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Dear Becky,

This is the response of the Financial Services Consumer Panel (the Panel) to the Financial Conduct Authority's Asset Management Market Study, Interim Report.

As the Panel highlighted in its two 2014 research reports concerning investment costs and charges in retail investments[1] and again concerning transparency of costs and charges in pension schemes in 2015[2] major changes in this market have been needed for a very long time, to the detriment of its investors and savers.

The Panel would like to commend the FCA team on the thoroughness and depth of this interim report and for highlighting major deficiencies in an established market that has long denied any wrongdoing and resisted any change. In particular, we are pleased to see that, finally, the active v passive funds question has been robustly challenged with clear evidence to show that there is not necessarily a relationship between paying a high price for investment funds and receiving improved performance.

Some of the findings of the report and the proposed remedies are far reaching and will have a major impact on the asset management industry and its customers. We would like to encourage the FCA to hold firm to its view that this industry is not working in the best interests of consumers and to withstand the inevitable push back from the industry to 'water down' the remedies.

Our response focuses on the proposed remedies.

Remedy 1: a strengthened duty on asset managers to act in the best interests of investors

The Panel believes that the FCA should recommend that the Government introduces a statutory duty of care, covering all financial services providers. This would meet the FCA's objective in respect of asset managers, and also have wide ranging benefits for consumers in other sectors. The primary purpose of such a duty would be to operate as a preventative measure, in particular by requiring providers to consider and avoid conflicts of interest, thereby reducing the opportunity for, and concomitant risk of, consumer detriment. We regard this as far more desirable than increasingly complex rules, breach of which gives rise to remedies which can be uncertain and inadequate, frequently well after the event.

A statutory duty of care would differ from regulatory reforms in that it would ultimately give a wronged consumer a direct cause of action against a firm. Whilst we would expect such actions to be infrequent - the cost can be prohibitive in the absence of any appropriate tribunal between the Financial Ombudsman Service and the High Court - we believe that a statutory

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[1] Rajiv Jaitly, *Collective Investment Schemes Costs and Charges*, (2014) https://www.fs-cp.org.uk/sites/default/files/investment_jaitly_final_report_full_report.pdf;
David Pitt-Watson, et al., *Investment Costs: An Unknown Quantity* (2014) https://www.fs-cp.org.uk/sites/default/files/investment_david_pitt_watson_et_al_final_paper.pdf
[2] Dr Christopher Sier FRSA, *The Drive towards Cost Transparency in UK Pension Funds,* (2016) https://www.fs-cp.org.uk/sites/default/files/finalthe_drive_towards_cost_transparency_in_uk_pension_funds_2015_2016.pdf

duty of care has the additional benefits of improving firm culture in the widest sense and encouraging firms to direct their resources to "doing the right thing" rather than "avoiding doing the wrong thing". Over time a statutory duty of care might even give scope for a reduction in detailed rules.

In the interim report, the FCA proposes other remedies to encourage asset managers to act in the best interests of their clients. Whilst our preferred option would be the introduction of a statutory duty of care, we would support two other remedies alongside this.

First, extending the Senior Managers and Certification Regime to authorised fund manager (AFM) board members would be a relatively simple remedy that could have far reaching effects. Second, the creation of separate independent bodies along the lines of Independent Governance Committees, which is something we suggested in our November 2014 discussion paper.[3] The creation of IGC-type governance bodies would also introduce a requirement that senior managers consider value for money.

Remedy 2: Introducing an all-in fee so that investors in funds can easily see what is being taken from the fund

This was one of the recommendations in the research the Panel commissioned in November 2014. In the accompanying discussion paper we said:

"*Disclosure is only effective if those to whom the details are provided can understand and act on the information; overly complex disclosure to consumers would be counterproductive in many cases. In addition, disclosure alone would not immediately change the incentives for fund managers to control those costs that can be charged against the value of funds and are consequently hidden from the investor. One solution might be a single investment management charge; all other intermediation costs, charges and expenses incurred by the investment manager, including transaction costs, would be borne directly by the firm and reflected in the single charge. A 'softer' option would be to allow investment managers to quote the costs of buying and selling (entry and exit) separately.*

A single charge would require firms to price their services in such a way that they remain profitable yet competitive. The single charge regime would place investment managers at risk for the decisions they make and strengthen accountability – to the consumer and also to the firms that employ them. The reform could trigger a sea change in industry practices and remuneration structures. The Panel fully understands that such a radical proposal would require structural changes in the industry and would be likely to be challenged by investment firms. However we believe a single charge merits consideration because - as Jaitly points out - other options are not working".[4]

We commend the FCA for its forward thinking in this area. Whilst we can see the virtues of option C, the Panel favours option D out of the four options put forward – a single charge which includes all charges taken from the fund, with no option for overspend.

