from the Innovation Hub became fully authorised firms over the last year.
- In addition to our existing agreements with regulators in Australia and Singapore, signing co-operation agreements with the Hong Kong Monetary Authority[6], Canada's Ontario Securities Commission[7], the Financial Services Agency of Japan[8], the Korean Financial Services Commission[9] and the People's Bank of China.[10]

These agreements aim to facilitate the entry of innovative overseas firms to the UK and the expansion of UK-based innovative firms into overseas markets.

6 See www.fca.org.uk/news/press-releases/co-operation agreement-between-financial-conduct-authority-and-hong-kong-monetary-authority.

7 See www.fca.org.uk/news/press-releases/fca-and-osc-sign-co-operation-agreement-support-innovative-businesses.

8 See www.fca.org.uk/news/press-releases/financial-regulators-japan-and-uk-announce-exchange-letters-co-operation.

9 See www.fca.org.uk/news/press-releases/uk-establishes-fintech-bridge-republic-korea

10 See www.fca.org.uk/publication/mou/fca-pboc-co-operation-agreement.pdf

New Bank Start-up Unit

The New Bank Start-up Unit (NBSU) is a joint initiative from the Prudential Regulation Authority (PRA) and the FCA to help reduce barriers to entry for prospective banks, to stimulate competition and drive innovation to promote better outcomes for consumers. The New Bank Start-up Unit also allows for a range of banking products and business models to be brought to market, with new banks who have engaged with NBSU ranging from technology-driven mobile-only banks to a new clearing bank that plans to stimulate competition and transparency within the UK financial services marketplace. Over the past year, eight new banks have been authorised.

Please see our Annual Report and Accounts 2016/17 for more information on our innovation work.

Market studies

Market studies are evidence-based studies of the way markets work. Through detailed analysis of a wide range of data and information, market studies identify features of the market that inhibit effective competition and propose remedies to correct them.

Some of our reviews may not warrant the scope of a full market study. However, much of the workflow involved in a market study will still apply.

Since 1 April 2016, we have:

- Completed the Investment and Corporate Banking and the Credit Card Market Studies. We have been developing and implementing remedies to address concerns identified in these markets.

Markets we have investigated include:

Credit cards

£67.6bn
outstanding debt
Source: Bank of England

Mortgages

£1.3tn
outstanding residential mortgage debt
Source: Bank of England

Asset management

£6.9tn
value of assets managed in the UK
Source: Asset Management Market Study Interim Report

Investment and corporate banking

$17bn
total gross fees in primary markets generated by investment banks' UK operations
Source: Investment and Corporate Banking Market Study

- Published our interim findings on the Asset Management Market Study, and a consultation on making a market investigation reference (MIR) to the Competition and Markets Authority (CMA) in relation to the provision of investment advisory services.
- Started the Mortgages Market Study and the Retirement Outcomes Review.
- Tested and implemented remedies following previous market studies on cash savings, retirement income and general insurance add-ons.

These studies tackle competition concerns on large markets that affect millions of consumers in the UK. Their progress and key findings are summarised in later chapters of this report.

In all our market studies, we ask firms for their views on how competition works in that market, including how regulation affects competition. This is a good opportunity for firms to tell us if they believe regulation makes it harder for them to compete. For example, during the Asset Management Market Study we heard about regulatory barriers to moving customers to cheaper share classes, even where this is in the best interest of investors. Our response to this is detailed in Chapter 8.

Our broader regulatory activities also help us identify competition concerns in the market – either from our own analysis or the concerns of firms in the market. Where these are identified we have tools designed to address competition concerns directly.

Following publication of the CMA's final report on its market investigation into retail banking, we published our response and have been taking forward the remedies set out in the recommendations. These remedies will make the market work better for consumers who in total hold 73 million personal current accounts.[11]

Over the next 12 months we are planning to:

- undertake a Strategic Review of Retail Banking Business Models
- open two new market studies on wholesale insurance and investment platforms

11 GfK Financial Research Survey (FRS)

- publish our interim findings on the Mortgages Market Study and the Retirement Outcomes Review
- complete our Asset Management Market Study
- continue the development and implementation of remedies following our previous market studies

Enforcing competition law
Since April 2015, we have had powers to enforce against breaches of competition law under the Competition Act (CA98) and conduct market studies under the Enterprise Act 2002 (EA02), concurrently with the CMA[12] – the UK's primary competition authority. The EA02 also gives us powers to make a market investigation reference to the CMA. This is explained in more detail in Chapter 2.

Competition law (which applies across the whole economy, not just financial services) prohibits certain arrangements between firms that stifle competition. It also prohibits certain actions by powerful firms that can harm competition.

Competition enforcement cases are in-depth investigations of one or more firms to establish whether their behaviour breached competition law.

During the year we continued to progress the competition enforcement case we opened in 2016. In April 2017 we launched our second competition enforcement case.

As well as formal investigations, we have other tools to increase compliance with competition law, including 'on notice' letters and advisory letters. Our use of these tools is explained in more detail in Chapter 2.

Our market study work included:

27
We received 27 written responses and had 40 meetings with stakeholders in the Investment and Corporate Banking Market Study

70
We engaged with over 70 stakeholders for our Asset Management Market Study

55
We collected sales data from 55 providers for our Retirement Outcomes Review

40,000
We surveyed 40,000 consumers as part of the Credit Card Market Study

Behavioural economics
Behavioural economics continues to play an important role in our analysis of competition in markets. We use behavioural economics more than any other competition authority in the world[13] and have led the way globally in applying behavioural economics to financial regulation.[14]

We use this approach to understand why consumers may not be in a position to drive effective competition and where they may

12 Please see Chapter 2 of this report on the FCA's concurrent powers.

13 Based on a recent survey of behavioural insights and public policy activity by the OECD for which the FCA was the largest contributor organisation, by number of cases, and our knowledge of the work of other organisations.

14 See a recent report by the Ontario Securities Commission on the use of behavioural insights. The chapter "Taking the Lead: the U.K.'s Financial Conduct Authority" covers the FCA's work.

need more protection. We also use experimentation to understand what works.

For example, in July 2016 we published the results of our trials which tested some of the proposed remedies in the Cash Savings Market Study.[15] These trials are detailed in Chapter 3.

Following our Retirement Income Market Study, we commissioned research to test whether certain 'prompts' can encourage consumers to shop around for their annuity. In June 2016 we published the results of the hypothetical experiment which showed that the targeted communications we proposed were likely to be effective. As such, we decided to take these measures forward.

We continue to use these methods to understand and test proposed remedies, including following our retirement income and credit card market studies. We will also be carrying out further research on prompting increased customer engagement over the coming year as part of our response to the CMA's market investigation into retail banking.

As co-chair of the UK Competition Network work stream on demand-side remedies, we are also helping to embed a better understanding of consumer behaviour among competition regulators in the UK. Within the FCA we are also using behavioural science in our wider regulatory activities to regulate more effectively and efficiently. Our dedicated team, the Behavioural Economics and Data Science Unit, leads and coordinates this work.

15 FCA Occasional Paper No. 19 (July 2016): www.fca.org.uk/publications/occasional-papers/occasional-paper-no-19-attention-search-and-switching-evidence.

Competition concerns in financial markets

Market studies allow us to address competition concerns by developing a detailed understanding of how specific markets work. However, they also increase our understanding of competition concerns that affect multiple markets we regulate. Particular cross-cutting concerns include the complexity of financial products, low consumer engagement with financial services and disparities in treatment between new and long-standing customers.

Complexity

Financial products are abstract and intangible. They often have many features and complex charging structures. As a result, in many cases it is hard for consumers to predict how much they will pay for a product. For example, the cost of using a credit card depends on what it is used for, how much consumers spend on it and when they make repayments – all of which are hard to predict in advance.

The structure of the market often adds to the level of complexity consumers face. Some firms offer a broad range of related services, while others specialise in certain products. Consumers can make a choice with the help of advisers, online platforms and price comparison websites.

These intermediaries aggregate information and so help comparison across products. However, they bring new challenges. For example, they might be overly focused on the headline price. This could lead to consumers not considering important features when choosing a product.

Throughout our competition work, we seek to identify where complexity makes choice difficult for consumers. Some of this complexity is inherent in financial services but it can also be spurious. Our aim is to reduce complexity where possible and to help consumers make sense of the information they receive to choose the product that best suits their needs.

For example, in our Asset Management Market Study we found that the lack of clarity of objectives and charges contributes to many consumers investing in expensive funds. We are proposing rules to help investors identify the best fund for them. These are explained in further detail in Chapter 8.

We also found that investors can incur a range of different platform charges and benefit from a variety of fee waivers and non-financial incentives, which could make it difficult to understand the full cost of investment. We have decided to launch a new market study to investigate concerns around platforms in more detail.

We have assessed how product complexity affects consumers' ability to make the right choices on other markets, including in our Credit Card and Retirement Income Market Studies. This is also one of the topics we are looking into in the Mortgages Market Study.

As mentioned above, price comparison websites (PCWs) are a key tool assisting consumers in dealing with product complexity. As a member of the UK Regulators' Network (UKRN), we led a project on PCWs. The report summarising the work was published by UKRN in September 2016.[16] It consolidates thoughts on how PCWs operate in the network members' respective areas, covering how consumers engage with PCWs, the benefits of PCWs for consumers and competition, potential risks and regulatory powers to address these risks. Alongside this report, the UKRN also published an open letter to the CMA containing recommendations of areas that the CMA may wish to consider in its investigation into digital comparison tools.[17]

Consumer engagement

When purchasing financial products, consumers may pay an upfront fee, but in many cases they incur charges as they use the product. These charges can vary over time. For example, firms often introduce a promotional period during which lower fees apply.

Similarly, financial products tend to provide benefits – such as interest earned – periodically. Interest rates on savings can also change over time.

In addition, most financial markets constantly evolve and competition drives firms to introduce new products.

All this requires consumers to engage with financial products and services from time to time to get the most out of them. During our competition work we have observed that consumer engagement in some financial markets is low. As a result, consumers may not get the best deal, or may pay charges they could avoid.

For example, many credit cards offer an introductory (often 0%) interest rate for a limited period. Our Credit Card Market Study found that there is likely to be a significant number of consumers who are able to repay their balances before the end of the promotional period, but delay doing so for a few months – possibly because they had only realised that the promotional period had ended when they start incurring interest.

To find a solution to this problem, we relied on some of our previous behavioural

16 UKRN Price comparison websites final report (September 2016): www.ukrn.org.uk/wp-content/uploads/2016/09/201609027-UKRN-PCWs-Report.pdf

17 www.ukrn.org.uk/wp-content/uploads/2016/09/20160927PCWs-Letter-to-CMA.pdf

research.[18] This research showed that text alerts and mobile banking apps were effective in reducing the number of consumers who incurred overdraft charges.

Following our recommendations, credit card providers agreed to inform consumers that their promotional offer is due to end by text or email. This notification is intended to increase consumer engagement at a crucial time and help consumers avoid charges.

We have assessed and addressed concerns around low consumer engagement in other competition work, including in the cash savings and the retirement income market studies, as well as in general insurance markets, with a particular focus on engagement at the time of policy renewal.

Long-standing customers

In many financial markets, engagement varies across groups of consumers. A significant proportion of consumers actively look for the best deals and switch providers. This puts pressure on firms to design and offer competitive products.

However, many consumers stay with the same provider and the same product for many years. Firms do not have incentives to lower, and may even be able to increase, the price these long-standing customers pay. As a result, passive consumers do not benefit from the new, more competitive product offerings.

There is a range of tools available to address this problem.

