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Financial Conduct Authority
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Dear Ms Choudry,

FCA Asset Management Market Study Terms of Reference

This is the response of the Financial Services Consumer Panel to the FCA's Asset Management Study Terms of Reference (MS15/2.1).

Scope of the market study

The Panel supports the FCA's decision to include retail investors in the scope of the asset management market study, and to incorporate other components of the value chain. However, we think the FCA can go farther still: while the Financial Advice Market Review will report next year on the provision of financial advice, we believe this market study should also examine how competition works for consumers when they purchase an investment product through an intermediary, in particular how this might lead to better informed choices.

Financial advisers and institutional investment consultants

We would urge the FCA to look at the role of advisers, investment consultants and other guardians of the consumer interest (for example Independent Governance Committees for workplace pension schemes) in assessing performance and value for money and whether they are effective drivers of competition on behalf of consumers.

Given that a significant proportion of sales of investment products are intermediated, a crucial test of competition in this market is whether these intermediaries have the information and levers they need to hold asset managers to account for investment decisions and incurred costs.

Examination of the role played by investment consultants is also an important part of this work and we agree should remain within scope.

A handful of large investment consultants wield enormous influence over the asset management industry, to the detriment of competition. The FCA has also noted the issue of consultants advising pension schemes to use more expensive investment options (including active over passive) to justify their fees.

A survey conducted in 2014 by the then National Association of Pension Funds¹ uncovered significant concerns among its members over the advice given by investment consultants on fund choices and pre-retirement investment options.

¹ http://www.plsa.co.uk/PressCentre/Press_releases/0389-Schemes-satisfaction-with-investment-consultants-remains-steady.aspx

Comparing value for money

One of the factors the FCA will be considering is how investors choose between asset managers. The Panel is pleased that the FCA recognises that transaction costs, which are not currently visible to consumers or their intermediaries, could be an important factor.

The Panel's discussion paper² and research³ on investment costs, published in November 2014, highlighted the fact that the full costs incurred by consumers when making long-term investments are not consistently and comprehensively defined, nor understood. Consumers need to be aware of these charges in order to be able to compare and assess value for money across providers.

In this regard, the Panel would urge the FCA to ensure its definition of transaction costs is sufficiently comprehensive to cover as many "hidden" costs as it can. The methodology proposed in the recent consultation paper on Key Information Documents for retail investment products covered by the PRIIPs Regulation⁴ should provide a useful starting point.

Whilst the Panel supports information being disclosed to consumers, disclosure is only effective if firms provide information consumers can readily understand. Disclosure of costs and charges must be clear and consistent across all consumer communications.

In this regard, it is likely that insights from the FCA's behavioural economics team have an important role to play. New and improved disclosure requirements should be informed by how consumers make decisions in this market.

Given persistent cost opacity in the asset management industry, traditional price signals are largely missing so that a traditional approach to transparency of costs may not have a significant impact: if consumers do not make decisions based on price, more information about costs may not be the most effective way to drive competition. Conversely, if price signals are missing, asset managers may not face normal competitive incentives to control their costs as these can easily be passed on to customers.

Passive and active trackers

The Panel also welcomes the inclusion of 'closet' trackers within the scope of the study. The higher charges borne by investors in these funds often result in lower net returns than those produced by genuine trackers. Requiring firms to publish certain metrics, such as the fund's active share, would go some way to addressing this.

We encourage the FCA to examine how performance is measured (including the ability to obscure poor performance) and how this affects perceptions of value for money and the ability to compare products and make good choices.

Any insights which FCA research can provide into behavioural biases which may result in asset managers not being held to account - particularly in view of the long term nature of investments - would be valuable.

Cost control in asset management

A major issue identified by several studies is that cost control in asset management is extremely poor where costs are defrayed against the value of the fund, rather than billed

² https://www.fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf

³ <http://bit.ly/1k6i1u1>

⁴ <https://www.eba.europa.eu/-/esas-consult-on-priips-key-information-for-eu-retail-investors>

directly to investors or met by the asset management firm itself. This in turn reflects issues of inadequate oversight and governance.

Increased transparency of costs aimed at retail and institutional investors is part of a potential solution, but ultimately this sector needs a governance structure that can exercise effective control if asset managers fail to control costs in the interests of their clients.

We urge the FCA to look at whether any efficiencies resulting from purchasing ancillary and third party services which are related to scale and bundling are passed onto the consumer. Research conducted for the Panel suggests that economies of scale appear to be operating to the advantage of investment service providers rather than to investors.

We also welcome the FCA's intention to look at how charges vary for different types of investor, as retail investors have little bargaining power vis-à-vis their asset managers unlike institutional investors. This problem is, of course, further compounded by persistent cost opacity.

Innovation and technological advances

We would urge the FCA to make clear that it is interested specifically in innovation which directly or indirectly leads to consumer benefit by driving competition and reducing costs.

The Panel strongly supports the aims of this market study, and we will engage actively with the FCA to work towards structural solutions which will address problems of cost opacity which have beset this industry for decades.

Yours faithfully



Sue Lewis
Chair
Financial Services Consumer Panel