We favour this option because it places the onus on the investment manager to manage costs as well as investments. All good businesses from a multi-million pound asset management company to a local builder must manage costs otherwise they will not survive. The asset management industry has survived for too long hiding its costs from its customers in order to give the illusion of being competitive and charging similar prices for similar services. A single charge that requires the fund manager to make up any shortfall in costs from the profit and loss account would soon focus the minds as to how those costs can be reduced so as to keep the overall charge competitive. As we said in 2014 "*it would require firms to price their services in such a way that they remain profitable yet competitiv*e".

In its report, the FCA suggests that asset managers may respond to a single charge by increasing the charge to cover the increased risk that costs might be greater than the single charge and also that managers may decide to trade less than is in an investor's best interests.

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[3] Investment costs – more than meets the eye, FSCP Discussion Paper, November 2014 https://www.fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf

[4] FSCP Discussion Paper on investment costs and charges Nov 2014 https://www.fscp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf

These concerns are valid. However, in the case of 'padding' estimates, competition should soon ensure that charges level out as investors will be able to see exactly what they are paying and shop around for a better estimate.

On 'under-trading' we would say that, for the large majority of investors, a high portfolio turnover rate is not in their best interests in any event. The FCA's interim report is very clear that *"overall, our evidence suggests that actively managed investments do not outperform their benchmark after costs – while products available to pension schemes and other institutional investors achieve returns that are not significantly above the benchmark".* We cannot see any great advantage to the majority of investors of the current level of market activity so cannot see any great disadvantage in incentivising asset managers to trade less and more thoughtfully, mindful of the costs they are incurring.

Remedy 3: Measures to help retail investors identify which fund is right for them

Yes, of course asset managers should be clear about the objectives of the fund and report against them. We would note that retail investors often misinterpret the risk level of a particular fund purely because of its name. This can lead to an overestimation of risk[5].

We would therefore support any intervention by the FCA that requires managers to be clearer about the objectives of the fund. A tool that investors could use to identify persistent underperformance would be invaluable for both retail, and institutional, investors as well as a mechanism which would alert investors if an underperforming fund is merged into another. Mergers, or even a slight change to the name of the fund, can obscure the history of problematic funds. There should be a requirement on all funds to disclose how many funds have been merged into it and what the values of the original investments made into the fund were, so that fund performance is measured against the actual money that was originally received into the fund[6].

Remedy 5: Requiring clearer communication of fund charges and their impact at the point of sale and in ongoing communication to retail investors

Research has proved over and over again that consumers do not engage with financial information that is provided as a percentage, but prefer information presented in pounds and pence. Firms will be required to provide investors with an estimate of charges they may incur in pounds when the PRIIPs KID is introduced. It makes sense to extend this requirement to all retail investments.

The Panel believes that this should be straightforward for hard copy communications. For example: *"total charges will reduce your investment by £xxx for each £1,000 (or £10,000) invested.* For online communications a simple calculator could easily be provided where the investor enters their total investment and the total charge and reduced amount available for investment is presented alongside this.

Even though it may be necessary to present ongoing charges in percentage terms, this could also be converted to a simple pounds and pence illustration alongside the percentage. So, for example: *"Ongoing charges will be 1 per cent a year of the value of your investment. So next year if your investment was worth £xxx you would pay £xx in charges."* Annual statements could declare the current value of the investment at the start of the year, charges deducted (in pounds and pence) and current value at annual statement date. Again, a simple calculator which clearly showed the charges against the investment value could be provided online.

The Panel recommends that the FCA prescribes the format of the communications so that all providers display the information to investors in the same format. Standardisation of data is the only way to ensure comparisons can be easily made. This will make it simpler for investors to compare charges against other providers and assess whether they are getting value for money. The exact format and presentation will need extensive consumer testing before finalising, but the research used in the development of both the PRIIPs KID and the IDD's Product Information Document could be used as a starting point.