For example, we are currently trialling a solution in the cash savings market. We refer to this as our 'sunlight' remedy.[19]

The Cash Savings Market Study found that providers had significant amounts of consumers' savings balances in accounts opened many years previously. These accounts paid lower interest rates than those opened more recently.

To bring to light firms' strategies towards their long-standing customers, we have published data on cash savings interest rates. These datasets allow comparisons between interest rates of cash savings products that are currently marketed and products that are no longer on sale.

The remedy targets market commentators, consumer groups and the media. We expect that raising awareness of firms' strategies should encourage them to offer better value products to existing customers.

We will evaluate the impact of this remedy. If we find it is effective, we will consult on whether the publication should be undertaken on a more permanent basis.

Other examples of our work on concerns over long-standing customers include the Asset Management Market Study (share class switching) and research into renewal of existing policies in the home and motor insurance markets.[20] This research led to us issuing rules that require general insurance firms to disclose the customer's previous year's premium at each renewal.

18 FCA Occasional Paper No.10 (March 2015) www.fca.org.uk/publications/occasional-papers/occasional-paper-no-10-message-received-impact-annual-summaries-text.

19 www.fca.org.uk/news/news-stories/cash-savings-sunlight-remedy-third-report.

20 FCA Occasional Paper No.12 Encouraging consumers to act at renewal Evidence from field trials in the home and motor insurance markets (December 2015) www.fca.org.uk/publications/occasional-papers/occasional-paper-no-12-encouraging-consumers-act-renewal-evidence.

Content of this report

We divide the financial system that we regulate into seven sectors. Chapters 3 to 9 cover our work in each of these sectors:

- retail banking
- retail lending
- general insurance and protection
- pensions and retirement income
- retail investments
- investment management
- wholesale financial markets

Each chapter starts with an overview of the sector, including a summary of competitive analysis of those markets that we investigated during the period covered in this report.[21] We then summarise our recent competition activity in the sector.

We also list other relevant regulatory developments and set out our plans to promote competition for the next 12 months.

Before looking at the sectors separately, we summarise our activities under concurrent competition powers in Chapter 2.

Related publications

In addition to the Annual Competition Report, a number of reports are relevant to our competition work:

- Annual Report and Accounts 2016/17 – published on our website alongside this report, covering the period 1 April 2016 to 31 March 2017, containing information on how we have advanced our operational objectives over the year, including our competition objective
- Business Plan 2017/18 – published in April 2017, setting out our planned activities for the coming year, including those on competition [22]
- Sector Views 2017 – published in April 2017, covering the period June 2015 to November 2016, setting out our views on the sectors we regulate, including on the state of competition [23]
- Our Mission 2017 – published in April 2017, setting out the framework for the FCA's strategic decisions, the reasoning behind our work and the way we choose the tools to do it[24]
- the CMA's concurrency report – published in April 2017, summarising the activities of UK regulators with concurrent powers, including that of the FCA[25]

21 As mentioned above, the Sector Views contain our views on all sectors we regulate, including our high-level thoughts on how competition works on them.

22 FCA Business Plan 2017/18 (April 2017) www.fca.org.uk/publication/business-plans/business-plan-2017-18.pdf

23 FCA Sector Views 2017 (April 2017) www.fca.org.uk/publication/corporate/sector-views-2017.pdf

24 FCA Our Mission 2017 (April 2017) www.fca.org.uk/publications/corporate-documents/our-mission.

25 CMA Annual report on concurrency 2017 (April 2017) www.gov.uk/government/uploads/system/uploads/attachment_data/file/611593/annual-concurrency-report-2017-cma63.pdf

2 Activities under concurrent competition powers

Key points

- We have made significant effort to increase awareness of competition law in financial services and our role in enforcing it.
- We have progressed our existing investigation into anti-competitive agreements and concerted practices under the Competition Act 1998 (CA98), which we opened in March 2016. In this reporting year we have opened a new investigation into anti-competitive agreements and concerted practices under CA98. We have issued 23 'on notice' letters to firms and six advisory letters.
- We have also consulted on making a market investigation reference to the CMA in relation to the provision of investment advisory sector services under our EA02 concurrent competition powers.

We have powers to enforce the prohibitions in the CA98 and the Treaty on the Functioning of the European Union concurrently with the CMA in relation to financial services. We have power to conduct market studies under the Enterprise Act 2002 (EA02) and to make market investigation references to the CMA in relation to the financial services sector.[26] These powers strengthen our ability to ensure financial services markets are competitive and deliver good consumer outcomes.

We can conduct market studies under either EA02 or the Financial Services and Markets Act 2000 (FSMA). We decide which route is most appropriate for a market study on a case-by-case basis.

Market investigation references

Market investigation references (MIR)[27] powers allow us to make referrals to the CMA for detailed investigation, which relate to the provision of financial services. The purpose of an MIR is typically to investigate markets where it appears that competition is adversely affected by the structure of a market, by the firms operating in the market or by the conduct of the firms' customers or suppliers.

As part of the Asset Management Market Study, we made a provisional decision that an MIR should be made to the CMA in relation to investment consultancy services, under our EA02 concurrent competition powers. This decision was based on consideration of evidence we gathered as part of the market study.

26 Details of our activities under these concurrent powers are also set out in the CMA's Concurrency Report, published in April 2017 and can be found at www.gov.uk/government/uploads/system/uploads/attachment_data/file/611593/annual-concurrency-report-2017-cma63.pdf

27 FCA Finalised Guidance FG15/9 Market studies and market investigation references (July 2015) www.fca.org.uk/publication/finalised-guidance/fg15-09.pdf

We published a consultation[28] on this provisional decision, alongside the Asset Management Market Study Interim Report, in November 2016.

The investment consultancy services market is relatively concentrated, with the top three firms accounting for around 60% of the market. Levels of switching in the market are low; 90% of the investors in our survey had not switched consultant in the last five years. Many institutional investors struggle to monitor and assess the performance of the advice they receive and whether investment consultants are acting in their best interests. We have concerns about whether the interests of investment consultants are in line with investors' interests. We think further investigation is needed, which is why we are consulting on making a market investigation reference to the CMA on the investment consultancy market.

CA98 developments

We have continued to progress our existing investigation into anti-competitive agreements and concerted practices under CA98 during the period of this report.

In April 2017, we launched a new investigation into anti-competitive agreements and concerted practices under CA98. We do not generally disclose further details about investigations before a statement of objections is issued.

In addition, we have made use of other tools to strengthen competition law compliance. We have issued 23 'on notice' letters to firms where evidence suggests there may have been a potential infringement of competition law, but where the situation is not a high enough priority to open an investigation. Having received on notice letters, these firms have undertaken a number of initiatives to strengthen competition compliance.

We also issued six advisory letters during the period of this report. These letters are intended to raise awareness of competition law to and increase compliance by the firms in question.

The type of behaviour that led to the on notice and advisory letters included inappropriate exchanges of competitively sensitive information, across a range of financial services sectors.

Other activities

Liaison activities

Our commitment to our programme of CA98-related work also includes working closely with external parties, including other regulators and competition authorities. This includes an ongoing and varied programme of engagement with trade bodies, professionals and firms. For example, in September 2016 we held a competition law workshop for members of the Council of Mortgage Lenders as part of the follow-on work from the Call for Input on competition in the mortgage sector. The event aimed to increase awareness of competition law, go through some basic information, and explain the role of the FCA as a concurrent competition regulator. This event is described in further detail in Chapter 4.

28 FCA MS15/2.2a Asset Management Market Study Provisional decision to make a market investigation reference on investment consultancy services (November 2016) www.fca.org.uk/publication/market-studies/ms15-2-2-a-mir.pdf

UK Competition Network (UKCN)

The FCA and the CMA are currently co-chairing a UKCN steering group to help competition regulators improve their demand-side remedies through a greater understanding of consumer behaviour. Quarterly workshops were held, aimed at sharing knowledge amongst regulators on topics such as demand-side remedies, enhancing impact through consumer testing and the design of remedies in a practical context. These workshops are one instance of behavioural economics feeding into our competition work, as discussed in Chapter 1, and will continue to take place during 2017. A set of online documents capturing lessons learnt from the process will be published at the end of the process.

3 Retail banking

Key points

- In November 2016 we published our response to the Competition and Markets Authority (CMA)'s final report of its Retail Banking Market Investigation. The CMA proposed a package of remedies to address the problems highlighted in the report, and we are currently taking action on the recommendations made to us. This work will continue in 2017/18.
- We have continued our work on the cash savings market, publishing our second and third sunlight remedies in 2016, as well as working with industry to improve the proportion of cash ISAs transferred within seven working days.
- We will launch a Strategic Review of Retail Banking Business Models in April 2017. This is discovery work to examine the business models used in the retail banking sector, focusing on the links between different parts of the business and their relative profitability.
- We also work closely with the Payment Systems Regulator on competition in payments.

Sector Overview

Retail banking is a vital part of the UK economy. Nearly all consumers and businesses need to use retail banking services in their daily lives, to pay bills, receive wages and for a range of other transactions.

Although large banking groups undertake a wide range of activities[29], for the purposes of this report the retail banking sector includes the following activities:

- **Transactional banking:** personal and business current accounts, including overdrafts, which are provided by banks, building societies and credit unions (known collectively as deposit-takers).
- **Cash savings:** personal and business savings accounts provided by deposit-takers.
- **Non-bank payment services and technology:** defined as payment services provided by firms other than deposit-takers such as money transmission firms, merchant acquirers and e-money providers. Market innovation has been vital in allowing many of these firms to develop.

Current accounts

96%
of adults in Great Britain have a current account

73 million
personal current accounts

Source: GfK Financial Research Survey (FRS)

4 million
business current accounts

BBA, Bank Support for SMEs

29 Banks engage in taking deposits but also in offering mortgages, loans, investment products, and corporate banking (and other wholesale activities).

Payment systems are regulated by the Payment Systems Regulator (PSR). We do not cover payment systems specifically in this report, but more information is available on the PSR's website[30], including a copy of its 2016/17 Annual Report.

CMA Retail Banking Market Investigation

In August 2016 the CMA published the results of its retail banking market investigation[31] into the effectiveness of competition in personal current accounts and aspects of retail banking for small to medium-sized enterprises (SMEs). The report found that:

- established banks do not have to work hard enough to win and retain customers
- new and smaller providers find it difficult to attract customers
- these failings are having a pronounced effect on certain groups of customers, particularly overdraft users and smaller businesses

The CMA published the Retail Banking Market Investigation Order on 2 February 2017, which set out a package of remedies that the CMA and others, including the FCA, will implement.

New entrants in retail banking

New entrants and innovation have led to some increased competition in recent years. New digital-only retail banks such as Monzo Bank and Starling Bank are now coming to market. In December 2016 ClearBank was authorised as a deposit-taker, seeking to become the first full clearing bank entrant to the UK banking market for over 250 years when it begins trading in the third quarter of 2017.

Retail lending and retail investments, including those primarily sold through retail banks, are covered in Chapters 4 and 8.

Recent competition activity

This section outlines our competition-related activities in retail banking and cash savings.

Response to the CMA Retail Banking Review

We published our response[32] to the CMA's Retail Banking market investigation in November 2016, which set out how we plan to act on the CMA's recommendations.

Our progress and plans on taking forward this work are set out below.

