FCA Asset Management Market Study – Final Report and Consultation

Seven months after the publication of its interim report, the FCA has now published its final report on its Asset Management Market Study (MS 15/2.3) (the "Final Report"). In addition to setting out the FCA’s responses to the main issues raised in the original terms of reference in November 2015, the Final Report also proposes further long-term action in relation to the asset management sector.

The majority of the specific proposals are currently expressed to apply to asset managers dealing with retail investors and/or retail funds. A number of other proposals relate specifically to issues identified within the pensions sector. With one significant exception relating to costs and charges disclosures (see the first item under Summary of Proposals below), the proposals are therefore not directly aimed at other types of asset managers, such as the private equity, credit or hedge fund industries. However, firms should be aware that the FCA’s increased focus on the asset management sector may result in additional future proposals with a broader scope which could also impact these sectors.

BACKGROUND

The Final Report represents the conclusion of the FCA’s Asset Management Market Study which was launched in November 2015. The FCA published an interim report on its findings in November 2016, setting out a series of initial suggestions and inviting further feedback from the industry.

We published a summary of the original terms of reference of the study in our 2016 New Year Briefing and a further briefing explaining key elements of the interim report in November 2016.

SUMMARY OF PROPOSALS

SINGLE TEMPLATE FOR COSTS AND CHARGES DISCLOSURES TO INSTITUTIONAL INVESTORS

This is the key proposal in the Final Report that relates to the asset management sector generally and therefore is not limited to authorised funds or the pensions sector. The FCA notes that while retail investors generally benefit from regulated standardised cost disclosures, institutional investors do not and may lack appropriate
information to enable them to scrutinise charges. In order to improve the disclosure of relevant information in this context, the FCA is proposing to convene a working group of stakeholders, including both industry and investor representatives, which will be chaired by an independent person. The working group will seek to develop a standardised disclosure template for asset managers, covering both mainstream and alternative asset classes. The FCA has emphasised, however, that the development of such a template is not intended to preclude institutional investors from requesting additional bespoke information, where appropriate.

It is clear that the development of such a template represents a significant technical challenge. These challenges are currently being faced by asset managers which are subject to the enhanced cost disclosure requirements under MiFID II. Firms may therefore wish to engage with their industry associations early in the process to ensure that they are appropriately represented on the FCA’s working group in due course. The FCA has not indicated a specific timeline for completing this work.

NEW REQUIREMENTS FOR RETAIL FUND MANAGERS

In conjunction with the publication of the Final Report, the FCA has also published a consultation paper (CP 17/18) setting out a number of proposed changes to the FCA’s Collective Investment Schemes (COLL) sourcebook, which will affect authorised fund managers (“AFMs”). AFMs are FCA authorised managers which manage funds that have also been authorised by the FCA (such as managers of UCITS funds or non-UCITS retail schemes). The consultation period ends on 28 September 2017. The relevant changes include:

- **Value for money assessment:** AFMs will be required to conduct a “value for money assessment” on at least an annual basis for each authorised fund they manage. This will consider whether charges paid from fund property are reasonable and whether investors are paying appropriate charges for the quality of services received. The AFM must publish the results of this assessment in a report to investors.

- **Senior management responsibility:** There will be a new prescribed responsibility under the Senior Managers and Certification Regime (“SMCR”) which must be allocated to the chair of the AFM’s board. This will require the chair to take reasonable steps to ensure that the AFM acts in the best interests of investors. The exact technical rules introducing this requirement will be included as part of the FCA’s consultation on the extension of the SMCR from banks and insurers to all firms authorised under the Financial Services and Markets Act 2000, which is expected to be published later this year. (It is possible that this requirement may be extended to the wider asset management sector, but this is not stated.)

- **Independent directors:** AFMs will be required to ensure that at least 25% of their board, with a minimum of at least 2 directors, consists of independent directors. The FCA is proposing specific eligibility criteria which would prevent individuals with recent connections to the AFM, its other group companies or third party portfolio managers to which it has delegated responsibility from being considered independent for these purposes.

- **Share class switching:** The FCA is proposing to amend its previous guidance in FG 14/4 on share class switching unresponsive investors and the circumstances in which an AFM may undertake a mandatory conversion of share classes.

- **Trail commission:** The FCA has asked the industry to provide additional information about the impact of stopping trail commission on share classes that pre-dated the Retail Distribution Review, but has not yet reached a firm decision.

- **Treatment of box profits:** The FCA is proposing new rules which would require the AFM to pass any “risk-free” box profits (i.e. those generated by netting off transactions at the same valuation point) back to the fund. However, AFMs will be able to retain “at risk” box profits generated from their own capital.

Separately, the FCA has also indicated in the Final Report that it is considering carrying out a further future consultation on AFM performance information and performance fees. Possible proposals include:
• requiring AFMs to present performance information by reference to the most ambitious target they have communicated to investors;

• where an AFM does not set a performance benchmark, prohibiting it from presenting past performance against a benchmark in any of the materials provided to investors or prospective investors; and

• introducing rules which would only permit performance fees where the fund exceeds the most ambitious performance target set by the AFM, or where it exceeds the fund’s most ambitious performance target after ongoing fees have been deducted.

The FCA notes, however, that it will need to consider the extent to which these proposals are compatible with requirements under EU law, particularly as regards disclosure requirements under the UCITS Directive and PRIIPs Regulation. AFMs should continue to monitor for a future consultation paper containing more concrete proposals on these issues.

MARKET STUDY OF INVESTMENT PLATFORMS

The FCA is proposing to undertake a market study of the investment fund platforms market to explore where retail investors are able to access investment products offering value for money. This will cover both “direct-to-consumer” and intermediated investment platforms and will assess competition within the market. The FCA has not yet specified a clear timescale within which the study will be carried out.

NO SINGLE “ALL-IN” FEE FOR RETAIL INVESTORS

In its interim report, the FCA had put forward the idea of requiring asset managers to disclose a single “all-in” fee to their clients in order to improve the visibility of charges. In the Final Report, the FCA has decided not to impose such a requirement for the time being. However, it has instead stated that it will monitor the impact of both the PRIIPs Regulation and MiFID II on retail client disclosures and will consider their effectiveness in due course. It is also continuing to test potential ways of improving the effectiveness of disclosures, such as introducing requirements for pounds and pence disclosures and requiring point-of-sale disclosures to be more consistent with ongoing disclosures to clients. Firms should continue to monitor for further developments in this area.

CLARIFICATION OF INVESTMENT FUND OBJECTIVES

The FCA considers that investors may benefit from greater clarity about funds’ investment objectives in order to facilitate easier comparisons between them. It is therefore proposing to chair a working group on this issue, which could ultimately lead to it publishing new rules or guidance on the use and publication of investment objectives. The working group may also consider whether investors require other information to allow them to understand returns from funds, such as environmental, social and governance metrics. The Final Report is not entirely clear on the scope of these proposals, although the context in which they are discussed suggests that the FCA may primarily have retail investors and authorised funds in mind.

PROPOSALS RELEVANT TO THE PENSIONS INDUSTRY

A number of proposals in the Final Report are relevant to pension funds and investment consultants. These include:

• the possibility of the FCA referring the investment consultancy market to the Competition and Markets Authority for investigation;

• a recommendation to HM Treasury to legislate to bring investment consultancy activities within the scope of UK financial services regulation; and
encouraging the Department of Work and Pensions to continue its work on pension scheme consolidation.

FOR FURTHER INFORMATION, PLEASE CONTACT

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