

# Asset management market study Terms of Reference

November 2015



If you wish to make any submissions on the topics raised in these terms of reference, please do so by 18 December 2015

You can send them to:

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# Contents

Abbreviations used in this paper	2
<b>1</b> Executive summary	5
<b>2</b> Introduction	8
<b>3</b> Overview of the asset management sector	12
<b>4</b> Topics to be explored	21
<b>5</b> Scope of the market study	35
<b>6</b> Regulatory landscape	40

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## Abbreviations used in this paper

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<b>AIFMs</b>	Alternative Investment Fund Managers
<b>AIFMD</b>	Alternative Investment Fund Managers Directive
<b>AMC</b>	Annual Management Charge
<b>AUA</b>	Assets under Administration
<b>AUM</b>	Assets under Management
<b>AUTs</b>	Authorised Unit Trusts
<b>B2B</b>	Business to Business
<b>CIS</b>	Collective Investment Scheme
<b>CMA</b>	Competition and Markets Authority
<b>COBS</b>	Conduct of Business sourcebook
<b>D2C</b>	Direct to Consumer
<b>DC</b>	Defined Contribution Pension Schemes
<b>DWP</b>	Department for Work and Pensions
<b>EA02</b>	Enterprise Act 2002
<b>EBC</b>	Employee Benefits Consultant
<b>ESMA</b>	European Securities and Markets Authority
<b>ETFs</b>	Exchange Traded Funds
<b>FAMR</b>	Financial Advice Market Review
<b>FCA</b>	Financial Conduct Authority
<b>FEMR</b>	Fair and Effective Markets Review

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<b>FPC</b>	Financial Policy Committee
<b>FSB</b>	Financial Stability Board
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>FTSE</b>	Financial Times Stock Exchange
<b>GDP</b>	Gross Domestic Product
<b>G-SIFIs</b>	Global systemically important financial institutions
<b>IA</b>	The Investment Association
<b>IFA</b>	Independent Financial Adviser
<b>IMA</b>	Investment Management Association
<b>IOSCO</b>	International Organization of Securities Commissions
<b>LDI</b>	Liability Driven Investment
<b>MiFID II</b>	Markets in Financial Instruments Directive II
<b>MIR</b>	Market investigation reference
<b>NAPF</b>	National Association of Pension Funds
<b>NBNI</b>	Non-bank non-insurer
<b>OCF</b>	Ongoing Charges Figure
<b>OEIC</b>	Open Ended Investment Companies
<b>OFT</b>	Office of Fair Trading
<b>PRIIPs</b>	Packaged Retail and Insurance-based Investment Products
<b>RDR</b>	Retail Distribution Review
<b>UCITS</b>	Undertakings for the Collective Investment in Transferrable Securities

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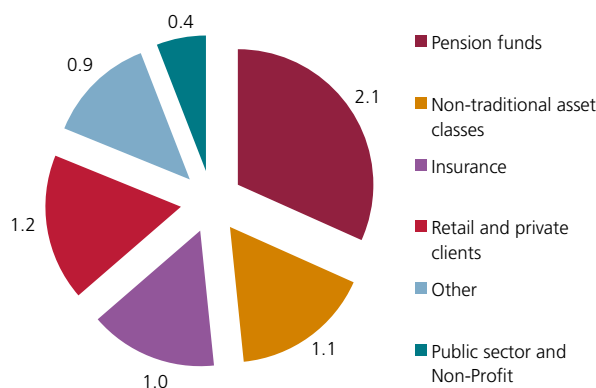


# 1.

## Executive summary

- 1.1** There are around £6.6 trillion<sup>1</sup> of assets under management in the UK, including around £2.1 trillion of pension fund investments, £1.2 trillion in retail investment products and £0.4 trillion in public sector and charity investments. There is a further £1 trillion investment in insurance products and £1 trillion invested in non-mainstream asset management products – both of which include pension fund investments.

**Figure 1 - UK Funds under management (£trillion) as at end 2014<sup>2</sup>**



- 1.2** Asset managers provide a vital economic function in bringing together those with money to invest (with the aim of achieving growth or future income) and companies and governments who need capital for investment, expansion or funding their ongoing operations.
- 1.3** Given the significant size of the asset management sector, and the direct impact it has upon consumers either directly through their retail investments or through their pension funds, or indirectly through insurance premiums, it is essential that competition works effectively for these services.
- 1.4** We announced our intention to undertake a market study into asset management in the 2015/16 business plan<sup>3</sup>, following feedback received as part of the wholesale sector competition review<sup>4</sup>, which raised a number of questions about the asset management value chain. These included:
- whether investors find it difficult to monitor asset managers and ensure they are getting value for money

<sup>1</sup> *Asset Management in the UK 2014-2015*, The Investment Association Annual Survey, September 2015

<sup>2</sup> *Asset Management in the UK 2014-2015*, The Investment Association Annual Survey, September 2015

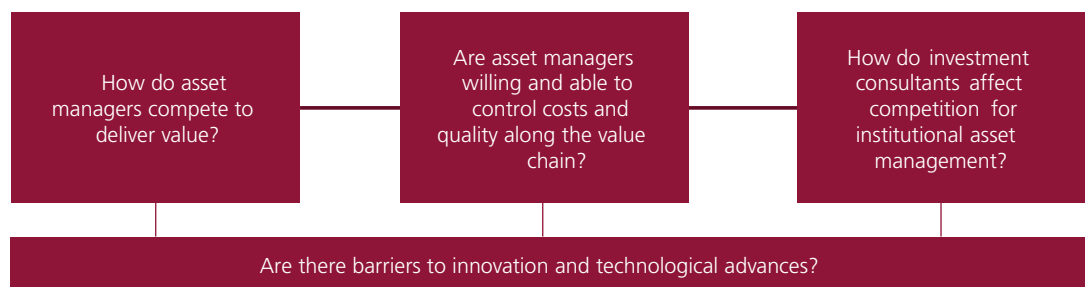
<sup>3</sup> *FCA Business Plan 2015/2016* at page 44: <http://www.fca.org.uk/static/documents/corporate/business-plan-2015-16.pdf>

<sup>4</sup> *FCA FS 15/2 Wholesale Sector Competition Review 2014-15* at page 27

- the role of investment consultants and whether potential conflicts of interest arise from the provision of both advice and asset management services
  - whether asset managers have the incentive and ability to effectively control costs incurred on behalf of investors along the asset management value chain
- 1.5** Whilst these questions arose from the wholesale sector competition review, a number of them are relevant to retail investors as well. The aim of the study will be to understand whether competition is working effectively to enable both institutional and retail investors to get value for money when purchasing asset management services.
- 1.6** There are a number of recent and forthcoming regulatory initiatives in the asset management sector and we will take into account how these have affected or are likely to affect how competition works for these services. We consider that the time is right to examine the questions outlined here as this sector has not been previously studied from a competition perspective. We do not expect that the regulatory work in relation to asset management will explore all of the competition questions that we have identified.
- 1.7** These Terms of Reference explain the scope of the market study, and the types of issues that we will explore.

### Topics we will be covering

- 1.8** Based on our current understanding of how the asset management sector works, we have identified three main areas to explore as part of the market study. Throughout our analysis we will also be considering whether there are any barriers to innovation that prevent investors from getting better outcomes, for example, as a result of regulatory requirements.



- 1.9** The themes we have identified here are starting points, not conclusions, and we will explore them further during the course of the market study. We would expect to narrow the focus of our market study as we proceed, depending on the evidence we gather.

### Next steps

- 1.10** This document marks the launch of our market study. Throughout our study we are keen to hear from all market participants about their experiences. We are not formally consulting on these Terms of Reference, but welcome any comments on the issues raised in this document, or others that we should be including, by 18 December 2015. To hear views, we will also host



a number of roundtables and bilateral meetings with stakeholders. We will also shortly be approaching market participants for information and data to assess the issues we have set out above.

- 1.11** We are conducting this market study under our FSMA powers. We aim to publish an interim report in summer 2016, setting out our analysis and preliminary conclusions and, where practicable and appropriate, possible remedies to address any concerns identified and our final report in early 2017.
- 1.12** If competition is not working well, we may intervene to promote effective competition. We can do this through rule-making, introducing firm-specific remedies or enforcement action, publishing general guidance or proposing enhanced industry self-regulation. We could propose the removal of existing rules that create barriers to entry or innovation which are not justified. We could also refer one or more issues to the Competition and Markets Authority (CMA) for further investigation – this is known as a market investigation reference (MIR). Where necessary, we could work to influence the debate at the European and/or global level.
- 1.13** We may also decide to take no further action. This could be because we do not identify any concerns that need addressing or we consider that any concerns we identify are likely to be addressed by upcoming legislative measures or action by the relevant firms. In such cases, we may continue to monitor the market in case our concerns are not addressed.

## 2. Introduction

Asset managers provide a vital economic function and the asset management sector has a significant impact on consumers both directly through their retail investments and pension funds and indirectly, through insurance premiums.

We are looking into asset management and related services as we have concerns that competition may not be as effective as it could be in some areas and we consider that the benefits of any improvements in competition could be significant.

The focus of this market study will be understanding whether competition is working effectively to allow both institutional and retail investors to get value for money when purchasing asset management services.

There is a significant amount of current and forthcoming regulatory activity that affects the asset management sector. While it may touch upon some of the competition issues identified in this sector, the focus of this other work has not been on competition. We consider there are areas of the asset management sector that have not been analysed previously from a competition perspective and would benefit from investigation in this study. Where it is relevant we intend to fully factor in wider policy reforms.

### Why are we looking into asset management?

- 2.1** We announced our intention to undertake a market study into asset management in the 2015/16 business plan.<sup>5</sup> This decision followed feedback from the wholesale sector competition review, which identified a number of areas within the asset management value chain where competition may not be working effectively.<sup>6</sup>
- 2.2** We have identified a number of potential areas for consideration, based on the feedback received in relation to institutional asset management. We also believe that retail customers are likely to be affected by the competition issues raised.
- 2.3** Given the size of the market and the long-term nature of investments, even a small improvement in the effectiveness of competition could be of substantial benefit for investors. For example, with over £6.6 trillion assets under management,<sup>7</sup> an improvement in competition that reduced total charges paid by investors by a small amount could have a large impact on investors' net

<sup>5</sup> FCA Business Plan 2015/2016 at page 44.

<sup>6</sup> FCA FS 15/2 Wholesale Sector Competition Review 2014/15 at page 27

<sup>7</sup> Asset Management in the UK 2014-2015, The Investment Association Annual Survey, September 2015.

returns. The chart below shows the impact that charges have on £20,000 invested for 20 years – a 1.5% charge as opposed to a 0.3% charge with 6% growth would cost the investor £12,789 more over the 20-year period.

**Figure 2: Fund value over 20 years assuming 6% growth and average active and passive charges**



- 2.4** There have been a number of regulatory initiatives over recent years to address concerns identified along the asset management value chain (see section 6). Some of these initiatives are ongoing, and some are yet to come in. Previous regulatory work in this sector has not set out to understand the structural features of the sector and the effect this has on the incentives of asset managers, or focused on understanding the investor journey – both of which will be key elements of our study. However, any issues and potential solutions that we identify will be set within the context of the work being done elsewhere.
- 2.5** The recent work has often focused on distribution, transparency and disclosure, and on asset managers' interaction with capital markets. Improved transparency and disclosure can be important in driving more effective competition but, in isolation, these initiatives may not sufficiently address any issues. For example, transparency and disclosure initiatives can enable investors to make better decisions, but the effectiveness will depend on the quality of the information provided and investors' ability to use it.

