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FCA to Impose Remedies in Asset Management Sector including Further Investigation into Investment Consulting

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On 18 November 2016 the Financial Conduct Authority (“FCA”) published its highly anticipated interim report into competition in the asset management industry. The report finds that price competition is weak in a number of areas of the industry and highlights wider concerns about the way the investment consulting market operates. The FCA has proposed a significant package of remedies to address the concerns identified, as well as proposing to make a market investigation reference (“MIR”) to the Competition and Markets Authority (“CMA”) for an in-depth investigation into the institutional investment advice market.

Background

In 2015 the FCA announced its decision to undertake a market study into asset management in the UK, following feedback from the FCA’s review of competition in wholesale financial markets, which identified a number of areas within the asset management value chain where competition may not be working effectively. The FCA explained that the market study would, among other things, explore how investment consultants affect competition for institutional asset management, with a view to ascertaining whether institutional and retail investors get good value for money when purchasing asset management services.

The CMA and the FCA have ‘concurrent powers’ in relation to the provision of financial services in the UK, meaning that both the FCA and the CMA can enforce rules on anti-competitive behaviour, while the FCA also has powers to carry out market studies and make MIRs to the CMA in connection with this sector. The CMA has a wide range of remedial powers in connection with market investigations, most recently exercised in its investigation in the payment protection insurance sector, which resulted in significant industry-wide change and expense.

Key Findings

The main finding of the interim report is that price competition is weak in a number of areas of the asset management sector, which has a material impact on the investment returns of investors through their payments for asset management services. In particular, the FCA found that there is limited price competition for actively managed funds, there is stronger competition on price for passively managed funds, fund objectives are not always clear, and performance is not always reported against an appropriate benchmark.

The FCA also found that, despite a large number of firms operating in the market, the asset management sector as a whole has enjoyed sustained, high profits over a number of years with significant price clustering, especially between 0.75 and 1%. Also, investment consultants undertake valuable due diligence for pension funds but are not effective at identifying outperforming fund managers and there are conflicts of interest in the investment consulting business model which require further scrutiny.

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Key Remedies

In order to address the concerns identified, the FCA has provisionally proposed a number of significant and interventionist measures, including the following:

- a strengthened duty on asset managers to act in the best interests of investors;
- an ‘all-in fee’ approach to quoting charges so that investors in funds can easily see what is being taken from the fund;
- exploring with government the potential benefits of the greater pooling of pension scheme assets;
- consulting on whether to make an MIR to the CMA for in-depth investigation of the institutional investment advice market; and
- recommending that HM Treasury brings the provision of institutional investment advice within the FCA’s regulatory perimeter.

The FCA has also suggested a number of other remedies designed to increase the transparency of costs in the sector with a view to providing greater clarity of fund objectives and performance reporting and protections for investors.

Further Investigation into Investment Advisory Sector

Specifically with regards to the investment advisory sector, the FCA has concerns about whether the interests of investment consultants are in line with investors’ interests. As investment consultants are expanding into fiduciary management, consultants are becoming both distributors for – and competitors to – asset managers, with the potential for conflicts of interest. The interim report also found that investment consultants accept hospitality from asset managers, which the FCA considers as posing a further conflict of interest and could ultimately result in poor outcomes for end investors.

The FCA has further identified specific competition concerns, such as weak demand side (with investors unable to assess the quality of advice provided and unwilling to switch advisors) and misaligned incentives, in light of which it has provisionally decided to make an MIR to the CMA. This would mean that the CMA would conduct an in-depth investigation, likely lasting two years, following which it would typically propose further remedies and regulation.

Next steps

The FCA has asked interested parties to submit their comments on its interim report and provisional decision to refer investment consultancy services to the CMA by 20 February 2017. The FCA will then publish its final report and remedies in 2017.

The FCA’s consultation is a key opportunity for asset management firms and investment consultants to engage with the regulator at an early stage in order to:

- a. ensure that the ultimate findings of the report accurately represent the true state of competition in the asset management market;
- b. make sure the proposed remedies are appropriate and proportionate; and
- c. help shape the scope and outcome of any further investigation.

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How K&L Gates can assist

Our Antitrust, Competition & Trade Regulation team along with our Financial Services Policy group have extensive experience in assisting companies responding to market studies and market investigations. Having previously advised clients in relation to numerous similar investigations, our team can help you draft your representations and engage effectively with the FCA with a view to protecting your interests, as well as assisting in respect of any further investigation.

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