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[5] Assessing online investment and advice services, Boring Money, Dec 2016

[6] Rajiv Jaitly, *Collective Investment Schemes Costs and Charges*, (2014), 124-125, https://www.fs-cp.org.uk/sites/default/files/investment_jaitly_final_report_full_report.pdf

Remedy 6: Requiring increased transparency and standardisation of costs and charges information for institutional investors

As FCA and DWP research on transparency of costs and charges in pension schemes has shown, institutional investors often have no more view of the total costs and charges in their investments than do retail investors.

The FCA is aware of the work the Investment Association is conducting to develop a template for the disclosure of all implicit and explicit costs and charges. We understand the template being developed is the same as that being adopted by the Local Government Pension Scheme (LGPS). The LGPS will be introducing a requirement on its local pension funds to only use asset managers that provide disclosure of costs and charges via the template and it would therefore make sense if this requirement was extended for all institutional investors.

The FCA should clearly set out its expectations on the scope and content of the standardised template and should work closely with the industry in its development. We also believe the FCA should make it a regulatory requirement to provide this information. We know that self-regulation will lead to non-compliance or the provision of less useful information.

The Panel believes that private equity strategies and hedge funds should be included within the scope of the disclosure template.

Remedy 7: Measures to improve the usefulness and comparability of performance information used by trustees.

The focus on past performance by institutional investors is, at one level, perfectly rational. In the absence of certainty about the future the past can be seen as an indicator of success or failure. However the study makes clear in 1.35 that, *"past performance is not a good indicator of future risk adjusted returns".*

The study also points to the lack of profile for passive funds. So a Trustee may be overly seduced by past performance, reputation and the prejudice for active management despite the extra costs.

The best way to assist the institutional investor is through better presentation of costs and charges, which have a predictable impact on a fund.

Remedy 8: Exploring the potential benefits of greater pooling of pension scheme assets

The most quoted reason to pool assets is to secure better terms from asset managers. Scale does appear to matter and if all other things are equal costs and charges are likely to be lower in larger funds. Evidence from Australia is often cited.

However, does pooling assets also mean pooling governance or is it simply co-mingling assets without impacting liabilities or other decisions? Pooling assets is primarily the way the local government system is being consolidated through collective investment vehicles at a regional level. Small schemes may not have the oversight capacity that is required for effective management of both asset allocation and asset manager choice. This requires a consideration of governance which goes further than simply asset pooling.

To achieve this, the FCA and TPR should provide evidence on net returns by pension fund size. It is important to determine where the cost savings may be and to what they are attributable, and whether they are equally spread across all asset classes. There also remains the question, if the evidence is compelling, whether Trustees should be mandated to merge or nudged to merge. Again looking to Australia suggests that compulsion may be required where a pension fund is producing poor returns.

Remedy 10: Consultation on whether to make a market investigation reference (MIR) to the CMA on the institutional advice market and bring the provision of this advice within the FCA's regulatory perimeter.

This is a sticky market with a high level of concentration and considerable questions about conflicts of interest. There is little evidence of performance assessment of investment consultants, or indeed the data to make that possible.

The Study raises serious concerns about conflicts of interest in fiduciary management and the acceptance of gifts and hospitality.

Section 8.46 is an alarming indictment of the work of investment consultants. They affect decision making but their recommendations do not create better investor returns. This is re-emphasised in section 8.61 of the study.

Section 8.92 on gifts and hospitality notes a correlation between ratings and gifts and hospitality but stops short of asserting causation.

The FCA has made a provisional decision to make a market investigation reference in the provision of investment advisory services, which we support.

We concur with the conclusions in section 3.2 of the features of the sector. The demand side is weak, the ability to assess the quality of advice is non-existent, the market is concentrated in three large firms, barriers to entry are high and the vertically integrated business model poses risk.

The FCA has not determined the remedies that the CMA could impose but in section 4.23 of the provisional decision it identifies some options. With regard to periodic reviews of contracts with investment consultants it would be possible to prohibit re-appointments beyond a defined time period.

We also welcome the proposal to HMT that the provision of advice be taken within the FCA regulatory ambit. The monitoring of the sector would be a positive outcome but the FCA itself admits that in itself this will be insufficient.

Yours sincerely

Sue Lewis
Chair, Financial Services Consumer Panel