#### **How would consumers benefit from effective competition in asset management?**

- 2.6** The benefits to consumers of more effective competition typically include lower prices, better quality products and services, useful innovation and genuine choice.

- 2.7** We consider that a wide range of end investors with pension funds, long term savings and retail investments could benefit from improvements in competition in this sector:
- 14.2 million pension savers could benefit from improvements in competition for institutional investors<sup>8</sup>
  - 11 million retail investors could benefit from improvements in competition at the retail level<sup>9</sup>
- 2.8** Improvements in competition that enable greater innovation by providers could result in better quality products, genuinely new product offerings which better meet investor needs and better value products, as providers become more efficient in serving investors. An example of this is where providers develop innovative new distribution methods that make it easier for investors to purchase services and/or monitor or switch services. A competitive UK market also brings benefits to industry. For example, good consumer outcomes could lead to greater inflows into UK asset management and support international competitiveness.
- 2.9** We want to understand how competition works for these services and, as part of this study, we will also consider whether there are any barriers to innovation that could otherwise improve outcomes for consumers.

### The scope of the market study

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- 2.10** We set out the questions that we are seeking to answer in the market study in section 4, and the products and providers within the scope of the study in section 5 of this document. The focus of the market study is on asset management products and services. However, to understand how competition is working for these services, we consider it necessary to understand aspects of both distribution and advice, and ancillary products purchased by asset managers. Some products and services (such as those supplied by ancillary service providers and platform providers) will be partially in scope, as we are looking into these areas to understand how they affect the way competition works for asset management services. However, we do not intend to carry out an in-depth analysis into competition within these areas. If we find that problems in these areas are driving poor outcomes for investors we may consider undertaking further work outside this study.
- 2.11** As we progress with the market study, we intend to prioritise issues and narrow the scope of the review to the issues where there is greatest likelihood of competition problems affecting end investors. We anticipate our interim report will set out the areas where no further action is needed as well as identifying any issues we will seek to remedy.

### Powers and procedures we will use to conduct the market study

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- 2.12** As noted in our market study guidance,<sup>10</sup> we may carry out market studies either under our powers under FSMA or under our concurrent competition law functions (and the provisions of the Enterprise Act (EA02)). We have a broad choice regarding which procedure to follow, and

<sup>8</sup> *DWP Family Resources Survey, United Kingdom 2013/14*, June 2015 at page 63.

<sup>9</sup> *FCA (2013) Consumer Spotlight* [www.fca-consumer-spotlight.org.uk/consumer-spotlight](http://www.fca-consumer-spotlight.org.uk/consumer-spotlight)

<sup>10</sup> *FG15/09 Market studies and market investigation references: A guide to the FCA's powers and procedures* (July 2015) [www.fca.org.uk/static/documents/finalised-guidance/fg15-09.pdf](http://www.fca.org.uk/static/documents/finalised-guidance/fg15-09.pdf)

decide on a case by case basis. We are also able to switch between our FSMA and/or EA02 powers when conducting market studies, if this is necessary.

- 2.13** We have decided to conduct this market study using our FSMA powers. We intend to use our FSMA powers to gather information in relation to regulated activities and the related unregulated activities that are carried out by authorised persons. We may also ask for information from organisations and individuals that we do not regulate, although we note that answering such requests will be on a voluntary basis.
- 2.14** Our procedures for market studies are set out in our market study guidance but can be summarised as follows.
- 2.15** We will shortly begin gathering information from stakeholders. This will include data, information and/or views from asset managers, platforms and investment consultants, and their customers/clients. We will also host a number of roundtable and/or bilateral meetings with stakeholders to hear their views on the topics set out in this document. Stakeholders can also use these sessions to raise other issues for discussion.
- 2.16** We aim to publish an interim report setting out our analysis, preliminary conclusions and, where practicable and appropriate, proposed solutions to address any concerns identified, in summer 2016. This will provide stakeholders with an opportunity to comment prior to publishing our final report in early 2017.
- 2.17** As set out in our market study guidance, if we conclude that competition is not working well and there is a need to take action, we may intervene to promote effective competition using a number of possible measures including:
- market wide remedies, such as
    - rule-making, including changing or potentially withdrawing existing rules
    - publishing general guidance
    - proposing enhanced industry self-regulation.
  - firm-specific remedies, this includes using own initiative variation powers or own initiative requirement powers, cancelling permissions, public censure, imposing financial penalties, as well as filing for injunction orders or restitution orders. Where we identify potential infringements of other laws, such as competition law, and we may open an investigation accordingly, or refer the matter to other enforcement agencies.
  - making a market investigation reference to the Competition and Markets Authority (CMA)
- 2.18** Alternatively, we may decide to take no further action for the time being. This could be because any issues we may identify are likely to be satisfied by upcoming legislative measures, action by the relevant firms or other circumstances. We may continue to monitor the market in case our concerns are not addressed.

## 3.

# Overview of the asset management sector

It is estimated that £6.6 trillion of assets are managed in the UK. Of this, around 80% are managed on behalf of institutional investors (including pension funds) and around 20% on behalf of retail investors.

The majority of assets are under active management, with less than 22% of assets invested passively, however this has been growing.

The ten largest asset management firms operating in the UK account for around 55% of total assets under management.

The asset management value chain is heavily intermediated. Retail investors are increasingly using platforms to access services. Pension funds, which represent £2.1 trillion or 38% of AUM, are often required by law to take advice from investment consultants on product and manager selection.

### Background

- 3.1** In this section we provide some detail about the asset management value chain and the participants within it, in order to provide context for the market study.
- 3.2** Asset managers (also commonly referred to as investment managers) provide an important economic function in bringing together those with money to invest who seek growth or future income, with governments and companies who need that capital. In addition, asset managers act as the representatives of capital owners and, in this role, can provide oversight and stewardship of the investments they make.
- 3.3** Asset managers are agents who perform investment management services on behalf of others. This consists of two activities:
- making investment decisions on behalf of others
  - operating the investment schemes which pool investors' assets and place them under the control of investment decision makers
- 3.4** In terms of assets under management, the UK asset management industry is the largest in Europe and second only to the US globally – the Investment Association (IA) estimates that the UK industry manages around £6.6 trillion of assets.<sup>11</sup>

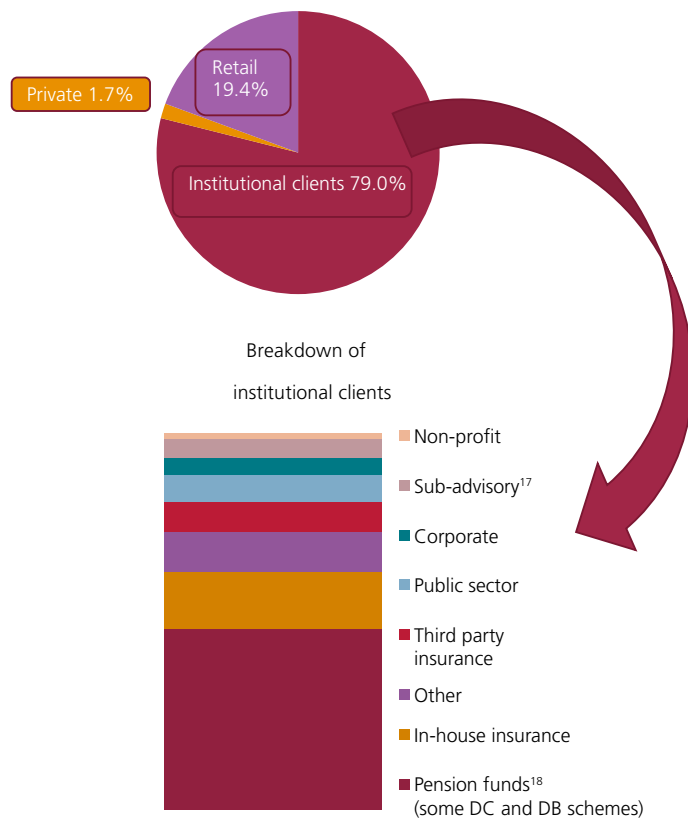
<sup>11</sup> *Asset Management in the UK 2014–2015*, The Investment Association Annual Survey (September 2015) [www.theinvestmentassociation.org/assets/files/research/2015/20150914-ams2014-2015-fullsurvey.pdf](http://www.theinvestmentassociation.org/assets/files/research/2015/20150914-ams2014-2015-fullsurvey.pdf)

**3.5** The IA estimates that nearly 40% of assets managed in the UK are for overseas clients, which makes investment management a successful export.<sup>12</sup> The asset management sector is a significant contributor to the UK economy both in terms of employment and tax revenue. In 2013 the UK asset management industry earned around £15 billion in revenue and generated about 1% of UK GDP.<sup>13</sup>

**Clients/investors**

**3.6** As illustrated in the chart below, institutional investors are the largest client type, accounting for nearly 80% of the asset management client base (by assets under management) compared to retail investors who account for less than 20%.<sup>14</sup> Pension funds are the largest single institutional client type with £2.1 trillion of assets under management.<sup>15</sup> The distinction between client types is important as the behaviours, relationships and governance may be different for institutional and retail investors (or within those client types). Institutional investors are more likely to have segregated mandates (where the client has an individual investment portfolio) at least for part of their portfolio, and retail are more likely to have pooled investments.

**Figure 3: Assets managed in the UK by client type as at end 2014<sup>16</sup>**



12 *Asset Management in the UK 2013–2014*, A summary of the IMA Annual Survey (September 2014) [www.theinvestmentassociation.org/assets/files/research/2014/20140909-IMA2013-2014-AMS-Summary.PDF](http://www.theinvestmentassociation.org/assets/files/research/2014/20140909-IMA2013-2014-AMS-Summary.PDF)

13 *Asset Management in the UK 2013–2014*, A summary of the IMA Annual Survey (September 2014) [www.theinvestmentassociation.org/assets/files/research/2014/20140909-IMA2013-2014-AMS-Summary.PDF](http://www.theinvestmentassociation.org/assets/files/research/2014/20140909-IMA2013-2014-AMS-Summary.PDF)

14 *Asset Management in the UK 2014 – 2015*, The Investment Association Annual Survey (September 2015)

15 *Asset Management in the UK 2014–2015*, The Investment Association Annual Survey (September 2015) [www.theinvestmentassociation.org/assets/files/research/2015/20150914-ams2014-2015-fullsurvey.pdf](http://www.theinvestmentassociation.org/assets/files/research/2015/20150914-ams2014-2015-fullsurvey.pdf)  
This figure includes defined benefit (DB) and some defined contribution (DC) schemes, DC pension assets that are operated via an intermediary platform are reflected in the insurance client data.

16 *Asset Management in the UK 2014–2015*, The Investment Association Annual Survey (September 2015) based on IA member firms

17 Investment management services offered to third party fund products- this may include 'white labelled' funds or manager of manager products.

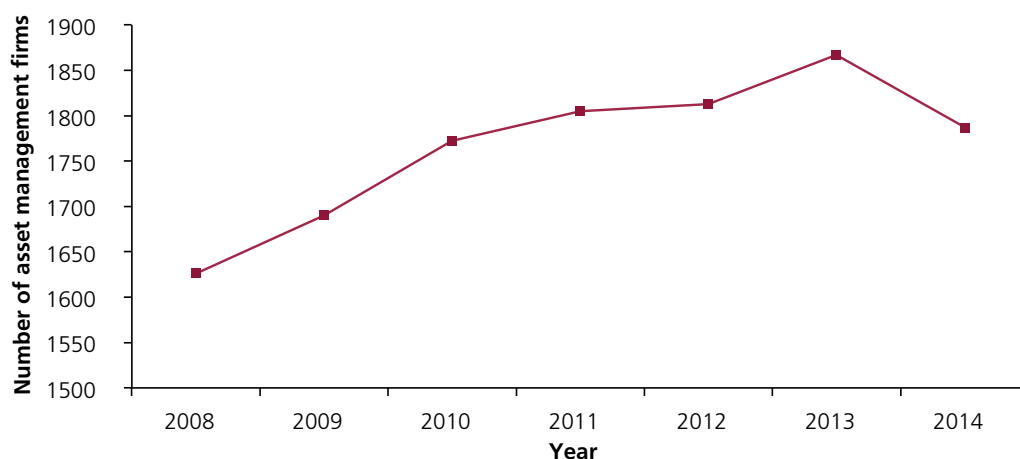
18 The NAPF annual survey 2014 of its fund members revealed that active membership of DC schemes now outnumbers that of DB schemes for the first time.

