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Competition Law Threat to Active Fund Managers

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SCM Direct ("SCM"), an investment manager based in the UK, has recently called for the Competition and Markets Authority ("CMA") and Financial Conduct Authority ("FCA") to investigate actively managed funds sector for alleged fixing of annual charges. This is the latest in a series of public comments and studies relating to an alleged lack of competition in the active funds sector. As this pressure continues to grow, there is an increasing risk of a competition law investigation by the CMA or FCA which could have a significant and negative effect on the industry.

Scrutiny of Active Funds Sector

The asset management industry, and in particular the active funds sector, is being subjected to increasing scrutiny from regulators with respect to the issue of price competition and whether they are delivering value for money for investors.

- The FCA published the interim report for its Asset Management Study in November 2016. This stated the FCA’s preliminary view that there is "weak price competition in a number of areas of the asset management industry", pointing to price clustering, stagnant pricing trends and a failure to pass on economies of scale to investors.
- The FCA has provisionally decided to make a market investigation reference (“MIR”) to the CMA in respect of the market for the provision of investment advisory services to institutional investors and employers. This relates to the FCA’s concerns, expressed in the Asset Management Study interim report, that investment consultants are not assisting institutional investors to identify better performing managers nor assisting smaller institutional investors to effectively negotiate better prices.
- The European Securities and Markets Authority (“ESMA”) has issued a statement outlining its concerns regarding ‘closet indexing’. ESMA’s concerns include that investors are paying higher management fees on an expectation that they are receiving an active fund management service.

Following the FCA’s interim report there have been calls for the CMA to investigate the active funds sector for price fixing. SCM, co-founded by Gina Miller (who was the lead claimant in the Brexit challenge), called for an investigation into the active fund sector for allegedly fixing annual charges. SCM cite their own research in claiming that 70% of companies in the industry imposed an identical 0.75% yearly management charge on their clients and that fees have not changed in five years.

On 10 March 2017 Mary Starks, Director of Competition at the FCA, said in a speech at the Association of Investment Companies conference that the ongoing Asset Management Study confirmed the FCA’s view that the market is in need of reform. It is clear this issue is one of the FCA's priorities and likely to garner additional attention from the regulator.

Possible CMA Response

If the active funds sector is subject to a CMA investigation on the grounds that asset managers are alleged to be engaging in anti-competitive activities, the sanctions

available to the CMA for such infringements are significant, as seen in the recent LIBOR and FOREX investigations.

Firms found to be engaging in such activities can be subject to fines of up to 10% of group global turnover. In addition, the provisions of any agreements that are in breach of competition law will be void and unenforceable and firms could expose themselves to actions for damages from customers who can show they have been harmed by paying excessive fees.

Individuals within asset managers could also be subject to personal liability under the Enterprise Act 2002 (amended by the Enterprise and Regulatory Reform Act 2013). Individuals prosecuted for cartel activities may be liable to imprisonment for up to five years and/or the imposition of unlimited fines. Individuals charged with the cartel offence may also be guilty of money laundering under the Proceeds of Crime Act 2002, which carries a possible sentence of fourteen years imprisonment and/or the imposition of unlimited fines. In addition, a competition director disqualification order may be placed on an individual director of an offending company which has a maximum period of disqualification of fifteen years.

If a MIR is finalised and submitted to the CMA then the CMA will have 18 months to conclude an investigation on the level of competition within the markets referred. One of the motivations for using a MIR is the availability of more extensive remedies which, among other things, can include structural remedies (for example divestment of business and assets); monitoring remedies (such as a requirement to provide regular information); behavioural remedies which either restrict firms' behaviour, or require them to act a certain way; and recommendations for other Governmental departments or industrial bodies to take action.

Next Steps

Active fund managers should undertake an internal review of their prior practices with respect to pricing and charges passed on to investors and their communications with their competitors in light of these recent developments, and evaluate areas of their business where they are at risk of exposure to a competition law investigation or MIR. Asset managers should also consider their ongoing relationships and interactions with investment consultants in the light of the MIR and the possibility of CMA action affecting the provision of investment advisory services to institutional investors.

K&L Gates has significant experience in investigations regarding alleged competition law violations. Our K&L Gates team is well placed to discuss any risk or exposure your company may have and advise on ways to mitigate these risks. K&L Gates also has a market leading investment management practice giving us an unique insight into this industry.

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