Promoting innovation

Open Banking will give customers the option to share information about how they operate their bank account with organisations that will aim to provide enhanced banking services – for example, by offering customers comparison and switching services to help them identify the best financial products for them. It is also an opportunity to deliver a market-wide solution for firms to comply with the 'access to accounts' requirements in the revised Payment Services Directive (PDS2).[33]

We have used our role as an observer on the Implementation Entity steering group, which is tasked with establishing the Open Banking Standard, to encourage the

30 www.psr.org.uk

31 CMA Retail Banking Market Investigation: Final Report (August 2016): assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf

32 FCA Our response to the CMA's final report on its investigation into competition in the retail banking market (November 2016): www.fca.org.uk/publication/corporate/response-cma-final-report-competition-retail-banking-market.pdf

33 PSD2 regulation includes provisions for the possibility of third party service providers having access to payment accounts held at other account servicing payment service providers. Such service providers will be obliged to provide access to providers of payment initiation or account information services.

delivery of solutions that will realise these benefits. The first tranche of Open Data, which included branch and business centre locations, branch opening times and ATM locations, went live in March 2017.[34] It is expected that Application Programming Interfaces will be active by January 2018, which will give access to data on personal and business current accounts, while seeking to ensure appropriate cyber risk mitigation being in place.

We continue our work to implement PSD2 to ensure that its aims are realised in the UK.[35]

Prompting increased customer engagement

We are carrying out research and testing to develop prompts designed to encourage consumers to consider their banking arrangements and review their account usage. We have completed the initial phases of this research, with a further phase being carried out during 2017. If supported by our findings, we are likely to bring forward proposals for consultation during 2018.

Improving transparency for overdraft users

We are also carrying out research and testing to design alerts to increase consumers' awareness of their overdraft usage and to help them manage it better. The initial phase of this testing has been completed and further work will take place during 2017, with a proposal for a consultation during 2018 if supported by our findings.

We will review the effectiveness of the CMA's requirement for firms to set and publicise the monthly maximum charge (MMC) consumers could incur from an unarranged overdraft. We will review the effectiveness of the MMC itself once it has been in place long enough to measure its impact. We expect this to be late 2018 at the earliest. We are also looking at overdrafts in the context of the wider consumer credit market and, in particular, in comparison to other forms of high-cost credit.[36]

We are also assessing whether improvements can be made to banks' account opening procedures to make consumers more aware of the costs and features of overdrafts.

Improving service quality

We are considering what information should be published to enable consumers to assess the differences in service quality between banks. We have established a stakeholder expert group to provide views on the service quality data and information that could be made available. We have conducted research with consumers and small businesses on the effectiveness of additional indicators.

We aim to bring forward proposals for consultation in the second half of 2017. At this stage we envisage any rules that might result would come into effect at the same time as the CMA's Order on core service quality data, expected in the third quarter of 2018.

Delivering a competitive market for SMEs

We are carrying out further research and, where appropriate, testing with firms during 2017 to establish which prompts and service indicators are effective for business current account (BCA) consumers. If supported by our research and testing, we are likely to bring forward proposals for consultation during 2018. We will also

34 www.openbanking.org.uk/2017/03/13/platform-distributing-bank-product-branch-atm-data-available/

35 FCA Revised Payment Services Directive: www.fca.org.uk/firms/revised-payment-services-directive-psd2

36 FCA Call for input on high-cost credit and review of the high-cost short-term credit price cap (November 2016): www.fca.org.uk/publications/calls-input/high-cost-short-term-credit-price-cap

act as an observer on the British Bankers' Association (BBA) industry group which is tasked with standardising the BCA opening procedures. The BBA group aims to make it easier for SMEs to open a bank account.

This year, we have focused on gathering information and engaging with a range of stakeholders to further develop our understanding of the banking needs of SMEs. In the second half of 2017 we intend to publish a consultation paper on SME access to the Financial Ombudsman Service to understand how businesses engage with the service.

Cash savings remedies

We have taken steps throughout 2016 and during early 2017 to implement remedies aimed at improving the treatment of long-standing savings customers in the cash savings market.

Our package of remedies[37], published in December 2015, came into force in December 2016. These measures are aimed at improving the information available to customers about their savings accounts.

In July 2016 we published our second set of data showing the lowest interest rates offered by 32 providers of easy access cash savings accounts and easy access cash ISAs.[38] This 'sunlight' remedy aims to shine a light on firms' strategies towards their long-standing customers' and especially those with products that are no longer on sale. Our remedy received considerable media attention for spotlighting the lowest savings rates offered as part of our work to help consumers compare and switch between accounts more easily.

87%

of personal current accounts are held with the six largest banking groups

Source: GfK Financial Research Survey (FRS)

66%

of consumers with a cash savings account hold them with their main current account provider

Source: GfK, Personal Current Account Investigation: A Report for the Competition and Markets Authority, by GfK NOP (April 2015)

At the same time, we published the findings of trials we carried out in 2015 on a series of other remedies. The full results of the trials are set out an Occasional Paper.[39] The trials tested:

- digital reminders to assess the effectiveness of reminders about interest rate changes sent by email and SMS compared with reminders sent by letter
- a switching box, which would periodically give customers information on the potential financial gains from shopping around and switching, and prompt them to consider their choice of account and provider
- a return switching form – a simple 'tear-off' form and pre-paid envelope enabling a customer to switch to a better-paying account offered by their existing firm more easily

The research found that digital reminders, the switching box and the return switching form had some positive effects. However, the switching box and form only stimulated switching within the same bank and did not increase switching to better accounts offered by other providers.

37 FCA PS15/27 Policy Statement Cash savings remedies: Feedback and Policy Statement to CP15/24 and next steps (December 2015): www.fca.org.uk/publication/policy/ps15-27.pdf

38 www.fca.org.uk/news/news-stories/cash-savings-sunlight-remedy-second-report

39 FCA Occasional Paper No. 19: Attention, Search and Switching: Evidence on Mandated Disclosure from the Savings Market (July 2016): www.fca.org.uk/publication/occasional-papers/occasional-paper-19.pdf

In December 2016 we published our third and final 'sunlight' data remedy.[40]

In addition, we announced an industry agreement between the British Bankers' Association, the Building Societies Association and Tax Incentivised Savings Association that, from 2017, a minimum of 80% of cash ISA transfers will be carried out within seven working days.[41] The industry will publish details of its performance against the target quarterly.

The results for the first quarter of 2017 were published in April 2017. It was reported that 85% of cash ISA transfers have been completed within seven days.[42]

Wider regulatory context

Ring-fencing

Ring-fencing is, by intent of Government, a pro-competitive piece of legislation – it is in part designed to remove the implicit guarantee and related funding cost advantage enjoyed by large incumbent banks that were considered 'too big to fail'. However, the implementation of ring-fencing and any resulting changes to business models, may have other impacts on competition.

While the PRA is the lead regulator for the implementation of ring-fencing and is responsible for firms' compliance with the regime, the FCA has key responsibilities and interests in its effective implementation, working closely with the PRA, the Bank of England, the Treasury, the PSR and the larger UK banks. As part of our work, we want to understand the impact of ring-fencing on competition in potentially affected markets. For example, implementation of ring-fencing may lead to certain cross-subsidies being unwound and consequential changes to the provision of certain services, which may impact competitors and consumers.

We are engaging with the firms affected to understand changes made to their business models and their potential impacts on competition in the UK banking industry.

Next steps

Strategic Review of Retail Banking Business Models

The retail banking business model spans multiple product lines, and the actions of firms in one market can affect consumers in another. Our market studies and the CMA's market investigation have, to date, not looked at market outcomes holistically across the broader retail banking sector. In our 2017/18 Business Plan we launched discovery work to examine the business models used in the retail banking sector, focusing on the links between different parts of the business and their relative profitability. This work will include considering the impact of free-if-in-credit banking and its effect on different groups of consumers. We will use the analysis to deepen our understanding of the impact of emerging developments, and to enhance our approach to current and future regulation of retail banks.

CMA Retail Banking Investigation remedies

We will continue to progress our work in response to the CMA's Retail Banking Market Investigation. We will also continue to work with firms and other stakeholders to research which interventions may be needed and to ensure they are designed effectively.

We will ensure this work remains aligned with the broader set of CMA remedies, as

40 www.fca.org.uk/news/news-stories/cash-savings-sunlight-remedy-third-report

41 This excludes transfers involving the smallest providers with less than 5,000 transfers per year.

42 www.bba.org.uk/news/press-releases/cash-isa-transfer-performance-q1-2017/#.WRwaU7k2yAU

well as our own work on high-cost credit and overdrafts, and our strategic review of retail banking business models.

Cash savings

We continue to consider steps to improve the treatment of long-standing customers in the cash savings market. We have evaluated the effectiveness of the sunlight remedies and are considering whether other regulatory tools are needed to achieve more effective competition.

4 Retail lending

Key points

- In December 2016, following a Call for Input, we launched our Mortgages Market Study to examine whether competition in the sector can be improved for the benefit of consumers. Focusing on first charge mortgages[44], the Market Study is looking look at the customer journey, decision-making tools available to consumers, commercial arrangements and increased levels of intermediation. We intend to publish an interim report in late summer 2017, with a final report in early 2018.
- We published the final report of the Credit Card Market Study. We found that competition is working fairly well for most consumers, but we had some concerns about the higher-risk end of the market and principally with consumers who are facing problem credit card debt. We published a consultation paper on our remedies in April 2017.[45]
- In November 2016 we launched the High-Cost Credit Review with the publication of a Call for Input. This work looks across a range of high-cost credit products to build a full picture of how they are used, whether they cause detriment and, if so, to which consumers. We are considering responses to the Call for Input and will publish the results of the high-cost short term credit price cap review in mid-2017.

Sector overview

The retail lending sector meets the borrowing needs of consumers and SMEs, helping them manage debt and obtain credit. The sector offers products that cover everything from day-to-day expenses to property purchases.

We divide the sector into the following broad sub-sectors: mortgages, secured consumer credit (such as pawnbroking), running account unsecured consumer credit (such as credit cards and overdrafts) and fixed-sum unsecured consumer credit (which includes high-cost short term credit, motor finance and personal and business loans).

The sector is central to the UK economy. Total lending to individuals reached £1.52tn in outstanding balances in February 2017, with mortgages accounting for the vast majority at £1.33tn and consumer credit accounting for £195bn.[45]

This report focuses primarily on the mortgage, credit card and high-cost credit markets, as this is where our competition work has been focused.

Mortgages

There are an estimated 11.1 million mortgages in the UK[46] with the value of all outstanding residential loans totalling £1.35tn in the first quarter of 2017.[47] Total gross lending in 2016 amounted to £249bn[48], which represents the highest annual gross lending figure since 2008. Regulated mortgage lending accounted for £207bn, or 83%, of this total.[49] 62% of regulated mortgage lending to individuals during 2016

43 First charge mortgages include new mortgages for a house purchase, reportages (new lender), internal product switch (same lender), further advance and equity release

44 FCA CP17/10 Credit Card Market Study: consultation on persistent debt and earlier intervention remedies Consultation Paper (April 2017) www.fca.org.uk/publication/consultation/cp17-10.pdf

45 Bank of England, Bankstats Tables A5.2, A5.3, A5.6.

46 www.cml.org.uk/news/press-releases/gross-mortgage-lending-182-billion-in-february/

47 FCA/Bank of England mortgage lending statistics, MLAR (2017 Q1)

48 FCA/Bank of England mortgage lending statistics, MLAR (2017 Q1)

49 FCA/Bank of England mortgage lending statistics, MLAR (2017 Q1)

Retail lending in the UK

60% of British adults have a credit card

48% of UK SMEs have a credit card

27% of UK adults have a mortgage

Sources: FCA Credit Card market study final findings report (July 2016)
FCA Consumer Spotlight Survey

was for home purchases (including first time buyers), with 31% for remortgages.[50]

As of the first quarter of 2016, the 'big six' banking groups share of outstanding balances had remained broadly constant at 77 %.[51]

There were 4,923 different residential mortgage products (excluding buy-to-let mortgages[52]) available to new consumers in January 2017.[53] Individual mortgage products are typically available for about 38 days, which highlights the rate of change in the range offered to consumers.[54]

The number of regulated products distributed by intermediaries increased by 23% in the period between March 2016 and January 2017, to 3,193.[55] There has also been a growth in the proportion of advised sales increasing from 69% to 97% between 2009 and 2016.[56]

This represents an increased level of complexity in the market, particularly in the consumer's decision-making process. The Mortgages Market Study (detailed in 'Recent competition activity') explores these issues further by considering whether the tools available (including advice) help consumers make effective decisions. There will also be a focus on whether there are opportunities for technological solutions to aid consumer decision-making.