- 3.7** The distinction between retail and institutional investors is not straightforward. Even though they are labelled as institutional (including in the chart above), the end-beneficiaries of many institutional investments are often retail investors and the shift from defined benefit pension schemes to defined contribution schemes has contributed to this.<sup>19</sup> Defined benefit schemes are pooled investment vehicles where the investment decision-making and much of the risk is removed from the retail investor. For defined contribution schemes, the risk, reward and choice of fund sit firmly with the retail consumer. This means that changes in the institutional market could have a direct impact on the retail consumer.

#### Asset management firms

- 3.8** The number of asset managers has increased over recent years (although the number has dropped between 2013 and 2014, and we would like to understand the reasons for this). The number of firms now stands at 1,787, a 10% increase since 2008. Over the same period, the UK assets under management for mainstream asset managers increased by 83% from to £3 trillion to £5.5 trillion,<sup>20</sup> which is likely due to both new money flow and market movements.

**Figure 4: Number of asset management firms with positive AUM**



Source - FCA Data based on Firm reporting up to June 2015.

- 3.9** The asset management industry does not appear particularly concentrated,<sup>21</sup> with the top ten asset managers accounting for around 55% of the assets under management.<sup>22</sup>
- 3.10** However, it is possible that parts of the sector may still have areas of higher concentration. One area highlighted in the wholesale sector competition review Feedback Statement related to Liability Driven Investment (LDI) mandates<sup>23</sup>, where it was suggested that the top three managers represented 90% of the UK market for LDIs based on notional value.<sup>24</sup>

<sup>19</sup> NAPF Annual Survey 2014 revealed that active membership of DC schemes now outnumbers that of DB schemes for the first time: [www.napf.co.uk/PolicyandResearch/Research/Annual-Survey.aspx](http://www.napf.co.uk/PolicyandResearch/Research/Annual-Survey.aspx)

<sup>20</sup> *The Investment Management Association Asset Management in the UK 2008, The IMA's Seventh Annual Survey and Asset Management in the UK 2014 – 2015*, The Investment Association Annual Survey (September 2015).

<sup>21</sup> The IA cite a Herfindahl-Hirschmann Index of 420 at manager level, based on funds under management, as indicative of a 'highly competitive environment', see *Asset Management in the UK 2013 – 2014 The Investment Association Annual Survey* (September 2014). The Herfindahl-Hirschman Index (HHI) calculates the sum of the squares of the market shares of all firms in the market, in order to obtain an overall figure that indicates the level of concentration in a market, accounting for the relative size of the firms.

<sup>22</sup> As of June 2014, *Asset Management in the UK 2014 – 2015*, The Investment Association Annual Survey (September 2015)

<sup>23</sup> A liability driven investment is a mandate where the investment strategy is based on the requirement for cash flow to meet both current and future liabilities as they fall due (this requires that the future cash flows can be predicted). It is commonly used to describe a range of investment strategies designed for situations where future liabilities can be predicted.

<sup>24</sup> FCA FS15/2 *Wholesale Sector Competition Review 2014-15* at page 28 [www.fca.org.uk/news/wholesale-sector-competition-review](http://www.fca.org.uk/news/wholesale-sector-competition-review)



- 3.11** Asset management firms can range from small companies with fewer than ten employees to huge international companies employing thousands. They can take many different legal forms from partnership structures to limited or unlimited companies. Some firms offer asset management services in isolation, whereas others are vertically integrated and offer other services such as investment consulting, platforms, access to other asset managers (e.g. through a multi-manager fund) or offer a greater variety of products, such as insurance products or pensions administration services.
- 3.12** Most asset managers act only in an agency capacity for their clients, with investment risk borne by the investors.<sup>25</sup> Managers often cross trade between funds or segregated mandates and clients in order to reduce transaction costs.
- 3.13** Firms may specialise in certain asset classes (such as equities or property), investment strategies (active asset management or passive products) or by the types of investor clients they cater to (such as retail clients or institutional clients).
- 3.14** As noted, many of the assets managed in the UK are for overseas clients. Some of these are managed for pooled funds domiciled overseas. The City UK estimates that £775 billion of UK managed assets were for overseas pooled funds at the end of 2013, around three-quarters of which were for funds domiciled in Luxembourg and Dublin.<sup>26</sup>
- 3.15** According to Lipper there were over 35,000 European funds at the end of 2013.<sup>27</sup> Of those, over 7,000 were available to buy in the UK (of which 3,500 were equity funds). The UK is the fifth largest centre in Europe in terms of fund domicile<sup>28</sup> with 11.6% of European investment funds domiciled in the UK. The largest centre is Luxembourg where over 27% of funds are domiciled, followed by Ireland (15%), France (14%) and Germany (14%). Our internal analysis (based on IA data) suggests that offshore funds have been increasing their share of UK retail investor money, from 4% in 2007 to 9% by September 2015.
- 3.16** As illustrated in figure 7, equities are the most popular asset class in terms of number of funds across all fund domiciles. However, Ireland and Luxembourg have a greater proportion of fixed income funds compared to the UK. Research suggests that if managers could choose a different domicile when starting afresh, they would look at regulatory conditions, legal and tax framework, and non-regulatory and non-tax business conditions (such as speed to market and investors' perceptions of a domicile).<sup>29</sup>

### Products and investments

- 3.17** There are two broad categories of investment:
- pooled funds (where client money is aggregated together and invested as one portfolio)
  - segregated mandates (where the client has an individual investment portfolio)
- 3.18** Currently there are slightly more assets managed in segregated mandates in the UK, based on AUM (54% compared to 46% in pooled investment funds).<sup>30</sup>

<sup>25</sup> Although the asset management firm's revenue is reliant on the retention of clients and their investment linked fees

<sup>26</sup> *UK Fund Management 2014, An attractive proposition for international funds* (September 2014), TheCityUK, [www.thecityuk.com/research/our-work/reports-list/uk-fund-management-2014/](http://www.thecityuk.com/research/our-work/reports-list/uk-fund-management-2014/)

<sup>27</sup> FCA FS15/2 Wholesale sector competition review 2014-15 at page 27, [www.fca.org.uk/news/wholesale-sector-competition-review](http://www.fca.org.uk/news/wholesale-sector-competition-review).

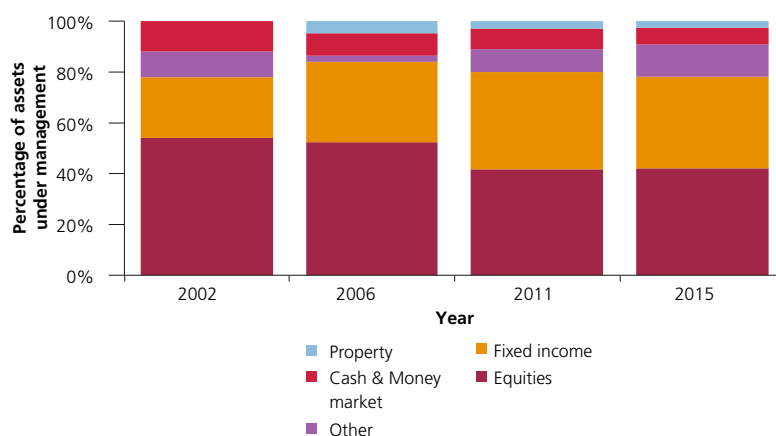
<sup>28</sup> *Asset Management in the UK 2014-2015, The Investment Association Annual Survey* (September 2015).

<sup>29</sup> *Choosing a European fund domicile: The views of global asset managers*, A survey conducted by the Economist Intelligence Unit on behalf of Matheson (March 2014) [www.economistinsights.com/financial-services/analysis/choosing-european-fund-domicile/fullreport](http://www.economistinsights.com/financial-services/analysis/choosing-european-fund-domicile/fullreport)

<sup>30</sup> *Asset Management in the UK 2014-2015, The Investment Association Annual Survey* (September 2015). This split is based on IA member firms only and so reflects more mainstream firms and assets.

- 3.19** Pooled funds can be set up using a variety of forms, including as a company (e.g. Open-ended Investment Company (OEICs)), a trust (e.g. Authorised Unit Trust (AUTs)), a partnership or a charity.<sup>31</sup> In the UK, pooled funds can be managed within a number of regulatory structures – for example, they may be set up as Undertakings for the Collective Investment in Transferrable Securities (UCITS) funds (i.e. funds that are intended for the retail market and comply with the requirements of the UCITS Directive. Not all pooled funds are FCA-authorized – there are also unauthorised pooled investments such as investment trusts. Some pooled funds are subject to the Alternative Investment Fund Manager Directive (AIFMD) which focuses on regulating the fund manager rather than the fund itself.
- 3.20** UK authorised funds are one of the main delivery vehicles for the UK retail market although other vehicles are also used (e.g. life funds and unauthorised investment vehicles).

**Figure 5: Summary of assets under management in the UK (IA data)<sup>32</sup>**



- 3.21** Asset management mandates and pooled funds can be restricted to specific asset classes or subsets thereof (e.g. UK smaller companies) or they can be wider (e.g. multi-asset) allowing the manager more discretion to switch between assets. The chart above illustrates that, although equity remains the largest investment asset class, accounting for 42% of investment by UK asset managers, investors have significantly reduced their equity exposure since 2002. The trend for ‘de-equitisation’ is driven by differing reasons, including market factors, changing demographics, and changes in accounting and regulatory rules.<sup>33</sup>
- 3.22** Another type of investment offering is the ‘fund of funds’ or multi-manager fund. In these funds, the asset manager will select underlying funds or managers (either in-house or third party) and allocate money to be managed by them.

<sup>31</sup> Other legal structures are available in foreign jurisdictions such as the French Fonds commun de placement.

