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December 2016

FCA review of the asset management industry.

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The Financial Conduct Authority’s (FCA’s) interest in pensions is ever-increasing, with its attention most recently turned to the asset management industry and the publication of a report and consultation paper (the Report) that covers the provision of investment advisory services to institutional investors (of which pension scheme trustees are the biggest group). The FCA’s review started just over a year ago in response to concerns that competition in the asset management sector may not be working effectively to ensure the best outcomes for investors.

The scope of the review

The review covered matters such as:

> Whether investors find it difficult to monitor asset managers to ensure they are receiving value for money;

> Whether asset managers have the incentive and ability to effectively control costs incurred on behalf of investors; and

> The role of investment consultants, including whether there are potential conflicts of interest in the provision of both advice and asset management services.

The FCA’s concerns

The Report presents the FCA’s interim findings and proposed remedies, on which it welcomes stakeholder views. In summary, the FCA is concerned that:

> There is weak price competition in a number of areas of the asset management industry, which has a material impact on the investment returns of investors;

> Not all asset managers are good at controlling transaction costs;

> Many pension trustees rely heavily on investment consultants, which can result in trustees accepting investment strategies proposed to them without adequate critique or challenge;

- The quality of advice given by investment consultants is difficult to assess, and consequently institutional investors tend to focus on evaluating service (i.e. how quickly queries are dealt with) rather than advice; and
- Many investment consultants now offer products and services that have traditionally been provided by assets managers (for example, fiduciary management services). The FCA is concerned that some investment consultants will recommend their own offerings to clients, even if there are better investment products on offer elsewhere.

Proposed remedies

The Report includes a number of proposed solutions to the issues identified. These include:

- A strengthened duty on asset managers to act in the best interests of investors, including holding asset managers accountable for how they deliver value for money, and introducing independence on fund oversight committees.
- Introducing an all-in fee approach to quoting charges so that investors can easily see what is being taken from the fund.
- Helping retail investors (which includes individual scheme members) identify the best fund for them by:
  - requiring asset managers to be clear about the objectives of the fund and report against these on an ongoing basis;
  - clarifying and strengthening the appropriate use of benchmarks;
  - providing tools for investors to identify persistent underperformance;
- Requiring clearer communication of fund charges and their impact at the point of sale and in communication to retail investors.
- Requiring increased transparency and standardisation of costs and charges information for institutional investors.
- Exploring with government the potential benefits of greater pooling of pension scheme assets.
- Requiring greater and clearer disclosure of fiduciary management fees and performance.
- Recommending that HM Treasury also considers bringing the provision of institutional investment advice within the FCA's regulatory perimeter.

Next steps

Alongside the Report the FCA published a paper explaining its provisional decision to make a “Market Investigative Reference” to the Competition and Markets Authority (CMA). The FCA believes that there are reasonable grounds to suspect that features of both the investment consultancy and employee benefits consultancy sectors restrict or distort competition. The FCA is inviting comments before it makes its final decision on whether to refer the matter to the CMA.

The consultation, including in respect of the possible CMA reference, will close on 20 February 2017 and the FCA intends to publish its final report later next year.

The changes proposed are significant for most investors, whether members or trustees, but they are nonetheless very welcome. Increased transparency, more user-friendly reporting standards, and clearer communications with investors will not only make investing easier and more effective, but most importantly these changes will have a positive impact for members.

It will of course be a while before we see the introduction of any new legislative or regulatory requirements, and the proposals will no doubt change before that happens, but it will be interesting to see how the market reacts to these initial suggestions. It will also be interesting to see how this Report ties in with the outcome of the FCA’s ongoing consultation on the disclosure of transaction costs, and the Green Paper due early next year in which we expect some consideration from the government on whether trustees should have a minimum level of training and/or whether boards should be encouraged or required to appoint at least one professional trustee.

For the time being, there is no action that trustees must take, although the expectation of change presents a good opportunity to schedule a review of asset management performance, including issues such as transparency.

We will of course update you as the review progresses. In the meantime, please do not hesitate to speak with your usual Linklaters pension contact if you would like to discuss any of these issues further.

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