Credit cards

In March 2017 the amount of outstanding net credit card debt to individuals for the UK was £67.6bn, with an annual growth rate in lending of 8.9%.[57] The number of consumers involved in this market is considerable, with 60% of adults in the UK having a credit card.

As set out in the Credit Card Market Study interim report in 2015, we found that competition is working fairly well for most consumers. Consumers are relatively engaged and are generally willing to switch, with around 6 million new accounts opened in 2014.

Evidence suggests half of those taking out a credit card shopped around first; that around 14% of existing credit card customers took out a new card in 2014; and

50 FCA / Bank of England mortgage lending statistics, MLAR (2016 Q4)

51 www.fca.org.uk/publication/research/retail-lending-sector-overview.pdf

52 Buy-to-let mortgages are generally not regulated. Consumer buy-to-let (CBTL) mortgages, which are subject to the legislative framework set out in the Mortgage Credit Directive Order 2015, are not reported as unregulated in MLAR.

53 Moneyfacts Analyser Report

54 Moneyfacts Monthly Treasury Report (March 2017)

55 Moneyfacts Analyser Report

56 www.fca.org.uk/firms/product-sales-data/interpreting-data

57 Bank of England, Money and Credit, Table K

that a further 8% compared at least two credit cards but did not take one out. Most consumers do not perceive material barriers to switching, and firms do not consider a lack of switching to be a significant barrier to entry or expansion.

High-cost credit

Since taking over regulation of consumer credit in April 2014, we have focused on products that we believe pose the highest risks to our consumer protection objective. One area of focus has been high-cost credit, which includes payday loans, home-collected credit, catalogue credit, some rent-to-own, pawnbroking, guarantor and logbook loans.

Since we took over regulation, arrears rates have fallen by a quarter and 800,000 fewer people took out a high-cost short-term credit (payday) loan over an 18-month period.[58]

Recent competition activity

Our key competition activities in this sector have been focused on the the Mortgages Market Study, the Credit Card Market Study and our work on the high-cost short term credit market.

Mortgages market

Mortgages Market Study – Terms of Reference

In December 2016 we launched the Mortgages Market Study. The Terms of Reference[59] set out the focus of the study, which covers two main questions that focus on demand and supply issues respectively:

1) At each stage of the consumer journey, do the tools available (including advice) help mortgage consumers make effective decisions?

2) Do commercial arrangements between lenders, brokers and other players lead to conflicts of interest or misaligned incentives to the detriment of consumers?

When referring to 'tools' we mean any sources of help a consumer may use when shopping around or choosing a product such as information on products provided directly by lenders, price comparison websites or best buy tables and mortgage calculators, as well as advice (whether provided by a lender or a broker).

We will also review whether there are opportunities for better technological solutions to any problems we identify, including where there are any barriers to efficient delivery of information or advice through digital channels. Through the Market Study we will look at the impact of the following features of the sector:

Multiple challenges that consumers face in making effective decisions

A key theme emerging from our Call for Input on competition in the mortgages sector, conducted during 2015 and 2016, was that consumers face challenges in making effective choices. For example, their ability to assess and act on information may be constrained by factors such as behavioural biases, financial literacy and product complexity.

58 www.fca.org.uk/news/press-releases/fca-launches-call-input-high-cost-credit-and-overdrafts

59 FCA MS16/2 Mortgages Market Study – Terms of Reference (December 2016): www.fca.org.uk/publication/market-studies/ms16-02-1.pdf

The consumer journey

We want to ensure that consumers are empowered to make effective choices through the different stages of their mortgage buying journey, from initial research to switching their product.

Commercial arrangements

The relationships between different players in the mortgages market are complex and wide-ranging. We are interested in understanding how these operate and whether any conflicts of interest that can arise from them. Practices such as choosing a selection of partners to do business with can be efficient and reduce operational costs, but can also create barriers to entry or expansion.

Increased levels of intermediated and advised sales

As previously mentioned, intermediation and advice are both playing a significantly increased role in the sector. Through our study we want to understand the extent to which these changes were driven by the Mortgage Market Review and how the intermediation and advice process affects consumer outcomes.

We intend to publish the interim report in late summer 2017.

Competition law workshop

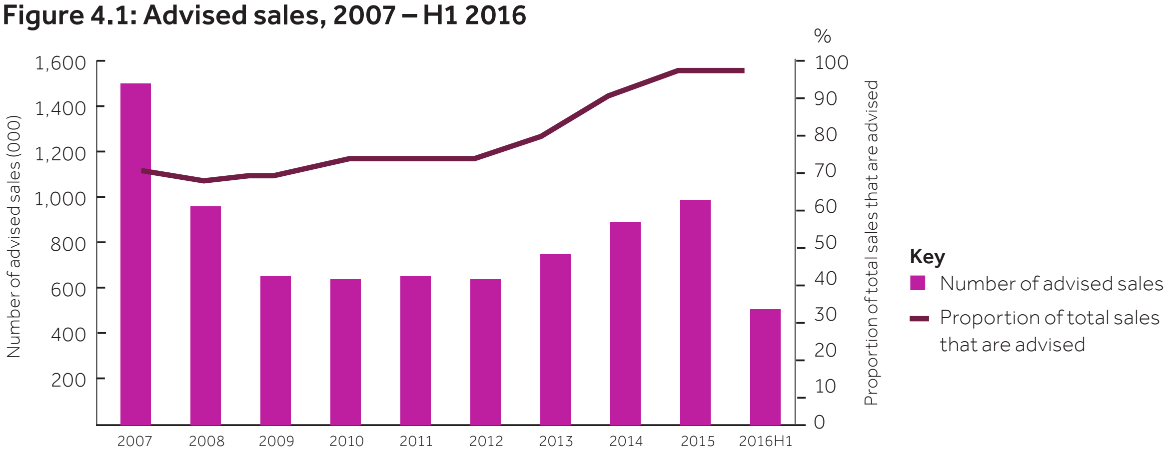
Before the launch of the Mortgages Market Study we committed to working with industry to increase awareness of competition law. To this end, we held a competition law workshop in September for members of the Council of Mortgage Lenders. The event included information on our role as a concurrent competition law regulator and covered some basics of competition law.[60]

Credit Card Market Study

In July 2016 we published the final report of the Credit Card Market Study.[61] This market has over 30 million cardholders in the UK.

We found that competition is working fairly well for most consumers. We did not find that cross-subsidisation - firms recovering their costs across different consumer groups - materially affected competition in the credit card market.

Figure 4.1: Advised sales, 2007 – H1 2016



Source: FCA Product Sales Data

60 www.fca.org.uk/publications/feedback-statements/fs16-3-feedback-statement-competition-mortgage-sector

61 FCA MS14/6.3 Credit Card Market Study Final findings report (July 2016): www.fca.org.uk/publication/market-studies/ms14-6-3-credit-card-market-study-final-findings-report.pdf

We had some concerns about the higher-risk end of the market and principally with consumers who are facing problem credit card debt.

We had, in particular, significant concerns about the scale, extent and nature of problem debt, and firms' incentives to manage and reduce this.

We found that in 2014 around 6.9% of cardholders (about two million people) were in arrears or had defaulted, and that an estimated further two million people had persistent levels of debt that some may have been struggling to repay.

Many consumers remain in persistent debt or continue making systematic minimum repayments for several years. Around 650,000 cardholders have been in persistent debt for at least three consecutive years and a further 750,000 cardholders have been making systematic minimum repayments for at least three consecutive years.

In April 2017 we published a consultation paper[62] which proposed new rules to tackle persistent credit card debt and encourage earlier intervention. This included a requirement on firms to take an escalating set of steps designed to encourage customers to repay debt more quickly and avoid getting into persistent debt in the first place. Where customers are not able to repay their debt in a reasonable period, firms would be required to offer them forbearance, which may include a reduction in the interest rate being charged.

These interventions form part of the overall package of remedies announced in July 2016 in the Credit Card Market Study Final Report. The primary objective of the package is to reduce the number of customers with problem credit card debt.

High-cost redit (HCC)

Although our work in the high-cost credit sector primarily falls under our operational objective of protecting consumers, there is a competition element to our work in this market. For example, we implemented new rules on high-cost short-term credit on price comparison websites that came into force in December 2016, which are intended to stimulate competition.

In November 2016 we published a Call for Input, which looked across a range of high-cost credit products to build a full picture of how these are used, whether they cause detriment and, if so, to which consumers. This will enable us to consider whether further policy interventions are needed, and whether these should be more consistent across the market than they are at present.[63]

The Call for Input also signalled the start of our review of the HCSTC price cap, which was implemented in 2015 and was designed to protect borrowers from excessive charges, as well as to exclude customers for whom continued use of HCSTC could be harmful. The Call for Input also invited views and evidence on overdrafts (both arranged and unarranged). In particular, we asked questions on the extent to which overdrafts are a substitute or alternative for other high-cost credit products, the key issues and measures we should consider and their risks and benefits. The scope of this work will be informed by our work on the CMA retail banking remedies and on the strategic review of retail banking business models (detailed in Chapter 3).

62 FCA CP17/10 Credit card market study: consultation on persistent debt and earlier intervention remedies Consultation Paper (April 2017): www.fca.org.uk/publication/consultation/cp17-10.pdf

63 FCA Call for Input: High-cost credit Including review of the high-cost short-term credit price cap (November 2016): www.fca.org.uk/publication/call-for-input/call-input-high-cost-short-term-credit.pdf

Next steps

Credit card market remedies
We will continue to consult on and deliver the package of remedies announced in July 2016 in the Credit Card Market Study Final Report. Having published our consultation paper proposing remedies on persistent debt and early intervention in April 2017, we plan to engage both with industry and consumer stakeholders. We will then review the responses and publish our feedback, policy decisions and any final rules and guidance in late 2017. We also intend to publish a second consultation paper in early 2018 on encouraging repayment.

Mortgages Market Study
We will publish our Mortgages Market Study interim report in late summer 2017, setting out our analysis, preliminary conclusions and any potential remedies. We intend to publish our final report in early 2018.

High-cost short-term credit
We will publish the results of the price cap review in summer 2017 along with our responses to the Call for Input. If we decide further work is necessary to restructure or recalibrate the price cap, we will undertake this in the second half of 2017 and the first half of 2018.

From the second half of 2017 onwards, we will undertake further work on the issues relating to high-cost credit and overdrafts that we will set out in our feedback statement.

5 General insurance and protection

Key points

- Our competition work has been focused primarily on two issues that affect consumers in retail general insurance markets: Big Data and value measures in retail insurance.
- In September 2016 we published a feedback statement on Big Data. We found that Big Data is facilitating a range of benefits for consumers in motor and home insurance, by transforming how they deal with retail insurance firms, encouraging more innovation in products and services and streamlining parts of the customer journey. We also, however, found some concerns about data protection rules and the use of data.
- Following our General Insurance Add-ons Market Study, we published the first set of data in our general insurance value measures pilot in January 2017 for 38 insurers. This was in response to our findings that consumers find it difficult to assess value due to the lack of commonly available measures.