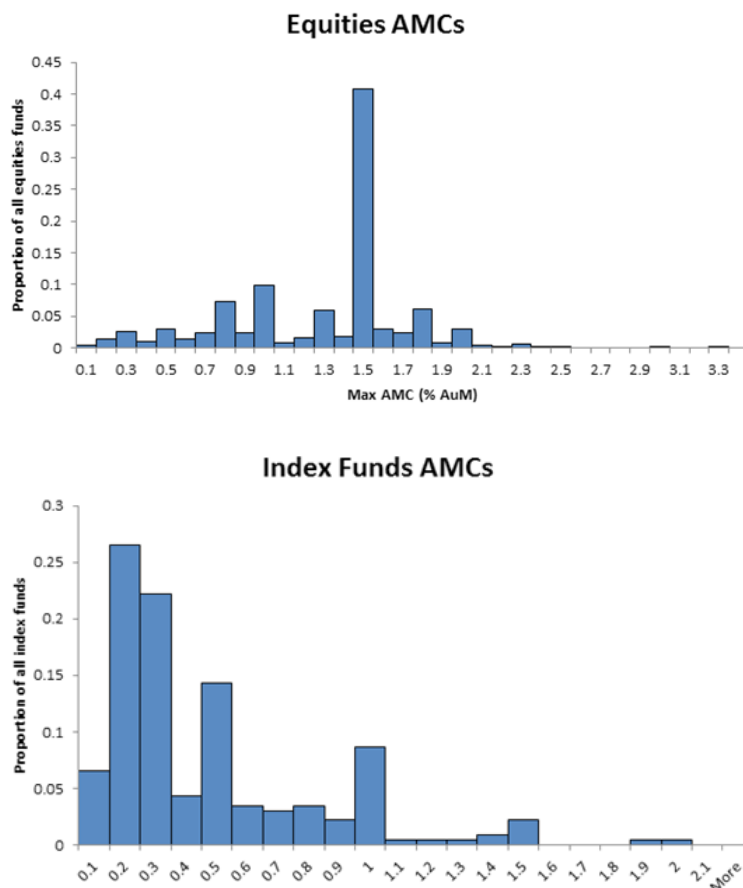
<sup>32</sup> *Asset Management in the UK 2014-2015*, The Investment Association Annual Survey September 2015 data and so reflects more mainstream firms and asset types.

<sup>33</sup> “The age of asset management?” Speech given by Andrew G Haldane, Executive Director, Financial Stability and member of the Financial Policy Committee (4 April 2014): <http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech723.pdf>

**3.23** Asset management products will typically fall under either ‘actively managed strategies’ or ‘passively managed strategies’. Passive investment management is where a fund will use a systematic process to follow an index (e.g. the FTSE 100). In active management, the manager aims to achieve a particular result by taking considered positions in particular markets, sectors or securities. Despite the higher annual management charge (AMC) for active management (average AMC is 1.2% compared to 0.5% for passive)<sup>34</sup> the majority of the UK market still favour it (78% compared to 22% passive). The ratio is lower for institutional clients than for the market overall (68% active).<sup>35</sup>

**3.24** The charts below illustrate the differences in, and spread of, AMC for active equity and index funds available to UK investors.<sup>36</sup> The chart illustrates that the AMC for passive funds is lower than for active equity funds. However, it also shows that the spread of AMCs is high for passive funds compared to active equity funds and that there appears to be a clustering of AMCs for active equity funds around 1.5% and this is something we will look to understand further.

**Figure 6: Annual management fee by Morningstar categorisation**



Source: Morningstar Direct data as of 18 January 2015

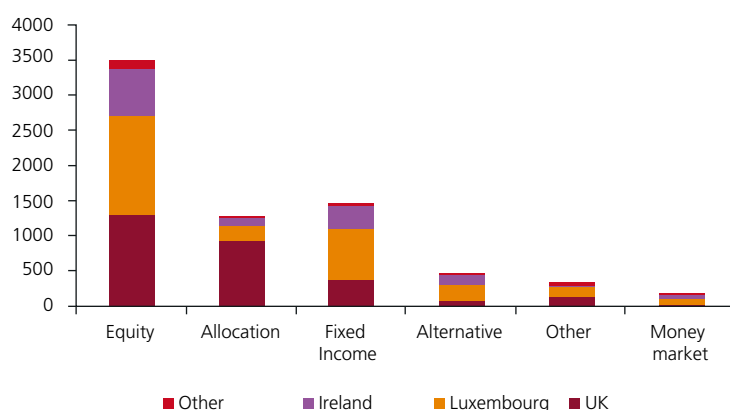
34 Based on Morningstar Direct data as of 18 January 2015

35 *Asset Management in the UK 2014-2015*, The Investment Association Annual Survey September 2015

36 By Morningstar categorisation for funds with a stated management fee but no performance fee, there is no adjustment or accounting for entry, exit fees or minimum subscription, Morningstar Direct data as of 18 January 2015

- 3.25** According to Lipper there were over 35,000 European funds at the end of 2013. Of those, over 7,000 were available to buy in the UK (of which 3,500 were equity funds). There appears to be plenty of choice for funds that invest in mainstream asset classes. For example, there were 350 funds classed as 'UK Equity Large Cap' and 47 of those were index funds.<sup>37</sup> This suggests that, for some asset classes, there are likely to be a significant number of comparable funds available to purchase in the UK.

**Figure 7: Breakdown of funds available to buy in UK, by asset type and domicile**



Source: Morningstar Direct data as of 18 January 2015

- 3.26** There has been evidence of some innovation in terms of new fund strategies, such as absolute target funds,<sup>38</sup> which accounted for nearly one-fifth of net retail sales for IMA classified newly launched funds in 2013.<sup>39</sup>

#### **Ancillary and third party services**

- 3.27** Often ancillary and third party service providers are employed or appointed by the fund operator, trustees or the asset manager but are ultimately providing a service to the end investor. These services can include, for example, custody banking (safekeeping of assets), securities lending, unit pricing/issue and redemption, and dividend/coupon collection. It is common for ancillary service providers to bundle a number of these different services together.
- 3.28** For regulated Collective Investment Schemes (CIS) (the main vehicles for pooled investment in the UK) the depositary,<sup>40</sup> fund trustee<sup>41</sup> and fund operators<sup>42</sup> have oversight duties under FCA rules. They hold the primary regulatory risk and can require the investment manager to resolve issues and/or breaches of regulatory requirements where they arise, for example, where an asset manager has breached investment restrictions or limits.

<sup>37</sup> Morningstar Direct data as of 18 January 2015.

<sup>38</sup> Some of these have large minimum investment criteria, track different benchmarks or have other features which mean they are not substitutes to all investors.

<sup>39</sup> *Asset Management in the UK 2013-14* A summary of the IMA Annual survey (September 2014)

<sup>40</sup> Depositaries are required for UCITS and most AIFMD funds. The UCITS V Directive is required to be implemented by 18 March 2016. We are currently consulting on our Handbook changes: UCITS V implementation and other changes to the Handbook affecting investment funds: [www.fca.org.uk/static/documents/consultation-papers/cp1527-ucits-v.pdf](http://www.fca.org.uk/static/documents/consultation-papers/cp1527-ucits-v.pdf)

<sup>41</sup> Trustees are required for trust based schemes, unit trusts, many pension funds and charity funds.

<sup>42</sup> A fund operator will typically oversee the setting up of a fund – securing the depositary, custodian and investment managers, preparing documentation and applying for FCA approval. From then on it will manage the scheme either directly or via delegation, providing accounting services, documentation etc.

**3.29** Some services are more directly linked to the investment process, such as research and brokerage services – we have looked into some of these as part of other recent work, which we set out in section 6.

### **Investment consultants and other institutional advisers**

**3.30** Large pension funds typically employ investment consultants to support their decision making. In the UK most pension fund trustees must ‘obtain and consider the written advice’ from a suitably qualified person before making an investment decision.<sup>43</sup> Following consolidation, three large groups share a high proportion of the UK pension consulting market but there is also an emergence of boutique players with more focused offerings.<sup>44</sup> Consultants generally advise on asset allocation, manager selection, and choice of custodian or transition manager, but clients can also choose to extend advice to specialist areas.

**3.31** A small but fast growing new offering is a service termed ‘fiduciary management’. The exact terms will be mandate specific but typically the fiduciary manager may accept responsibility for the selection of underlying asset managers and may have discretion to deviate from the original asset allocation decision specified by the client. Mandates for these services are often awarded without a tender process.<sup>45</sup>

**3.32** Some investment consultants also act as employee benefits consultants (EBCs). EBCs provide, among other things, advisory and administration services in relation to pension schemes for organisations, and are a distribution channel for Defined Contribution (DC) pension products in the UK.

### **Platforms**

**3.33** Typically, most UK retail consumers buy investment products through intermediaries (e.g. financial advisers or tied agents) and more recently, via online platforms and fund supermarkets.

**3.34** Platforms are online services, used by intermediaries and consumers, to allow investors to buy a range of funds from different asset managers and hold them together in one account. As well as providing facilities for investments to be bought and sold, platforms are often used to aggregate, and arrange custody for customers’ assets as well.

**3.35** The term ‘platform’ is often used to describe both wraps and fund supermarkets, which are similar. One important difference is that investors can often invest in a wider variety of products on wrap platforms (such as direct equities), whereas usually fund supermarkets only offer funds.

**3.36** Broadly speaking, there are two main platform types:

- those targeted at businesses, primarily Financial Advisers, but also pension schemes and fund management firms (B2B)
- those targeted at retail investors called Direct to Consumer (D2C) which offer execution services for investors who choose their own investments, typically without seeking advice

**3.37** Platforms have become an important part of the investment market, with over three million customers using them to hold assets or invest.<sup>46</sup> According to Platform there are now nearly

<sup>43</sup> Regulation 2 (2a) *The Occupational Pension Schemes (Investment) Regulations 2005*, ‘Before preparing or revising a statement of investment principles, the trustees of a trust scheme must – (a) obtain and consider the written advice of a person who is reasonably believed by the trustees to be qualified by his ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of the investments of such schemes’

<sup>44</sup> *FT Fund Management “UK pension consulting market heats up,”* By Bob Campion, FT.com, March 13 2011 10:01am

<sup>45</sup> *KPMG Investment Advisory 2014 KPMG UK Fiduciary Management Market Survey*, November 2014 kpmg.com/ukat page 4. [www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Tax/fm-survey-2014-printable.pdf](http://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Tax/fm-survey-2014-printable.pdf)

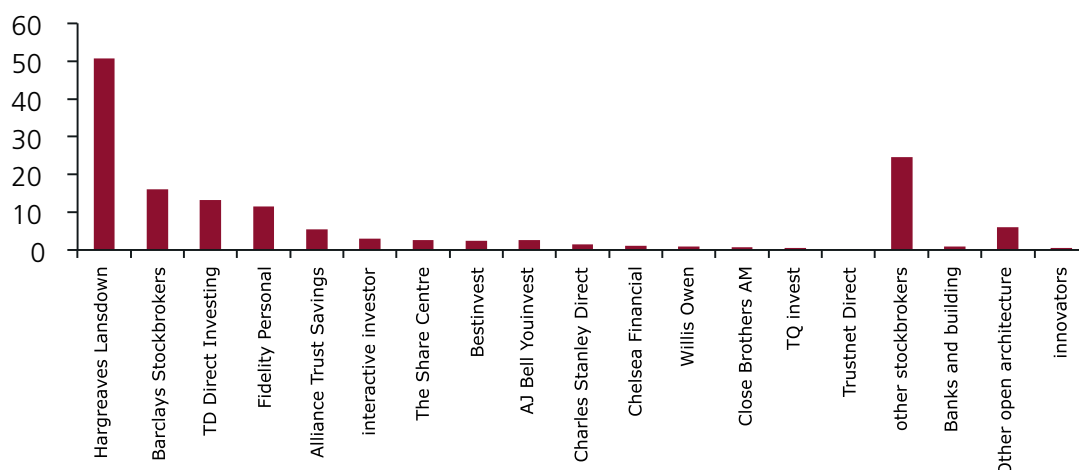
<sup>46</sup> FCA Review of implementation of platform rules 3 March 2014: [www.fca.org.uk/news/review-of-implementation-of-platform-rules](http://www.fca.org.uk/news/review-of-implementation-of-platform-rules) and UK D2C Guide - Direct Platforms and Investors “Steady as she goes”, Platform Issue no 5, February 2015, Centaur Financial.

£145 billion of assets held on D2C platforms<sup>47</sup> (see figure 8 below) and in excess of £340 billion assets under administration (AUA)<sup>48</sup> on advisor platforms.<sup>49</sup> Around 80% of new retail investment business is now done through platforms.<sup>50</sup>

**3.38** The D2C market continues to grow and AUA as at 31 March 2015 are £144.7 billion - an increase of 9.7% over the preceding six months.<sup>51</sup>

**3.39** The RDR<sup>52</sup> made significant changes in order to improve the effectiveness of the fund distribution market. However, new platforms have launched and market concentration has fallen. The top five adviser platforms accounted for over 90% of the market in 2009, and this fell to 63% as at end-2014. However, the largest three providers still account for half the adviser platform market<sup>53</sup> and the top three D2C platforms similarly account for 55% of the D2C assets under administration.<sup>54</sup>

**Figure 8: Direct Platform £billion AUM<sup>55</sup>**



**3.40** Many platforms are vertically integrated (where two or more parts of the value chain are under common ownership) for example, with an asset manager or an advisory firm. As we explain in section 4, we are interested in understanding the impact of platforms on competition between asset managers and how funds are purchased, but competition between platform providers will not be a focus of this market study.

<sup>47</sup> Platform UK D2C Guide Market Overview and Consumer Research Update, July 2015

<sup>48</sup> Assets under administration (AUA) is the value of assets that a third-party administrator provide services for. Those services can include accounting, custody and tax related duties.

<sup>49</sup> UK Advisor Guide: Platforms, funds and products by Platform May 2015

<sup>50</sup> FCA Review of implementation of platform rules 3 March 2014: [www.fca.org.uk/news/review-of-implementation-of-platform-rules](http://www.fca.org.uk/news/review-of-implementation-of-platform-rules) and UK D2C Guide – Direct Platforms and Investors “Steady as she Goes”, The Platform Issue no 5, February 2015, Centaur Financial.

<sup>51</sup> Platform UK D2C Guide Market Overview and Consumer Research Update, July 2015

<sup>52</sup> FSA Retail Distribution Review [www.fsa.gov.uk/Pages/About/What/rdr/index.shtml](http://www.fsa.gov.uk/Pages/About/What/rdr/index.shtml)

<sup>53</sup> UK Platform Market: A Point of View (2013) Campbell Macpherson & Associates LTD

<sup>54</sup> As at end September 2014. UK D2C Guide - Direct Platforms and Investors “Steady as she Goes”, The Platform Issue no 5, February 2015, Centaur Financial.

<sup>55</sup> Platform UK D2C Guide Market Overview and Consumer Research Update, July 2015

## 4. Topics to be explored

We want to understand whether competition is working effectively to enable both retail and institutional investors to get value for money when purchasing asset management services. To do this, we have identified three main topics to explore in the market study:

1. how asset managers compete to deliver value
2. whether asset managers are willing and able to control costs and quality along the value chain
3. the effect of investment consultants and other advisers on competition for institutional investment management

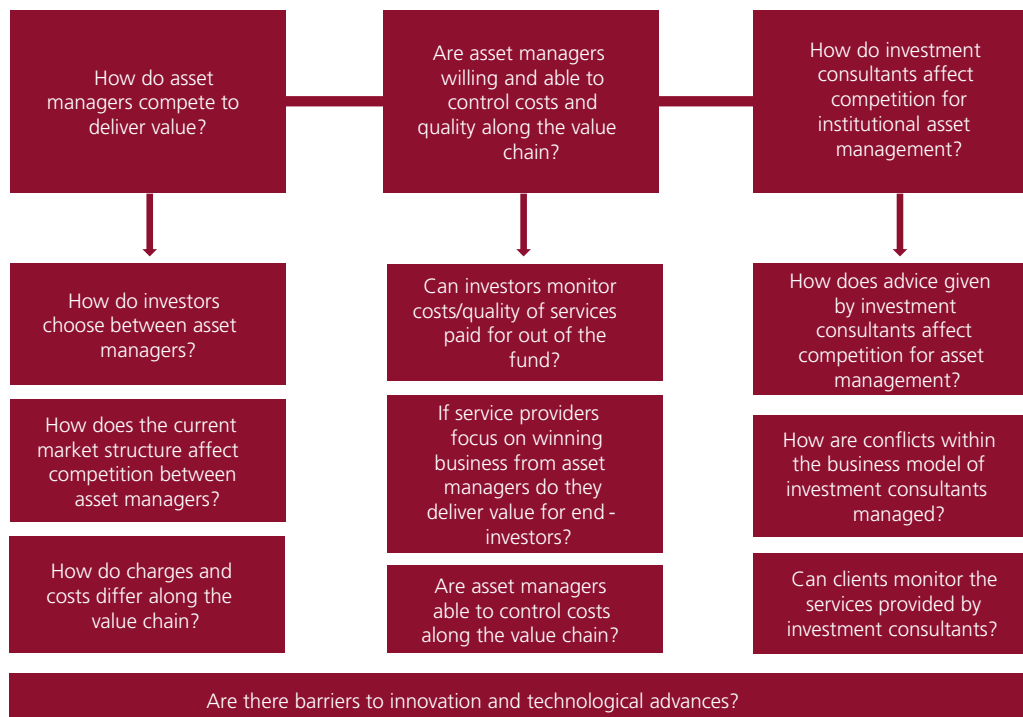
As part of our analysis of each of these topics, we will consider whether there are any barriers to innovation or technological improvements which are preventing investors from getting better value for money.

### Potential competition issues to be explored

- 4.1** The focus of the market study will be to understand whether competition is working effectively to enable both retail and institutional investors to get value for money when purchasing asset management services.
- 4.2** As explained in section 3, the asset management sector is not generally considered to be concentrated. However, a large number of competitors does not necessarily mean there is effective competition. Effective competition implies that firms have sufficient incentives to identify and satisfy clients' demands as efficiently as possible and constantly seek to win the business of clients who use rivals' services. The benefits of achieving effective competition include lower prices for investors, better quality service and greater innovation.
- 4.3** In order to understand whether competition is working effectively for these products and services, we have identified three topics for further investigation covering asset managers, distributors and ancillary/third party service providers.
- 4.4** These topics follow the issues identified in the wholesale sector competition review, where respondents identified some key areas where competition may not be working effectively. We set out the relevant responses further in this chapter, but broadly they related to the ability of institutional investors to get value for money when purchasing asset management services, the effectiveness of competition for ancillary services, and the role of investment consultants in helping or hindering investors getting value for money.

- 4.5** The diagram below sets out the three main issues we will consider, and the questions we will be seeking to answer.

**Figure 9: Summary of topics to explore**

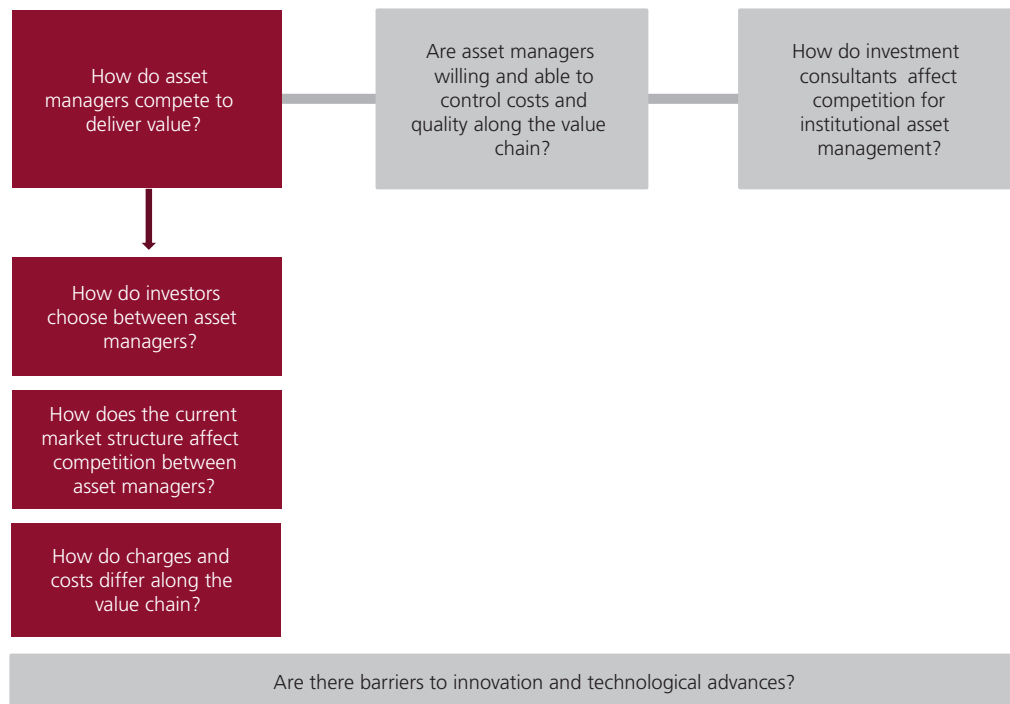


- 4.6** Although the first two topics above cover both retail and institutional investors, we recognise that there are substantial differences in the way these groups of investors access asset management products and services. We will be mindful of the differences as we assess the issues and our analysis and any possible solutions will reflect these differences. We will also consider whether other products/services require different treatment, for example to reflect differences between active and passive asset management.
- 4.7** Across all three topics we are interested in understanding whether there are any barriers to innovation or technological advances which may be preventing new ways of doing business that could benefit investors. We want to explore the nature of any barriers and what impact they are having on the ability of firms to deliver value for money.
- 4.8** We explain the scope of these three issues in more detail in this section. However, it is important to note that this sets out what we are proposing to explore - we have not reached any conclusions at this stage.
- 4.9** For each topic we will collect evidence from investors, trade and consumer bodies, as well as firms, to understand the extent of any detriment arising from any impediments to effective competition.
- 4.10** In addition, we will assess which factors (structural features, consumer and firm behaviours) are driving any identified concerns.



**How do asset managers compete to deliver value?**

- 4.11** We want to understand the incentives that asset managers have to compete to provide value for money. Value for money in this sector will reflect the expected rate of return, net of any costs and charges, for a given risk tolerance, taking into account the nature of service required by the investor.
- 4.12** Stakeholders have told us that charges<sup>56</sup> for asset management products vary significantly across different types of clients. We intend to map out charges across the asset management value chain to better understand any differences between different client types. We recognise that there is no set way of doing this and we would welcome views on different approaches.
- 4.13** We expect that asset managers are motivated to compete on expected future performance but this cannot be known with certainty in advance. As a result, asset managers and investors must use proxies for future performance. We want to understand the proxies used by asset managers and investors to identify future performance and whether these lead to good outcomes for investors.
- 4.14** We also want to understand whether there are features that investors (and asset managers) focus less on, such as price. We recognise that price is not the only factor when assessing value for money. It is, however, a significant determinant of net future performance and one which can be largely known in advance.
- 4.15** In order to understand how asset managers compete on value, we want to consider the following questions:



<sup>56</sup> 'Charges' in this document refers to all the fees and charges paid out of the fund, in particular the OCF, unless we refer to a specific charge, such as admin charge or charge for custody services etc.

### How do investors choose between asset managers?

**4.16** Retail and institutional investors can drive effective competition if they are able and willing to compare different products and choose or switch to the one that represents the best value for them. We will investigate the extent to which different types of investors are able to access the right information to make informed choices, assess this information to find the best products for their needs and act on this information to ensure they are getting the best value product for them.