Sector overview

The general insurance and protection sector is divided into three broad sub-sectors: retail, commercial and wholesale. The sub-sectors are interconnected, although each has a distinct market built around the consumers it serves and the products and services it provides.

We consider non-investment life and protection products as part of the sector, although we do recognise that their longer duration and different distribution channels set them apart from general insurance.

The main driver of change across the sector as a whole is technological innovation affecting demand and strengthening firms' capabilities to predict costs to serve consumers (eg telematics). This will increase quantification of risk, enable providers to tailor products to cover multiple customer requirements (ie multi-line policies) and increasingly segment consumer groups.

The value chain in this sector can be long and complex, but includes (among other types of firms):

- Reinsurers. Insurance companies purchase reinsurance to transfer some or all financial risk to other companies (ie the reinsurers).
- Insurers/underwriters. This includes commercial insurers in the Lloyd's and London Market, which typically underwrite large commercial and wholesale specialty risks, as well as personal lines insurers.
- Distributors/brokers. There is a wide range of intermediaries and distributors in the insurance sector. Price comparison websites play a significant role in this sector. Brokers are positioned between the potential policyholder and the insurers, helping buyers to determine their coverage and risk management needs and matching them to the most suitable underwriters.

Retail insurance sub-sectors

- The **retail** sub-sector provides insurance to individuals and households. Motor and home insurance are the main markets within this sub-sector[64], followed by retail other (ie speciality, like pet and gadget insurance), accident and health (eg private health cover), and protection (eg income protection). Consumers use a wide range of distribution channels ranging from high-street brokers, price comparison websites, banks and insurers directly.

  With the exception of private medical insurance, there is a significant number of providers in every retail sector. Price comparison websites are the most significant distribution channel for motor and home insurance. The majority of remaining products are sold via other means of intermediation.

- The **commercial** sub-sector serves 4.1 million sole traders, 1 million micro-businesses and 240,000 SMEs.[66] Commercial products protect firms from financial loss, including their liability to third parties and employees. At the larger end of this sub-sector consumers require bespoke products tailored to their needs, while small and medium firms tend to buy packaged products that are either generic or specific to their trade.
- The **wholesale** sub-sector serves the largest and most complex businesses, including multinationals. These consumers tend to have the most complex insurance needs and often use brokers. Reinsurance essentially provides 'insurance for insurers' and allows insurers to manage their exposure to a large individual claim (or series of claims) and to provide capital and support of growth in risk.

Recent competition activity

FCA competition activity

Big Data

We announced in November 2015 that we wanted to develop a better understanding of how retail general insurance firms are using data and analytics, and the potential impact on consumer outcomes and competition in the market. Our focus was on private motor and home (buildings and contents) insurance.

In September 2016 we published a feedback statement.[65] We found that Big Data is bringing about a range of benefits for consumers in motor and home insurance by transforming the way they deal with firms, encouraging more innovation in products and services and streamlining parts of the customer journey.

However, we also identified some concerns. Some stakeholders expressed concerns about data protection rules and the use of data. Big Data may also lead to factors other than risk and cost in pricing becoming more prevalent. There is also the potential for Big Data to increase risk segmentation and consequently lead to consumers with higher risks being unable to obtain affordable insurance.

Our analysis indicated these concerns have not yet materialised but we continue

64 FCA PS16/21 Policy Statement Increasing transparency and engagement at renewal in general insurance markets – feedback on CP15/41 and final rules and guidance (August 2016): www.fca.org.uk/publication/policy/ps16-21.pdf

65 FCA FS16/5 Feedback Statement Call for Input on Big Data in retail general insurance(September 2016): www.fca.org.uk/publication/feedback/fs16-05.pdf

66 Business Population Estimates for the UK and Regions, Department for Business Innovation & Skills (2016).

to monitor market developments. However, addressing some of the impacts of micro segmentation is likely to fall into the realm of social policy rather regulation. Whilst protecting consumers is a core part of our mandate, remedies that go beyond to mandate specific outcomes, would need to be made by Government in consultation with regulators, industry and other stakeholders. One such example is the creation of *Flood Re*.

We proposed specific discovery work to look at pricing practices in a limited number of retail general insurance firms. This will ensure we can gain a better understanding of how these developments are affecting the market. We will look at how firms' pricing approaches and rating factors work in practice, as well as the drivers and the types of systems and data firms use to determine the final price to consumers. Following this work, we will consider whether, and what, further steps need to be taken in this market. We will carry this out in 2017/18.

Value measures in retail

As a follow-up to our General Insurance Add-ons Market Study (where we found among other things that consumers find it difficult to assess value due to the lack of a commonly available measure), in January 2017 we published the first set of data[67] in our general insurance value measures pilot. We published data for 38 insurers who provided claims data for the pilot products, including claims frequencies, claims acceptance rates and average claims pay-out by insurer and product for four general insurance products:

- home insurance
- home emergency insurance
- personal accident insurance, sold as an add-on to motor or home insurance and
- key cover, sold as an add-on to motor insurance

The pilot will gather evidence about the take-up and use of the data, the product changes that firms introduce and the subsequent impact on the published data. We will therefore be gathering both qualitative and quantitative data to assess the impact in these areas in order to evaluate the impact of the pilot.

We expect that the combined pressure generated by publicity, changes in wider consumer behaviour, regulatory intervention and peer review will incentivise firms to improve value.

Transparency and engagement at renewal

In August 2016 we published a policy statement on transparency at renewal in general insurance markets to address the issues of barriers to consumers switching, and ensuring that communications from insurers are fair and not misleading.

In the paper we issued rules that require general insurance firms to:

- disclose last year's premium at each renewal
- include wording to encourage consumers to check their cover and shop around for the best deal at each renewal
- identify consumers who have renewed with them four consecutive times, and give them an additional standard message encouraging them to shop around

We stated that firms should look at these issues particularly carefully if the proposal is to automatically renew the policy. We also encouraged firms to consider whether their customers have enough time to review their renewal documentation and to take appropriate action, which may

67 www.fca.org.uk/publications/data/general-insurance-value-measures-data-year-ended-31-august-2016

include shopping around. We required that firms make the necessary changes to their renewal communications by 1 April 2017.[68]

EU/UK competition activity

The European Commission announced that it would not be renewing the Insurance Block Exemption Regulation (making competition law inapplicable to certain arrangements in the insurance sector). Accordingly it lapsed on 31 March 2017. Insurance companies are now expected to assess whether their arrangements which no longer benefit from the exemption may need to be amended so as not to infringe competition laws.

In August 2016 the Competition and Markets Authority announced that the final provisions of the Private Motor Insurance Market Investigation Order 2015 came into effect. These require private motor insurance providers and price comparison websites to make better information available on the costs and benefits of no-claims bonus protection.

Wider regulatory context

Insurance Distribution Directive

The Insurance Distribution Directive (IDD) is a new EU legal framework for insurance distribution which replaces the Insurance Mediation Directive.

The IDD regulates the activities of distributors of insurance products. It states what information distributors should give their customers, imposes conduct of business and transparency rules and clarifies the rules for cross-border business. It also includes new requirements for selling insurance products that have investment elements, to ensure a similar level of protection with other investment products that are regulated under MiFID II. The IDD was adopted in December 2015, and must be implemented in the UK by February 2018.

Next steps

Market study on wholesale brokers

We want to ensure that the wholesale insurance market is working well and fosters innovation and competition in the interests of a diverse range of consumers.

We will conduct a market study to assess how effectively competition is working in these markets, including how firms ensure practices do not create market integrity and conduct risks. Following the publication of this market study, we will consider appropriate remedial actions.

Big Data

As we have already highlighted in this chapter, we have proposed a piece of discovery work for 2017/18 to look at Big Data use in pricing practices in a limited number of retail general insurance firms. Following this work, we will consider whether, and what, further steps need to be taken in this market.

68 FCA PS16/21 Policy Statement Increasing transparency and engagement at renewal in general insurance markets – feedback on CP15/41 and final rules and guidance (August 2016): www.fca.org.uk/publication/policy/ps16-21.pdf

6 Pensions and retirement income

Key points

- As our Annual Report and Accounts 2016/17 states, the pensions sector was a priority theme for us during 2016/17. This was due to the major changes in policy and regulation that have taken place in the sector in recent years, including the introduction and staging of auto-enrolment into workplace pensions and the introduction of the pension freedoms in April 2015.
- We have been developing and testing a number of remedies designed to enhance competition in the interests of consumers in the annuity market. In particular, we have consulted on the provision of an information prompt comparing the rate available from the existing provider with the best available in the market. We hope to publish final rules in summer 2017.
- We continue to monitor market developments through our market data collection exercises (published in our Data Bulletins) and have identified a number of key trends. In the period post the introduction of the pension freedoms, the majority of pensions being accessed are by those under 65.[69] Over half of all pensions accessed have been fully withdrawn and drawdown has replaced annuities as the most widely purchased product.[70] Now that the impact of the pension freedoms is clearer, we are also assessing how firms and consumers have responded in our Retirement Outcomes Review. The Review is looking at what impact the freedoms have had on competition in the decumulation market. In July 2016 we published our Terms of Reference and we will publish our Interim Report in summer 2017.

Sector overview

There are two main sub-sectors with which consumers engage in the pensions and retirement income sector: accumulation (saving into a pension) and decumulation (withdrawing those pension savings). Some firms only participate in one of these activities, while others participate in both.

In the accumulation phase there are two main pension regimes: defined benefit and defined contribution. We regulate firms providing contract-based personal pension schemes, including stakeholder, self-invested personal pensions (SIPPs) and workplace group personal pension schemes.[71] The Pensions Regulator regulates occupational trust-based schemes which include defined contribution and defined benefit schemes.[72] The Government, through the Treasury and the Department for Work and Pensions, sets the overall framework for pensions.

69 We base our analysis on data gathered from October 2015 onwards

70 www.fca.org.uk/publication/data/data-bulletin-issue-8.pdf

71 Some of the firms that provide contract based schemes also provide trust based schemes.

72 Guide to the regulation of workplace defined contribution pensions (March 2014): www.thepensionsregulator.gov.uk/docs/guide-to-the-regulation-of-workplace-defined-contribution-pensions.pdf

Defined contribution trust-based schemes account for approximately 27% of the accumulation market. However, many do not offer decumulation options. Most consumers seeking to access their pension are required to transfer out of these schemes and purchase a contract-based decumulation product.

Decumulation

For decumulation, the retirement income value chain can be split into three elements:

- **product providers:** includes those who only operate on the open market, those who only serve their existing consumers, and those who operate in both markets
- **intermediaries:** provide a range of services to consumers, from basic price comparisons through to financial advice
- **reinsurers:** offer specialist underwriting expertise to annuity providers, allowing them to insure against the longevity risk when selling products to consumers.

Between April 2016 and September 2016 302,107 pension pots were accessed for the first time. 56% of those accessing their pension savings took a full withdrawal. The number of consumers taking a full encashment has now reached a stable rate in the post-freedoms period, with around 80,000 doing so per quarter.[73]

Concentration in both the drawdown and annuity markets is high.

In our Retirement Income Market Study we noted that there had been limited new entry into the decumulation market in recent years. Since that report, there has been consolidation in the sector:

Market share: accumulation

67%

The top five firms providing personal and stakeholder pensions had a 67% share of the market in terms of gross written premiums

FCA Sector Views

Market share: decumulation

67%

The top five firms offering annuities had a 67% share of the market by value of income paid out to existing annuities

43%

The top five firms offering drawdown had a 43% share of the market of assets available

FCA Sector Views

- Aviva and Friends Life merged in 2015
- Just Retirement and Partnership merged in April 2016
- Abbey Life was acquired by the Phoenix Group in December 2016
- Aegon agreed to acquire BlackRock's defined contribution pension platform in May 2016

There have been no significant new entrants into the retirement income sector in recent years.