**4.17** The opacity and lack of clarity around charges that investors face may not be limited to retail investors or retail products- the Financial Services Consumer Panel noted that even institutional investors of multi-billion pound pension funds may not know the full costs of investing.<sup>57</sup>

### Access

**4.18** Access refers to the availability of information about the product, some of which may not be currently visible to investors at the point of sale, such as transaction costs. It also refers to the way information is presented, for example, whether it is presented clearly and upfront. There are a number of current and forthcoming initiatives to improve transparency at both the retail and institutional level. Examples include; the FCA's discussion paper on Smarter Consumer Communication which challenges firms to consider innovative ways of engaging and communicating with consumers about fees and charges, the Packaged Retail and Insurance-based Investment Products (PRIIPs) regulation, and work being undertaken by the FCA and DWP to provide disclosure of transaction cost information for workplace pension schemes (which are set out in Section 6). In addition, the increasing trend for investors to purchase products through online platforms<sup>58</sup> may mean that information about ongoing charges becomes more standardised, allowing investors to compare between products found on the same platform. We would like to understand the extent to which these initiatives will help investors better understand products, fees and charges.

**4.19** Asset management products offered to investors (both retail and institutional) can be complex, which may prevent investors from selecting the best value product for them. We would also like to understand the extent to which products are unnecessarily complex and do not serve the needs of end investors.

### Assess

**4.20** Information should be presented in a way that investors can understand and act on. The FCA's recent work on clarity of fund charges for retail investors (TR14/7) showed that some firms disclose performance fees and charges in a way which could potentially make it more difficult for investors to compare value for money.<sup>59</sup> This includes using the AMC (instead of the ongoing charges figure (OCF)) as a headline figure on marketing material and other disclosures, and/or providing unclear descriptions of administration charges which make it more difficult for investors to directly compare funds with each other.

**4.21** The benefit of increased disclosures will only be realised if investors have the skills or knowledge to understand product information and utilise it in their decision making. Investors, particularly retail customers, appear to make decisions based on past performance, reputation, and other features such as marketing and advertisements. This may be because they find it difficult to assess other features of the product or service. While these features may be useful for investors

57 Discussion paper on investment costs and charges Investment costs – more than meets the eye: Financial services consumer panel (November 2014)

[www.fs-cp.org.uk/sites/default/files/investment\\_discussion\\_paper\\_investment\\_cost\\_and\\_charges.pdf](http://www.fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf)

58 FCA Review of implementation of platform rules, 3 March 2014: [www.fca.org.uk/news/review-of-implementation-of-platform-rules](http://www.fca.org.uk/news/review-of-implementation-of-platform-rules)

59 TR14/7 Clarity of Fund Charges (May 2014) [www.fca.org.uk/your-fca/documents/thematic-reviews/tr147--](http://www.fca.org.uk/your-fca/documents/thematic-reviews/tr147--)

and help in their decision making, we want to understand whether they are good indicators of value for money (i.e. net returns for a given risk tolerance and/or service quality).

- 4.22** When buyers do not focus on particular aspects of a product or service, firms may not compete on that aspect. This could lead to important features not being the subject of innovation or competition. For example, if investors do not focus on charges when purchasing products/services, it may mean that asset managers do not focus on reducing charges to win clients but instead may compete on other characteristics.
- 4.23** Investors' ability to make use of information presented to them also needs to be considered in light of the behavioural biases which may prevent them from selecting the best value product for them. For example, in assessing the likely return on their investment, investors may typically focus on past performance, rather than charges for the product, despite the fact that charges have a direct impact on future returns. Past performance is typically presented net of asset management charges, however investors may not focus on the explicit charges which (unlike future performance) can be known in advance and will directly impact future net returns. In our Occasional Paper<sup>60</sup> looking at how behavioural biases affect a consumers' choice and use of financial products, we found that most retail consumers find financial products complex, and making financial decisions hard, unpleasant and time-consuming. We also found that retail consumers are not good at assessing risk and uncertainty. We would like to understand the impact this has on retail investors, but also to consider whether similar (or other) behavioural biases exist for institutional investors.
- 4.24** We also want to understand whether investors can monitor and assess asset management providers over time, how they do this, and what features they are monitoring. For example, we considered the issue of 'closet tracker' funds within the wholesale sector competition review. Closet tracker funds are those which are described as actively managed, and charge in line with actively managed funds, but are managed in a way similar to passive funds and have portfolio holdings (and therefore returns) similar to their reference benchmark. Their gross returns are in line with a passive fund but net returns are typically lower because of the higher charge paid for an 'actively' managed fund. Investors might remain invested in these funds if they are not able or willing to effectively monitor their asset managers.
- 4.25** For retail investors, the way platforms display and disseminate information has an impact on their ability to select the right product and monitor performance. As platforms become the main point of contact for retail investors on an ongoing basis, we would like to understand how they display information about the product and on charges. We also want to assess whether the information provided to the customer over time enables them to evaluate whether the fund is performing adequately for their needs. Further, we would like to consider the way platforms disseminate information on changes to terms and conditions to allow retail investors to monitor their investments and how intermediated investment affects the communication between fund managers and end investors.
- Act**
- 4.26** We will consider the ability of different investors to act in response to the information they assess. As part of this we will consider the extent to which switching occurs between funds, and the existence of switching costs which prevent investors from acting in their own best interests. These costs may be real or perceived and can be monetary or non-monetary and include:

- where retail investors do not switch because of exit or entry charges imposed on certain funds

<sup>60</sup> FCA Occasional Paper No.1 *Applying behavioural economics at the Financial Conduct Authority* (April 2013)

- the perceived time/effort in finding an alternative fund
- the (real or perceived) 'tax complexity' of switching

**4.27** We recognise that investors' ability and willingness to compare asset management products and switch providers may vary depending on the type of investor (for example, retail and institutional, or different investor groups within these) and the distribution method they use. We will consider any differences and the reasons for them in our analysis.

#### **How does the current market structure affect competition?**

**4.28** There may be aspects of the way the asset management market is structured which affect the way both investors and asset managers behave and impacts the way competition works for these services. We would like to understand the extent to which structural features of the asset management market affect the incentives and/or ability of asset managers to compete effectively with each other.

**4.29** In particular we will consider:

- potential for concentration in certain mandates, or certain asset classes
- barriers to entry for new funds and fund managers including regulatory barriers
- vertical integration in the asset management value chain

#### **Potential for concentration**

**4.30** In general, high concentration levels could indicate that one or more firms feel less pressure to compete with rivals, particularly where other firms find it difficult to enter or expand in the market.

**4.31** Although asset management is not generally considered to be a concentrated sector, there may be some types of investments, customer groups or investment vehicles which are more concentrated. For example, as noted in the wholesale sector competition review, in one survey, the top three managers by size represented 90% of the UK sector for LDI based on notional value.<sup>61</sup>

**4.32** Where we identify subsectors which are concentrated, we will seek to understand the reasons for this, and the effect that it has on competition for those services.

#### **Barriers to entry and expansion**

**4.33** High barriers to entry and expansion reduce the likelihood that new firms will enter or that existing firms will expand. This, depending on the level of competition for these products, may reduce the incentives of existing firms to offer value for money, as the threat of other firms entering and winning business is lower.

**4.34** Some barriers may be a result of investor activity. For example, where investors use past performance as a proxy for future performance, an over-reliance on past performance and/or reputation by investors could act as a barrier to entry for new funds which do not currently have a track record.

<sup>61</sup> Notional value is the value of liabilities whose interest rate or inflation risk has been hedged  
 KPMG Investment Advisory 2013 KPMG LDI Survey Exploring the Evolution of the UK LDI Market, 2013  
[www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Tax/Ldi-surveyjune-2013v2.pdf](http://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Tax/Ldi-surveyjune-2013v2.pdf)

**4.35** We also recognise that regulation can act as a barrier to entry and/or expansion and would like to understand whether existing regulations are preventing new firms from competing, or preventing existing providers from expanding. We will also consider whether regulations slow down or prevent technological developments in the industry which could improve outcomes for investors. This is discussed in more detail from paragraph 4.75.

#### ***Vertical integration in the asset management value chain***

**4.36** A firm is vertically integrated where it operates along different levels in the supply chain – for example, where an asset management firm also operates a platform. Vertical integration may benefit end investors as it can lead to increased efficiency within a firm which may be passed on to consumers in the form of lower prices or better service. A vertically integrated firm’s understanding of the market and consumers may also enable it to develop products which are better suited for end consumers. However, in particular circumstances, vertical integration can make it more difficult for competitors to enter the market and it can create conflicts of interest in certain business models.

**4.37** We will explore whether vertical integration along different parts of the asset management value chain can lead to conflicts of interest and whether these are being managed appropriately. We will also seek to understand the impact that vertical integration has on new entrants seeking to compete.

**4.38** In particular, we will consider where pension providers and asset managers are vertically integrated. The Office of Fair Trading (OFT) market study on defined contribution workplace pensions noted that many major contract based providers, such as insurance companies, have a vertically integrated fund management arm. The OFT explained that while there might be strong efficiency arguments for this, given the weakness of the demand side of the market and the lack of ongoing scrutiny of value for money, there is a potential for conflicts of interest. The OFT recommended a number of changes in response to this issue, such as the introduction of independent governance committees. In this market study we will consider evidence of any remaining concerns.<sup>62</sup>

**4.39** We will also consider where the platform provider is part of a vertically integrated business and sells its own products alongside competitors’ funds. In this case, the platform may benefit from recommending certain funds or placing them in more prominent positions on the platform. In order to assess the potential conflicts, we will need to understand how platforms negotiate with asset managers and assess the relationship between asset managers and platform providers.

#### **How do charges and costs differ along the value chain?**

##### ***Pricing analysis***

**4.40** We will consider the charging structures and underlying costs for providing asset management services to different groups of investors.

**4.41** Our initial analysis suggests that certain groups of investors pay more for products and services than other groups, and we would like to understand the extent to which this reflects differences in the underlying cost. Our analysis will include understanding differences in cost and charges:

- between retail and institutional investors
- between different institutional investors

<sup>62</sup> PS15/3 *Final rules for independent governance committees, including feedback on CP14/16* (February 2015) [www.fca.org.uk/static/documents/policy-statements/ps15-03.pdf](http://www.fca.org.uk/static/documents/policy-statements/ps15-03.pdf)

- between active and passive mandates
- for comparable products depending on fund vehicle and/or asset classes

**4.42** We will also look at entry and exit charges imposed on investors when buying a fund or switching between funds, and whether they reflect the cost of providing the service (alongside considering the impact they have on switching).

**4.43** In addition, we are looking to understand prices and costs along the value chain – from advice and distribution to asset managers and ancillary/third party products. Some stakeholders have tried to do this previously and have expressed the difficulty in isolating data which shows the costs along the whole value chain. We are therefore open to hearing views about ways in which we could get meaningful data to show this.

**4.44** We also want to understand what has happened to total charges (for service and distribution) over time. In particular, we will look at changes to total charges post-RDR for retail investors (after platforms were required to charge explicitly for their services and were banned from earning commissions from asset managers). As part of this, we would like to understand the dispersion of charges between different funds and different platforms over time as this may help us understand the extent to which competition on price is occurring.

#### ***Profitability analysis***

**4.45** We would like to undertake an analysis of the profitability of the asset management sector to inform our overall analysis. Any assessment of profitability will be indicative only and cannot be considered in isolation, but will form part of our wider assessment of the way the market is working. This is because firms in a competitive market would generally be subject to competitive forces which bring profits down to a normal rate of return. Normal rates of return are typically proxied by the firm's cost of capital for that activity. There are likely to be year on year fluctuations in profitability levels due to market conditions or marketing initiatives. However, where firms in a sector or industry generate profits above a normal rate for that activity over a sustained period, it may indicate that competition is not working effectively for those services.

**4.46** Profitability of the asset management sector appears to be quite high, both globally<sup>63</sup> and in the UK.<sup>64</sup> Our internal analysis on a sample of firms indicates that average operating profits for asset management firms are around 35% of revenues.<sup>65</sup> As part of our wider analysis of the effectiveness of competition in the market, we would like to understand the business models of asset management firms and their levels of profitability. However, this is not without difficulty – for example, the accuracy of any assessment of profitability will depend on the quality of the data gathered, and the assumptions used in undertaking the analysis. We recognise that this analysis can be approached in a number of ways and will engage with stakeholders with respect to our methodology including on the most appropriate metrics to use.

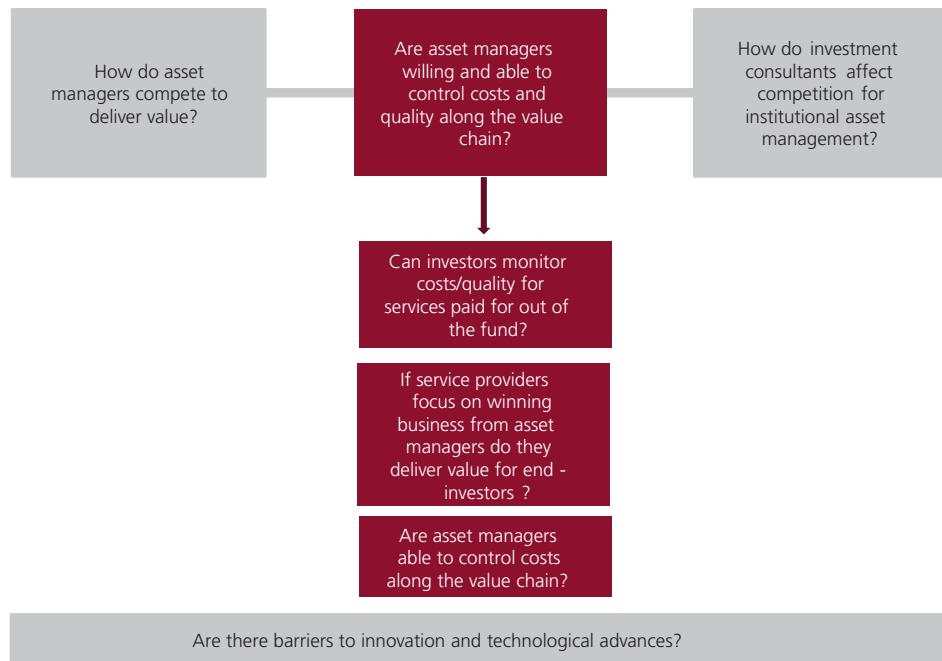
63 "Global Asset Management 2015: Sparking Growth with Go-to-Market Excellence, 7 July 2015 bcg.perspectives, The Boston Consulting Group.

64 FCA FS15/2: Wholesale Sector Competition Review 2014-15

65 Based on a sample of 22 firms in 2014 conducted as part of our supervisory function

**Are asset managers willing and able to control costs and quality along the value chain?**

- 4.47** As explained in the wholesale sector competition review,<sup>66</sup> asset managers commonly outsource some ancillary services, such as custody banking, securities lending and fund administration services to other firms.
- 4.48** Asset managers may also purchase some products and services from third party providers which are typically needed for an asset manager to carry out their investment management function e.g. market research, benchmarking data or trade execution services.
- 4.49** Some of these services are paid for by the fund investors, while other costs are borne by the asset management firm. When purchasing these services on behalf of investors, there is potential for the interests of the asset manager (acting as ‘agent’ in the relationship) to differ from those of the investors (‘principal’).
- 4.50** We want to understand the extent to which asset managers are willing and able to control and scrutinise costs when purchasing services on behalf of the fund or, in the case of segregated mandates, paid from the assets managed. Further, we want to explore whether the level of scrutiny differs depending on the nature of the cost, the service provider, the end investor (e.g. retail or institutional) and the information that is provided to investors on the cost. In particular we would like to answer the following questions:



**Can investors monitor costs and/or quality for services paid for out of the fund?**

- 4.51** Where investors are not able to monitor costs and/or quality of services paid for using fund assets, asset managers’ incentives to manage these costs effectively may be reduced. Investors may be able to indirectly monitor these costs as they are included in the OCF (and impact net returns), but often investors cannot isolate these charges from the overall charge paid for the product and may not understand the impact of these charges on net future returns. They may also not be able to assess whether the costs and quality of these services represent value for money.

<sup>66</sup> Para 3.16-3.18 FCA FS 15/1: Wholesale Sector Competition Review 2014-15.

- 4.52** Where the investor cannot effectively monitor the asset manager, they may be unable to switch providers to increase competitive pressure (and incentives of the asset manager to ensure that they are getting value for money). On the other hand, even where the incentives of the asset manager and end investor are not aligned, if the investor is able to effectively monitor the asset manager, this may not be problematic. Investors could, for example, take action by switching to an alternative asset manager who can demonstrate that they act more in the interests of investors.
- 4.53** The incentives and ability of investors and their representatives to monitor the asset manager are likely to vary according to their type, size and level of sophistication. While we expect there will be differences between retail investors and institutional investors, it is likely that the inability to monitor at least some of these costs is a feature across both retail and institutional investors. The FCA Consumer Panel noted that even institutional investors of multi-billion pound pension funds may not know the full costs of investing.<sup>67</sup> Likewise, we heard during the wholesale sector competition review that fund-governance bodies may be ineffective at overseeing costs. Moreover, some institutional investors may not have the expertise to effectively monitor asset managers.
- 4.54** As part of understanding whether investors can assess and monitor the value for money of their asset management products (see paragraph 4.19) we will consider the information provided to investors on these costs as well as the timing and presentation of this information. We will also consider the ability of investors to evaluate this information (including, for example, the availability of benchmarks to assess whether the costs paid or service received demonstrate value for money). The OFT noted in its report that the introduction of a 1% AMC cap for stakeholder pensions was taken by some providers as a new competitive benchmark for other workplace pension schemes.

**If service providers focus on winning business from the asset managers, do they deliver value for end investors?**

- 4.55** The incentives of the asset manager and the end investors may differ. When the asset manager purchases a number of services on behalf of the end investor, the ancillary or third party service provider may compete to win custom from asset managers in a way that does not align with the interests of investors.
- 4.56** Asset managers may look to achieve value for money over their total fund business rather than on a fund by fund level. Asset managers may, for example, value the ease of use and oversight of a service more than the cost. Ease of use may represent a saving in time for the asset manager which could be passed onto the consumer in the form of lower charges. However, it could be that the higher charge for the service is not fully offset by any time savings (even if they are passed on to investors) and might run counter to investors' requirements. We will explore the way that asset managers purchase these products on behalf of end investors.

**Are asset managers able to control costs and quality along the value chain?**

- 4.57** Asset managers may be unable to get value for money when purchasing services along the asset management value chain for reasons outside of their control.
- 4.58** Where this is the case, it could be as a result of existing regulations which require asset managers to purchase services in a particular way or from a particular group of providers. Alternatively, we will also consider whether providers of ancillary services (either existing or potential new entrants) face regulatory barriers or costs which prevent them from offering value for money to end investors. For example, where regulations inhibit firms from finding new ways of serving clients, create costs for firms which are not justified, or present barriers to innovation.

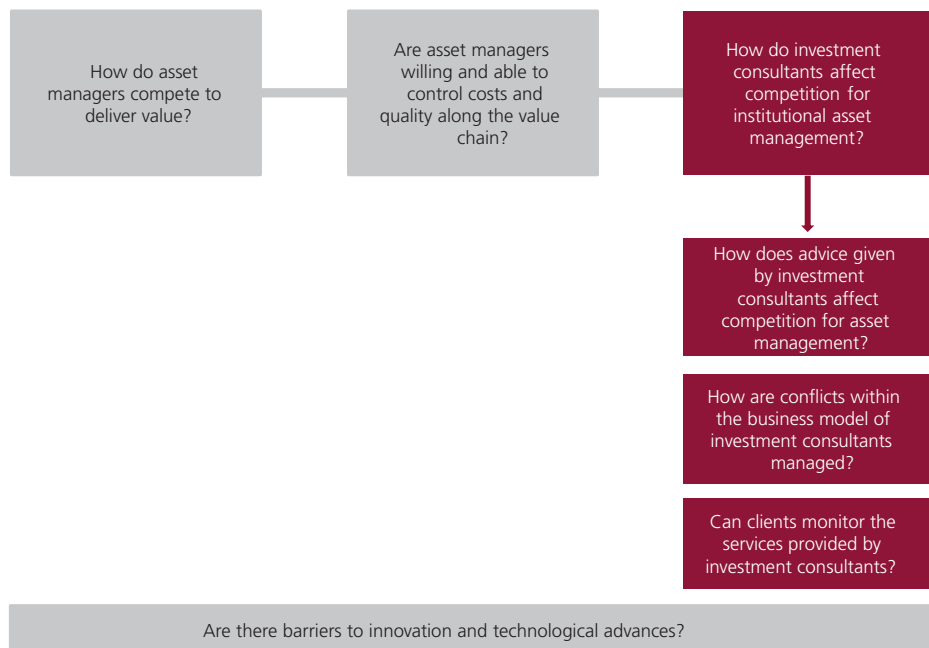
<sup>67</sup> *Financial Services Consumer Panel Investment Costs – more than meets the eye* at page 4 (Nov 2014) [www.fs-cp.org.uk/sites/default/files/investment\\_discussion\\_paper\\_investment\\_cost\\_and\\_charges.pdf](http://www.fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf)



- 4.59 We will also consider any concerns about ineffective competition for services along the value chain resulting in asset managers paying too much or purchasing lower quality products/ services. For example, where asset management products are sold as a bundle, the asset manager may not be able to negotiate lower charges for individual services; or where high concentration levels in a market for ancillary services reduces the choice of service providers.
- 4.60 We will not undertake an in-depth assessment of the effectiveness of competition in each of these markets within this study, although it will have a bearing on our assessment of this topic. To the extent that it appears that problems in distribution or ancillary/third party service providers are adversely affecting competition, we may consider further work outside of this market study.

**What impact do investment consultants have on competition for institutional asset management services?**

- 4.61 Investment consultants play a significant role in the market for institutional asset management. Their role ranges from providing benchmarking data on fund managers to advising pension funds on their asset allocation and providing fund management (or fiduciary management) services. According to a recent survey, more than half the pension schemes with assets of over £1 billion have some form of fiduciary management in place.<sup>68</sup> Given this role, we would like to assess the ways in which investment consultants affect competition for institutional asset management.
- 4.62 Within the wholesale sector competition review, we received responses on the role of investment consultants and the impact that they have on the purchase of asset management services by institutional investors, which we set out in the following paragraphs. In order to better understand this, we would like to explore:



68 Aon Hewitt Fiduciary Management Survey 2015 shows UK pension schemes continue to increase use of delegated services”, London (7 September 2015) AON Media Center aon.mediaroom.com/index.php?s=25776&item=137297

**How does advice given by investment consultants affect competition for asset management?**

- 4.63** Many institutional investors, pension funds in particular, seek advice from investment consultants on their investment strategies and asset allocation. They may also ask for recommendations on what asset managers (or funds) to select.
- 4.64** The ranking or rating of asset managers is typically done using a series of metrics designed by the investment consultant. A number of respondents to the wholesale sector competition review noted that investment consultants encourage clients to look at factors other than charges and performance such as governance, and viewed this as positive for competition. However, one respondent suggested that consultants do not focus sufficiently on fund charges highlighting the risk that these are inadequately considered by institutional investors.
- 4.65** We would like to understand the extent to which the consultant-led metrics used to rate asset managers affect competition, including:
- whether the metrics act as a barrier to entry for funds looking to enter the institutional asset management market
  - how the metrics used help investors to get value for money
  - whether asset managers focus on getting recommended by investment consultants and if so how this alters their behaviour
  - whether advice given by investment consultants enables institutional investors to make good decisions

**How do investment consultants ensure that their advice meets the needs of their clients?**

- 4.66** We want to understand whether investment consultants are incentivised to suggest or promote investment strategies which may increase their business, but which may not be in the best interests of the investor. For example, respondents to the wholesale sector competition review suggested that investment consultants may be incentivised to recommend active or complex strategies rather than passive strategies to justify the fees being paid to them.
- 4.67** Conflicts of interest may also arise as a result of the business model of investment consultants where investment consultants offer fiduciary management services alongside advisory services. For example, investment consultants may offer fund of funds and/or multi-manager funds to their clients where they will invest the client's money in a specified set of recommended funds (or segregated mandates), negotiate on behalf of the client, and charge them accordingly. Where investment consultants offer these 'asset management type' services we will explore how this conflict is being managed, and the impact it may have on competition for institutional clients.
- 4.68** We will also seek to understand arrangements between the investment consultant and the asset managers who are part of the fund of funds or multi-managers and the impact arrangements have on competition. For example, how the investment consultant determines which firms to include in any 'fund of funds' and what requirements, if any, are consequently imposed on the asset manager as a result. We will also assess situations where firms are creating their own pension products, such as master trusts, where they are simultaneously distributing and competing with asset management products.