73 FCA Data Bulletin Issue 8 (February 2017): www.fca.org.uk/publication/data/data-bulletin-issue-8.pdf

Recent competition activity

Retirement Outcomes Review

We launched the Retirement Outcomes Review with the publication of the Terms of Reference[74] in July 2016. The Review will assess the impact of the pension reforms on competition in the retirement income market. It will review how consumers make choices to access their pension savings without using an adviser, and whether they shop around and switch to products that better meet their needs.

It will also look at how firms have changed their business models and the impact of these changes on competition along with other factors, such as the pace of regulatory change.

Given the profound changes to the retirement income sector, the focus of this review is on decumulation activities: full withdrawal, income drawdown, annuities and uncrystallised funds pension lump sum cash withdrawals.[75]

We aim to publish an interim report in summer 2017, followed by the final report at the beginning of 2018.

Retirement Income Market Study

This Market Study, completed in March 2015, proposed a number of remedies and recommendations to support consumer choice in this market. Following on from the Market Study, in July 2016 we published the outcome of our consumer behavioural testing[76] to encourage consumers to shop around when buying an annuity. This concluded that the introduction of an information prompt would lead to a significant increase in shopping around. In November 2016 we published a consultation paper[77] to implement this information prompt.

We are also testing potential improvements to the information consumers receive from their providers in the run-up to their retirement.

Fair treatment of long-standing consumers in the life insurance sector

In December 2016 we published finalised guidance[78] setting out our expectations on the actions life insurance firms should take to treat their closed-book customers fairly. We found a mixed picture with most firms demonstrating good practice in one or more areas but poor practice in others.

Capping early exit pension charges – changes to our rules

In November 2016 we published a policy statement[79] with a number of changes to our rules. Parliament has placed a duty on us to cap charges borne by consumers accessing the pension freedoms ahead of their selected retirement date.[80]

As a result, we introduced new rules requiring that from 31 March 2017:

- early exit charges be capped at 1% of the value of existing contract-based personal pensions, including workplace personal pensions, for consumers aged 55 and over

74 FCA MS16/1 Retirement Outcomes Review (July 2016): www.fca.org.uk/publication/market-studies/retirement%20outcomes%20review%20tor.pdf

75 Where a consumer withdraws sums of cash in chunks from their pension pot until it runs out. Alternatively, consumers may decide to withdraw their pension savings in full.

76 Oxera and the Nuffield Centre for Experimental Social Sciences Increasing consumer engagement in the annuities market: can prompts raise shopping around? (June 2016): www.fca.org.uk/publication/research/consumer%20engagement%20in%20annuities%20market.pdf

77 FCA CP16/37 Implementing information prompts in the annuity market (November 2016): www.fca.org.uk/publication/consultation/cp16-37.pdf

78 FCA FG16/8: Fair treatment of long-standing customers in the life insurance sector – feedback on TR16/2 and finalised guidance (December 2016): www.fca.org.uk/publication/finalised-guidance/fg16-8.pdf

79 FCA PS16/24: Capping early exit pension charges – feedback on CP16/15 and final rules (November 2016): www.fca.org.uk/publication/policy/ps16-24.pdf

80 Section 137FBB FSMA 2000

- early exit charges that are currently set at less than 1% may not be increased
- firms do not apply an early exit charge to personal pension contracts entered into after these rules take effect

The caps have the potential to drive more effective competition in the market for decumulation products, as firms seek to benefit from a potential redistribution of customers who access their pension savings following the cap (both within and between firms.)

Wider regulatory context

Automatic enrolment

Automatic enrolment of employees into workplace pension schemes began in 2012, with the intention to complete the staged process by 2018. Automatic enrolment aims to get 9 million more people saving, or saving more, in a workplace pension scheme.

Pension Wise

In February 2017 the Treasury and the Department for Work and Pensions closed their consultation on a single financial guidance body and are analysing feedback. The new body would merge Pension Wise, the Pensions Advisory Service and the Money Advice Service, bringing together pensions guidance, money guidance and debt advice in one place. The new body would complement financial guidance provided by the third sector and the industry.

Next steps

Retirement Outcomes Review

We will continue our review of the retirement outcomes market and will aim to publish an interim report in summer 2017, followed by the final report at the beginning of 2018.

Retirement income products

We are currently conducting behavioural research with several providers to test how to make wake-up packs more effective at directing consumers to Pension Wise. We will publish results of that research later this year.

Non-workplace pensions

We will undertake initial discovery work to find out if the non-workplace pensions market is sufficiently competitive to work effectively in consumers' interests.

7 Retail investments

Key points

- We undertook the Financial Advice Market Review (FAMR) jointly with the Treasury. FAMR explored the supply and demand sides of the market for financial advice and guidance, and any barriers to providing these services. FAMR's recommendations sought to improve access to the advice market for firms and consumers. They included a recommendation that we build on the success of Project Innovate by establishing an Advice Unit, which was opened in May 2016.
- As we outline in Chapter 8, the asset management industry is currently the subject of an FCA competition market study, which may have implications for retail investments. The Asset Management Market Study Interim Report, published in November 2016, highlighted a number of areas for concern and identified potential competition issues in the investment platforms market. As a result, we are currently scoping a market study into 'direct to consumer' and intermediated investment platforms.
- We launched a post-implementation review of our crowdfunding rules in July 2016, and in December 2016 we published our Interim Feedback Statement which set out the responses we received to our Call for Input. In this statement, we highlighted the need to modify our rules as this sector develops, based on the feedback received alongside consumer research and information gathered through our supervision and authorisation of crowdfunding firms.

Sector overview

The retail investments sector aims to enable individuals to grow the value of their assets or obtain an income by making investments. Typically investors seek higher returns than available from cash savings but, unlike cash, investments do not normally provide a guaranteed return. Consumers tend to invest once they have met their needs through other savings and investment options, such as pensions and cash savings.

The sector covers three main activities:

- the provision of investment products
- services (such as platforms) that provide access to, and ongoing administration of, those products
- the provision of advice and guidance to help consumers select which products and services to buy

12.6m

British consumers have retail investments products[81], equating to 25% of the UK adult population

£1.8tn

are held in retail investments[82], this compares to £1.5tn held in cash deposits and savings accounts[83]

81 GFK Financial Research Survey, six months ending June 2016 data. Retail investments defined as any investment product, any alternative investment (including property bought to let), unit linked endowment, with profits endowment or Premium Bond.

82 FCA calculation based on various sources: a) Nesta and University of Cambridge, Alternative Finance Report (2014); b) Datamonitor (2015); c) UK Government (2015); d) Investment Association (2015); e) NS&I website (Oct 2015); f) FCA returns data (2015); g) FCA Supervisory estimates (2015).

83 Bank of England data taken from Moneyfacts Treasury Report (October 2016).

£948bn

of funds under management for UK retail investors

Source: The Investment Association Annual Survey

14%

of gross household financial wealth is held in retail investment funds

Source: The Investment Association

For the purposes of this report, the retail investments sector covers the retail consumer's journey to purchasing investment products, including distribution and retail advice. We distinguish this from investment management in this report, which covers the suppliers of investment products and institutional investors (see Chapter 8).

The retail investments sector is closely linked to other sectors and in particular to the investment management and pensions and retirement income sectors. For example, advisers and platforms provide advice on and access to pension accumulation and decumulation products as well as non-pension investments.

The retail investment products with the largest amounts of assets invested are collective investment schemes, direct holdings of shares and insurance-based investment products. Crowdfunding and peer-to-peer lending products are growing fast, but they currently account for a small proportion of the sector.

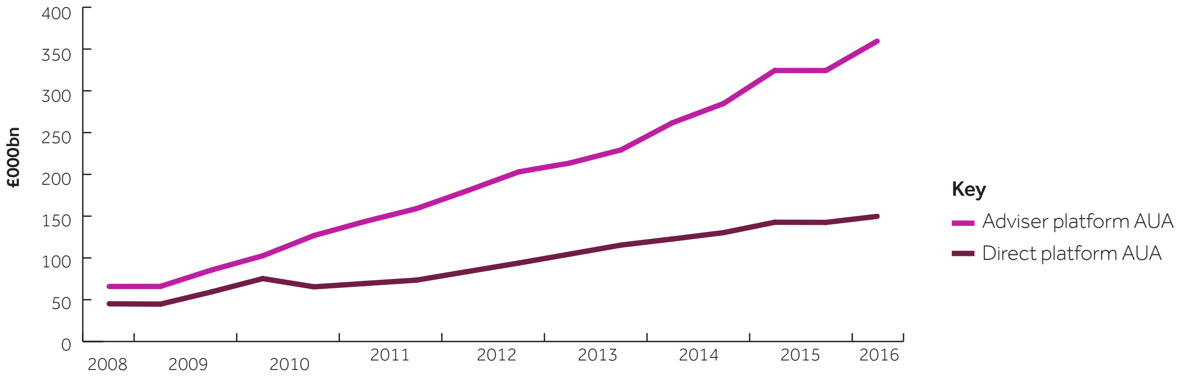
Some consumers may choose to seek advice on which products to hold. They may choose to do so for all their financial products including investments, or only for specific products or in specific circumstances.

Consumers can buy retail investment products through different distribution channels. This includes buying through their advisers, direct from manufacturers as well as through web-based platforms.

Platform service providers are online portals that allow investors to buy a range of retail investment products from different providers and organise the safeguarding and administration of those investments

There are two main types of platform: those aimed at retail consumers – known as 'direct to consumer' or D2C platforms, and those aimed at intermediaries such as advisers.

Figure 7.1: Growth of assets under administration (AUA) on direct to consumer and adviser platforms



Source: Asset Management Market Study Interim Report

Both types of platform have seen growth in assets under administration for a number of years, with adviser platforms growing more quickly than D2C platforms. Both platforms are now an important part of the investment market.

Platforms' increasing scale and influence over consumers' choices may allow them to negotiate better deals with product manufacturers (buyer power). However, the Asset Management Market Study interim report found that although retail platforms do sometimes secure discounts on fund charges, there is little differentiation between platforms and it is not clear that retail investors benefit fully from the economies of scale possible in this area.

Recent competition activity

The Asset Management Market Study

Many firms operating in the retail investments sector will have participated in or be affected by our Asset Management Market Study. More details can be found in Chapter 8.

Investment platforms

The Asset Management Market Study identified a number of potential competition issues in the investment platforms market. These included complex charging structures, whether platforms' investment tools support effective choice, and whether platforms have the incentives and ability to put competitive pressure on asset management charges.

Our Thematic Review into suitability of advice, published in February 2016[84], found that although firms mainly sought to achieve positive outcomes for their clients, there were issues relating to platform research and due diligence. There is an inherent conflict for adviser platforms; they are selected by and usually used by the adviser, but paid for by the retail customer.

Addressing these issues is a high priority for us. Please see the 'Next steps' section of this chapter for further information.

Crowdfunding

In July 2016 we launched a post-implementation review of our crowdfunding rules. Our Call for Input[85] invited views on the development of the market and whether our rules offered sufficient consumer protection.

Loan-based crowdfunding platforms have the potential to compete with existing firms, such as banks or consumer credit firms, for both funding and lending opportunities. The existence of this alternative intermediary channel can provide competition in the pricing of lending and savings products. Our review aims to ensure that the market in crowdfunding develops sustainably, in a way that provides appropriate consumer protections and allows competitive forces to operate in the interests of consumers.

In December 2016, we published our Interim Feedback Statement[86] which set out the responses we received to our Call for Input. Having reviewed the feedback alongside consumer research and information gathered through our supervision and authorisation of crowdfunding firms, we believe we need to modify our rules in a number of areas. The review is ongoing, but we plan to consult in 2017 on rules to address some of the more immediate concerns.

84 FCA TR16/1 Thematic Review Assessing suitability: Research and due diligence of products and services (February 2016): www.fca.org.uk/publication/thematic-reviews/tr16-01.pdf

85 FCA Call for input to the post-implementation review of the FCA's crowdfunding rules (July 2016): www.fca.org.uk/publication/call-for-input/call-input-crowdfunding-rules.pdf

86 FCA FS16/13 Feedback Statement Interim feedback to the call for input to the post-implementation review of the FCA's crowdfunding rules (December 2016): www.fca.org.uk/publication/feedback/fs16-13.pdf

Developments in advice

Financial Advice Market Review (FAMR)

FAMR's[87] final report in March 2016 set out a number of recommendations intended to tackle the barriers to consumers accessing advice. In April 2017 we published a joint progress report with the Treasury[88] setting out our progress in meeting the Review's recommendations.

This was the final update on progress before the 2019 review of the outcomes from FAMR.

In March 2017, in response to recommendations in the FAMR report, we also published a consultation[89] on proposals for further guidance on streamlined advice, among other things. We plan to publish subsequent consultations throughout the year covering guidance on the remaining FAMR recommendations, and we we intend to publish our final guidance later in 2017.

Wider regulatory context

Main regulatory developments in the EU include the following:

Markets in Financial Instruments Directive II (MiFID II) – This is covered in Chapter 8.

Packaged Retail and Insurance-based Investment Products (PRIIPs) – This is covered in Chapter 8.

87 FAMR was launched in 2015, as a collaboration between the Treasury and FCA, to explore ways in which the government, industry and regulators could take collective steps to stimulate the development of a market that delivered affordable and accessible financial advice and guidance to everyone, at all stages of their lives.

88 Financial Advice Market Review Progress report (April 2017) : www.fca.org.uk/publication/corporate/famr-progress-report.pdf

89 FCA GC17/4 Guidance consultation Financial Advice Market Review (FAMR): Implementation part 1 (April 2017) : www.fca.org.uk/publication/guidance-consultation/gc17-04.pdf

Next steps

Retail platforms

We identified retail platforms as one of our priority themes in our 2017/18 Business Plan. We will conduct a market study, beginning in 2017, to explore how 'direct to consumer' and intermediated investment platforms compete to win new and retain existing customers. The study will explore what products and services are offered and the extent to which consumers can achieve and assess value for money from platforms.

We will also explore whether platforms enable retail investors to access investment products that are well suited to their needs, and whether conflicts are effectively managed by vertically integrated firms.

Advice and guidance

We will continue to consult on FAMR recommendations throughout 2017, and plan to publish our Final Guidance in Autumn 2017.

8 Investment management

Key points

- The UK investment management industry is the largest in Europe and second only to the US globally. The fund market continues to grow both in terms of total assets under management and net flows into funds.[89]
- We published our interim report of our Asset Management Market Study in November 2016. In particular, we proposed a package of remedies to boost competitive pressure both for retail and institutional investors.
- We have received stakeholders' responses on both the findings and the proposed remedies included in the interim report. We will publish our final report in summer 2017, in which we will set out our final findings and remedies.

Sector overview

Around £6.9tn of assets are managed in the UK. Of these, over £1tn is on behalf of UK retail investors and around £3tn is on behalf of UK pension funds and other institutional investors.[91]

The majority of UK households use asset management services. Around three-quarters of UK households have occupational or personal pensions and 14% of adults hold stocks and shares ISAs. Over the past year we have continued our work on a detailed market study into asset management

Asset management products are typically marketed as either 'actively managed' or 'passively managed', although in practice some funds may be a blend of these. 74% of the UK market is actively managed compared to 23% passively managed, although this proportion has been growing gradually.

The industry is not particularly concentrated with the largest 10 asset management firms operating in the UK accounting for around 55% of total assets under management.

The asset management industry is heavily intermediated. Retail investors are increasingly using platforms to access services. Pension schemes tend to seek investment consultant advice to fulfil the requirement for trustees to get advice related to investment matters from qualified advisers with appropriate knowledge and skills.

90 FCA MS15/2.2 Asset Management Market Study Interim Report (November 2016): www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf

91 FCA MS15/2.2 Asset Management Market Study Interim Report (November 2016): www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf

Recent competition activity

Asset Management Market Study

We are currently carrying out the Asset Management Market Study. We published our interim findings in November 2016, and these are summarised below.

The evidence suggests there is weak price competition in a number of areas of the asset management industry. This has a material impact on the investment returns of investors. We believe there is room for improved outcomes in both the institutional and retail sections of the market. However, our evidence also indicates that competitive pressures are building in some parts of the market, and stakeholders and commentators suggest this is likely to continue.

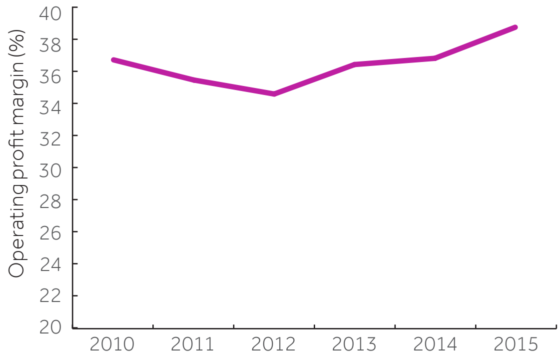
Price trends, charging practices and profitability

We found that charges for passive funds have fallen over the last 5 years and this, combined with the growth of passive investing, suggests that price awareness and competitive pressure on price is building among certain groups of investors. However our analysis shows that charges for mainstream actively managed funds have remained broadly static for the past 10 years.

The fact that the price does not fall as the fund size increases suggests that the economies of scale are captured by the fund manager rather than being passed on to investors. The asset management firms in our sample have consistently earned substantial profits over a 6-year period.

In many markets, weak pressure on price is associated with weak cost control and we found the evidence on cost control in this market to be mixed.

Figure 8.1: Average operating profit margin of asset management firms over 6-year sample period, 2010-2015



Source : Asset Management Market Study Interim Report FCA analysis based on financial data submitted to the FCA from 16 firms.

Investor outcomes

Our evidence suggests that, on average, actively managed investments do not outperform their benchmark after costs. We found that there is no clear relationship between price and performance; the most expensive funds do not appear to perform better than other funds before or after costs. Many partly active funds also offer similar exposure to passive funds, but some charge significantly more.

Transparency and clarity of objectives and investment outcomes

We found the prices for ancillary services bought by asset managers are usually clear to investors. However, investors are not given information on transaction costs in advance, which means they cannot take the full cost of investing into account when they make their investment decision.

We have concerns about how asset managers communicate their objectives and outcomes to investors. Investors may continue to invest in expensive funds because fund managers do not adequately explain the fund's investment strategy and charges.

Investor behaviour

We found that most investors generally think of value for money as risk-adjusted net returns. We also found that retail investors and, to some extent, institutional investors focus on past performance when choosing between asset managers. However past performance is not a good indicator of future risk-adjusted net returns for two main reasons: it can be difficult to interpret and compare past performance information; and even if past performance were easier to interpret and compare, it has limited value as an indicator of future performance.

The evidence on investor focus on charges is mixed. Although there is evidence of some investors paying greater attention to charges, around half of retail investors in our survey were not aware they were paying fund charges, as indicated in the chart below.

Figure 8.2: Do you pay fund charges on your most recent investment product?

Source: Asset Management Market Study Interim Report – NMG Consumer Research (2016)

Switching

Investors can incur a range of costs if they switch between funds and asset managers. Investors may also be reluctant to switch if it would involve crystallising a loss or cutting their holding period to one shorter than the period that was recommended. It is often difficult for investors to know whether they would be better off switching and in some cases we have found retail investors remaining in persistently poor performing funds.

Asset managers told us that it can be difficult to switch investors to new share classes even where this is in the best interest of investors.

Ability to negotiate

Retail investors do not usually negotiate directly with asset managers and our evidence suggests that fund governance bodies acting on their behalf do not typically focus on value for money. Trustees of pension schemes, and other types of oversight committees for institutional investments, face a range of challenges in their role and their dealings with asset managers. The challenges appear to increase in relation to scheme size, with smaller schemes generally less well-resourced and knowledgeable. It is likely that smaller pension schemes could achieve significant benefits from consolidating their assets, although there are complications and incentives that work against consolidation.

Retail intermediaries

Retail intermediaries provide tools for retail investors to help them identify the best funds. Although we have identified some examples of discounting on platforms, retail investors do not typically appear to benefit from economies of scale by pooling their money through direct to consumer platforms. We also have concerns about the value provided by distributors and are proposing further work in this area. This work is outlined in Chapter 7.

Investment consultants

Investment consultants rate asset managers and we found their ratings do influence which asset managers institutional investors choose. However, we have also found that these ratings do not appear to help institutional investors identify better performing managers or funds. While larger institutional investors are able to negotiate effectively with asset managers, investment consultants do not appear to help smaller institutional investors negotiate, or otherwise drive significant price competition between asset managers.

The investment consultant market is relatively concentrated, with the top three firms accounting for around 60% of the market. Levels of switching in the market are low; 90% of investors in our survey had not switched consultant in the last 5 years. Moreover, many institutional investors struggle to monitor and assess the performance of the advice they receive.

We also have concerns about whether the interests of investment consultants are in line with investors' interests. Investment consultants are expanding into fiduciary management, which means these consultants are both distributors for – and competitors to – asset managers.

We think further investigation into these issues is needed, which is why we consulted on making a market investigation reference to the CMA on the investment consultancy market.

Other competition work

Meeting investors' expectations

In April 2016 we published a thematic review[92] which considered whether UK authorised investment funds and segregated mandates operated in line with the expectations set by their marketing material, disclosure material and investment mandates. We also considered how firms monitored the appropriate distribution of their funds. We found some examples of unclear product descriptions and inadequate governance or oversight. All firms in our sample received individual feedback and we urged all fund management firms to consider the findings in our paper and review their arrangements accordingly.

Smarter Consumer Communications

We launched our Smarter Consumer Communications initiative[93] to bring about a change in the way information is provided to consumers. Communication in asset management was one of the issues we examined. We welcomed the suggestions made by firms for making information more effective and engaging and have fed the findings from this work into the Asset Management Market Study.

Transactions disclosure in workplace pensions

We have published a consultation paper on transaction cost disclosure in workplace pensions.[94] We aim to standardise the disclosure of transaction costs incurred by pension investments. We are proposing to place a duty on asset managers to disclose aggregate transaction costs to pension schemes that, directly or indirectly, invest in their funds. We are also proposing that asset managers provide a breakdown of transaction costs on request, with the total broken down into categories of identifiable costs. We aim to publish our rules in summer 2017.

92 FCA TR16/3 Meeting investors' expectations (April 2016): www.fca.org.uk/publication/thematic-reviews/tr16-3.pdf

93 FCA PS16/23 Smarter Consumer Communications: Removing ineffective disclosure requirements in our Handbook (October 2016) www.fca.org.uk/publication/policy/ps16-23.pdf

94 FCA CP16/30 Transaction cost disclosure in workplace pensions (October 2016):www.fca.org.uk/publication/consultation/cp16-30.pdf

Wider regulatory context

Market liquidity
High demand for market liquidity, including from open-ended funds invested in less liquid assets, remains a risk in this market.[95] The Bank of England's Financial Policy Committee is concerned that redemptions on a large scale within such funds could potentially impair market liquidity. In January 2017, the Financial Stability Board published its policy recommendations to address structural vulnerabilities from asset management activities which are now being implemented by the International Organization of Securities Commissions.

In February 2017, we published a discussion paper aimed at gathering evidence to decide whether changes were needed to our regulatory approach to all open-ended funds invested in illiquid assets.[96] This work relates to our market integrity objective though the implications of changes to our regulatory approach will also be examined in line with our competition duty.

Packaged retail and insurance-based investment products (PRIIPs)
This regulation was developed with the aim of encouraging efficient EU markets by helping retail investors to better understand and compare the key features, risks, rewards and costs of different PRIIPs.[97]

MiFID II
MiFID II aims to promote the integration, competitiveness and efficiency of EU financial markets more widely, and some of its provisions will apply to asset managers.[98] The revised directive is expected to improve investor protection, for example through conditions for providing independent investment advice and disclosing costs and charges. As part of our work on implementation of MiFID II we have published four of our five consultation papers over the past year.[99]

Next steps

As part of the Asset Management Market Study interim report we proposed a package of remedies to boost competitive pressure both for retail and institutional investors.[100] We have received stakeholders' responses on both the findings and the proposed remedies included in the interim report. We continue to develop our thinking on which interventions would be most effective in improving competition to the benefit of investors. The final report will set out our findings and conclusions and we expect to publish during the second quarter of 2017.

95 Bank of England Financial Stability Report (June 2017): www.bankofengland.co.uk/publications/Documents/fsr/2017/fsrjun17.pdf

96 FCA DP17/1 Illiquid assets and open-investment funds (February 2017): www.fca.org.uk/publication/discussion/dp17-01.pdf

97 The European Commission has announced it will extend the application date of the PRIIPs Regulation by one year. It will now apply from 1 January 2018.

98 The European Commission has announced it will extend the application date of the PRIIPs Regulation by one year. It will now apply from 1 January 2018.

99 Please see CP17/8, CP16-43 CP16-29 and CP16-19. The first of our consultations was published in December 2015. See CP15/43

100 For our proposed remedies, please see the Asset Management Market Study Interim Report.

9 Wholesale financial markets

Key points

- As outlined in our Annual Report and Accounts 2016/17, the wholesale financial markets sector was one of our priority themes in 2016/17.
- Well-functioning wholesale financial markets are a critical part of the global economy and are vital for driving economic growth. It is important that competition works effectively within these markets. They provide access to financing for firms and governments, and investment opportunities for retail and institutional investors. The UK plays a key role as a leading international financial centre.
- In October 2016 we published the final report of our Investment and Corporate Banking Market Study.[100] We found that the universal banking model of cross-selling and cross-subsidising between lending and corporate broking services and primary market services works well for many clients, and particularly for large corporate clients. However, there are some practices that could have a negative impact on competition, particularly for medium-sized and smaller clients. We also had concerns about the initial public offering (IPO) process, IPO allocations, and the credibility of league tables.
- We are implementing a targeted package of remedies to address these concerns and to ensure effective competition takes place. One of these remedies is the reforms we proposed in March 2017 to the IPO process. These reforms seek to ensure that a prospectus or registration document is published, and providers of 'unconnected research' have access to the issuer's management before any connected research is released.
- In wider policy work, we have also helped to ensure that the provision of fair, reasonable and non-discriminatory access to regulated benchmarks, as well as ensuring that pro-competitive aims of the MiFID II access arrangements, are achieved.

Sector overview

Wholesale financial markets play a vital role in supporting economic activities and other financial services, including enabling firms to raise finance and financial institutions to manage risk.

There are many sub-sectors and markets within wholesale financial markets.

We divide them into five distinct, yet interconnecting sectors, based on the need each sector fulfils. This enables us to assess whether the markets are working well.

101 FCA MS15/1.3 Investment and corporate banking market study Final report (October 2016): www.fca.org.uk/publication/market-studies/ms15-1-3-final-report.pdf

Wholesale sub-sectors

- **Transaction services** – Transaction services provide cash flow management, local and cross-border payments, and trade financing services for wholesale market users
- **Lending** – This serves the financing needs of a wide range of wholesale market participants, including those who cannot access traded capital markets
- **Equity and debt primary and secondary markets** – Enable companies and public entities to raise funds from investors by issuing and

selling equity and debt instruments that are tradable in capital markets. They also facilitate the trading of debt and equity instruments and the associated financial risk between investors and traders acting to achieve a return on their investment

- **Derivatives** – these are markets for risk (distinct from capital allocation) providing participants with the ability to tailor their risk profile by offloading or taking on financial risk
- **Foreign exchange and commodities cash markets** – these allow end-users to meet or hedge business needs through buying and selling currencies and commodities. They also allow end-users and intermediaries to invest in currencies and commodities.

Recent competition activity

Investment and Corporate Banking Market Study (including reforms to the IPO process)

Our Investment and Corporate Banking Market Study focused on primary markets and related activities provided in the UK.

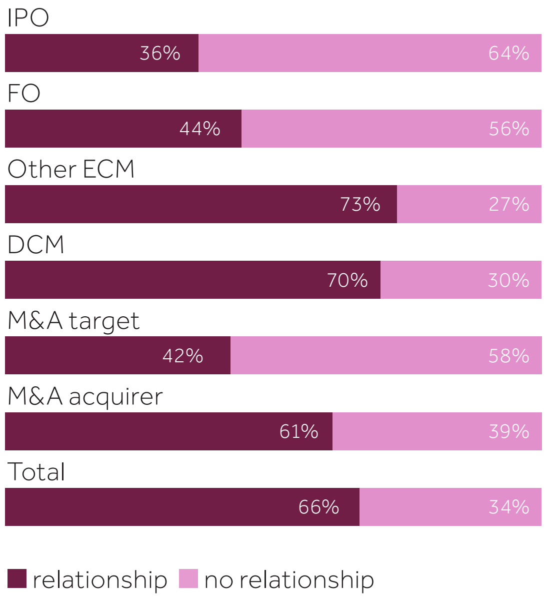
We published our interim findings and proposed remedies in April 2016, and consulted with a range of stakeholders including investment banks, clients, corporate finance advisers, innovators, buy-side investors and league table providers. Having considered the consultation feedback and carried out further work to address the feedback received, we confirmed our interim findings as final. We published our final report in October 2016.[102]

We found that the universal banking model of cross-selling and subsidisation seems to work well for large corporate clients, but may not work as well for some small and medium-sized ones.

In primary market services, a wide range of banks and advisers are active. There are often between 20 and 40 banks active in any particular sector and for different types of client – sovereigns, supra-nationals and agencies, financial institutions and corporate clients.

Lending and corporate broking are typically supplied at a low rate of return or below cost in exchange for a flow of transactional business that is, typically, more lucrative.

Figure 9.1: Proportion of roles awarded to banks which have not provided lending or other corporate banking services in the 2 years prior to the transaction, January 2014 to May 2015



Source: Investment and Corporate Banking Market Study Interim Report (FCA analysis of transactional data described in Annex 2).

Nearly three-quarters of debt capital market primary market roles are awarded to a bank with whom the client has an existing corporate banking or lending relationship. However, the link is significantly weaker for IPOs.

102 FCA MS15/1.3 Investment and Corporate Banking Market Study Final Report (October 2016): www.fca.org.uk/publication/market-studies/ms15-1-3-final-report.pdf

Banks sometimes use clauses that restrict a client's choice in future transactions. In our consultation paper, published alongside the final report, we proposed to ban contractual clauses which restrict competition without being clearly beneficial to clients.[103]

As part of our findings, we identified some areas of the IPO process that need improving. These included the timing, sequencing and quality of information being provided to market participants. These factors often leave research by the syndicate banks as the only source of information available to investors during a crucial stage of the IPO process. We published a consultation paper in March 2017[104] which proposes a package of policy measures intended to improve the range and quality of information available to investors during the IPO process. These included a series of rules which seek to ensure that a prospectus or registration document is published, and providers of 'unconnected research' have access to the issuer's management before any connected research is released.

Allocations of shares in IPOs can be skewed towards buy-side investors from whom banks derive greater revenues from other business lines (eg trading commission). In 2017/18 we will carry out supervisory work with those firms where we identified shortcomings in their allocation policies or a skew in their allocation practices.[105]

League tables that rank investment banks can be misleading because some banks routinely present league tables to clients in a way that inflates their own position. We are working with the British Bankers' Association and the Association for Financial Markets in Europe so they can develop and adopt industry guidelines to improve the way banks present such information to clients. Furthermore, some banks carry out loss-making transactions purely to generate a higher position in league tables. We asked league table providers to review their recognition criteria to reduce the incentives for banks to undertake such league table trades.

We will continue to implement these remedies in 2017/18.

Effectiveness of primary markets

In our Business Plan 2016/17 we committed to reviewing the structure of the UK's primary markets to ensure that they continue to serve the needs of issuers and investors.

In February 2017 we published a discussion paper[106] that considers the broader market landscape and sets out a number of areas where we want to explore opportunities for structural enhancements to UK primary markets. At the same time, we published a consultation paper[107] which sets out more developed proposals to enhance certain aspects of the Listing Rules. We will progress this area of work and make appropriate rule changes during 2017.

Benchmarks

On 1 April 2016, we introduced rules governing access to regulated benchmarks. The rules were introduced to address concerns over the lack of constraints on the ability of administrators to set the prices of benchmarks. Specifically, we were concerned that any administrator of an

103 FCA CP16/31 Consultation Paper, Investment and corporate banking: prohibition of restrictive contractual clauses (October 2016): www.fca.org.uk/publication/consultation/cp16-31.pdf

104 FCA CP17/5 Reforming the availability of information in the UK equity IPO process (March 2017): www.fca.org.uk/publication/consultation/cp17-05.pdf

105 FCA Occasional Paper No. 15: Quid pro quo? What factors influence IPO allocations to investors? (October 2016): www.fca.org.uk/publication/occasional-papers/occasional-paper-15.pdf

106 FCA DP 17/2 Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape (February 2017):www.fca.org.uk/publication/discussion/dp17-02.pdf

107 FCA CP 17/4 Review of the Effectiveness of Primary Markets: Enhancements to the Listing Regime (February 2017):www.fca.org.uk/publication/consultation/cp17-04.pdf

industry standard benchmark may have market power which enabled them to vary the terms, including the price at which it offered that benchmark, with limited fear of customers switching to an alternative, or of other suppliers entering to provide an alternative. Our rules require the provision of fair, reasonable and non-discriminatory access to regulated benchmarks by benchmark administrators for certain users, namely central counterparties. By limiting the ability of benchmark administrators to exploit their market power the new rules reduce the risk that such behaviour might hinder effective competition.

Wider regulatory context

Other work that may affect how competition operates in the wholesale sector includes:

Ring-fencing – this is discussed in more detail in Chapter 3.

MiFID II implementation – the impact of MiFID II is far-reaching, and we have conducted work to ensure the pro-competitive aims of MiFID II are achieved. Our work has included consideration of the open access requirements and reviewing readiness for the data provision obligations for trading venues and systematic internalisers. This work will continue during 2017/18.

Next steps

Investment banking market remedies

We will be completing the implementation of remedies on our Investment and Corporate Banking Market Study, working with market participants to implement our proposal for improving information availability in the UK IPO process.

MiFID II preparation

We will work to ensure firms are ready for MiFID II, including those aspects that are aimed at opening markets to competition.

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