**4.69** There may be benefits for clients from getting advice and products from the same place and we will also explore any benefits to clients, alongside the impact on competition.

#### **Can clients monitor the services provided by investment consultants?**

**4.70** As mentioned above, an investor's ability to monitor and assess the performance of their service provider can drive providers to deliver better outcomes. An inability to monitor the performance of their investment consultants can impact the quality of service institutional investors get from their investment consultant and ultimately from their asset manager, in particular where interests are not aligned.

**4.71** We want to understand the ability of institutional investors, such as pension trustees and governance committees to monitor the actions of the investment consultant. In many markets, the nature of the product or service is such that consumers are not able to assess the quality before they buy the product. However, as they experience the product/service, they will be able to assess its quality. In the case of advice provided by investment consultants, it might be difficult for clients to assess the quality both in advance, and also once that advice has been provided (where returns are measured over the long term).

**4.72** One respondent to the wholesale sector competition review noted that pension trustees often find it difficult to assess the quality of advice given by investment consultants. The respondent noted that only a small proportion of defined contribution schemes had a formal process to assess the quality of the services provided by investment consultants. We want to understand how institutional investors assess the quality of advice provided on an ongoing basis.

**4.73** In doing this, we will consider whether clients have access to sufficient information to enable them to assess the quality of advice given and whether they have sufficient experience and skills to evaluate this.

#### **Are there barriers to innovation and technical advances?**

**4.74** One of the benefits of effective competition can be an increase in innovation. In a competitive market we would expect firms to identify new ways to meet the needs of their customers through better product design, better distribution models or new pricing models. For example, different levels of service for different prices, or different products with unique features better suited to the needs of investors.



**4.75** We would like to understand the motivation and ability of firms within the asset management value chain to innovate in the interests of end investors. Although innovation is often linked to technological advances, other changes such as product or service improvements can also be classed as innovation which benefits consumers. For example, if product manufacturers improve disclosure documents by simplifying them, or if they find ways of presenting information in a way which improves investors' ability to select the best product for them. Platforms are an example of market innovation and we want to investigate further how this innovation has shifted the dynamics of competition in the asset management sector.

- 4.76** We will consider the barriers that firms across the asset management value chain face when trying to develop innovative new products or when introducing new ways of doing things. We will consider whether there are barriers to innovation, such as where regulatory requirements prevent firms from doing things differently or where the conduct of existing firms discourages the introduction of new technology. As part of this we will examine and compare innovative developments in other international markets.
- 4.77** We will also investigate whether innovation exists that is not in the interests of investors – either because it introduces unnecessary complexity or is used by firms to charge more for services that do not represent good value for the end-investor.

## 5. Scope of the market study

The main focus of the market study will be on asset management services. However in order to understand the sector, the scope will include:

- **distribution** – in particular, platforms and investment consultants
- **asset management products and providers** – where assets are managed in the UK and sold to UK investors
- **ancillary and third party service providers** – particularly where the costs are paid for out of the fund

Although the scope of the market study is necessarily broad to understand the context of the sector, as we progress with the study we will prioritise issues where ineffective competition is having the greatest impact on investor outcomes. We will also examine the extent to which it appears that problems in distribution or ancillary/third party services provision are driving poor outcomes.

If we find evidence of poor outcomes outside of the products and services within our main focus we may subsequently undertake further work outside the market study.

- 5.1** As explained in section 3, the asset management value chain is highly intermediated, with a number of providers offering both standardised and bespoke services and catering to different types of investors. The central focus of our market study will be on asset management services but we will consider related products and services to the extent that they affect competition in the asset management market.

The table below sets out the products and services we will examine as part of our market study:

Third party products and services	Administrative or ancillary services	Providers	Distribution	Investment products	Consumers
Investment and portfolio management systems	Custody	Mainstream asset managers	Wholesale advisers (investment consultants)	Pooled vehicles	Retail/high-net worth
Stock lending services	Fund administration	Private Equity funds	Retail advisers	Segregated mandates	Pension funds
Research* and execution	Risk management	Discretionary Private Client Managers		Contracts for difference	Insurance companies
Benchmarking data	Other	Other asset managers	Stockbrokers	Other	Sovereign wealth funds
Other		Contracts for difference providers	Platforms		Other institutional investors

<span style="display:inline-block; width:10px; height:10px; background-color:#800000;"></span>	Partially in scope
<span style="display:inline-block; width:10px; height:10px; background-color:#4B0000;"></span>	In scope
<span style="display:inline-block; width:10px; height:10px; background-color:#C08080;"></span>	Out of scope

- 5.2 Some of these products and services will be the central focus of our market study, e.g. the provision of investment management services or the provision of investment consultancy services. Others will only be partially in scope; that is, we will consider them to the extent that they have an effect on the provision or consumption of asset management products and services. For example, we will consider the market for custody banking to the extent that asset managers have to buy custody banking services and this is a cost for the end investor. We will not within this market study conduct an in-depth investigation into the effectiveness of competition in the market for custody banking.
- 5.3 There are also some products and services which are part of the asset management value chain but will not be included within the scope of this market study, such as financial advisers. We set out the rationale for this below.
- 5.4 As the market study progresses we may narrow down our scope if evidence suggests that some topics do not warrant further investigation or if our concerns are being considered as part of other ongoing work.

## Areas of the value chain we will focus on

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### Investors

- 5.5** Our market study will cover both institutional and retail investors. In the wholesale sector competition review we concentrated on issues impacting institutional investors. However, our internal analysis suggests that many of the issues identified also affect retail investors and so we have decided to expand the scope of the market study accordingly.

### Advice and Distribution

- 5.6** Asset management products and services are distributed and accessed by investors through many different channels. The distribution channel through which an investor buys an investment product can have a significant impact on the way that competition works for these products. In this market study, we will focus on:

- **Investment consultants** – Investment consultants are crucial to the way that some institutional investors, primarily pension funds, buy asset management services. We will consider the role of investment consultants as advisers and providers of asset management products for institutional clients to help us understand the dynamics of competition in institutional asset management.
- **Platforms** – Increasingly, retail investors are buying long-term investment products through online platforms. As part of the market study we will focus on D2C platforms i.e. where investors deal directly with the platform provider without an intermediary. However, where financial advisers use platforms on behalf of end investors this will be out of scope of the market study.

- 5.7** The market study will not consider:

- **Financial Advisers/IFAs** – We will not look at the provision of investment advice to retail investors. Some of the potential issues in relation to financial advice will be examined in the joint HMT-FCA Financial Advice Market Review, which will look at, among other things, whether there is an advice gap for consumers who think they cannot afford financial advice and how to encourage a healthy demand side for financial advice.<sup>69</sup>
- **Wealth management firms** – We do not intend to focus on private client wealth management services as part of our market study. Wealth management services can include discretionary and advisory portfolio management services, tax management and execution only services. However, where wealth management firms provide and distribute asset management products and services, they will be in scope.
- **Stockbroking firms** – Where stockbroking firms provide execution-only services on direct securities, they will not be within the scope of our market study. However, where a stockbroking firm provides services similar to an investment platform (selling and distributing asset management products) they will be in scope.

### Providers of asset management products and services

- 5.8** Within the scope of this market study are firms that manufacture or provide asset management products and services. These include where asset management products are manufactured by distributors such as platforms, fiduciary management services offered by investment consultants, and insurance companies that offer asset management products and services.

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<sup>69</sup> *Financial Advice Market Review: Terms of Reference* (3 August 2015)  
[www.gov.uk/government/publications/financial-advice-market-review-terms-of-reference](http://www.gov.uk/government/publications/financial-advice-market-review-terms-of-reference)

### Products and services we will focus on

**5.9** We will consider most types of collective investment funds and segregated mandates, irrespective of their legal structure. We will focus on funds and mandates that invest in mainstream asset classes (such as securities, derivatives, and property).

**5.10** We will consider both actively managed funds and passive investment management.

**5.11** Within the scope of the market study are:

- **Pooled investment funds** – Investment funds offered to retail and institutional investors are within scope. As part of this we will also consider tracker funds, exchange traded funds (ETFs), funds of funds and multi-manager funds. Hedge funds that are seen as close substitutes to any of these products will also be within the scope of the market study. Asset managers that offer pooled investment funds will also be within scope.
- **Insurance-based investment products** - Investment bonds (which are also referred to as single premium life insurance policy, insurance bonds or single premium bonds) are a type of investment product offered by insurance companies. They are designed to be either 'with-profits' or 'unit-linked'. The market study will consider unit-linked insurance products which are often offered as part of DC pension schemes, but with-profits products will be out of scope. This is because with-profit products have features that differ from mainstream asset management products. Most notably, the guaranteed minimum pay-out and the smoothing of annual increases in the fund.
- **Segregated mandates** – Investment portfolios managed specifically for a single investor are also within scope.

**5.12** The market study will not focus on:

- **Private equity funds and venture capital funds** – these will not be the focus of our market study. While there may be concerns around the opacity of investment strategies and disclosures to investors in these types of funds, we have limited the scope to other asset management products- although if during the course of the market study, competition issues in these areas come to light, we may suggest further work there.

### Ancillary services and third party providers

**5.13** Our market study will consider ancillary services such as custody banking, fund administration, securities lending and risk management which are provided in addition to investment management services, as part of the asset management product offering. Depending on the business model of the asset manager, some of these services are outsourced while others are provided in-house.

**5.14** We will also look at how asset managers procure and pay for services from third party providers, such as market data services or post-trade analytics. However, the use of dealing commissions to acquire research goods and services will not be a focus of the market study. We expect forthcoming MiFID II legislation will introduce changes that will impact firms' ability to receive third party research bundled with execution services and we also completed a comprehensive review of our dealing commission regime in 2014.<sup>70</sup>

<sup>70</sup> DP14/3 *The Use of Dealing Commission Regime* (July 2014) [www.fca.org.uk/news/dp14-03-the-use-of-dealing-commission-regime](http://www.fca.org.uk/news/dp14-03-the-use-of-dealing-commission-regime)



**Geographic scope**

- 5.15** The market study will cover investment funds and segregated mandates managed in the UK. This will include UK-authorized funds and asset managers which are approved by the FCA.
- 5.16** Where investment funds and segregated mandates are domiciled abroad but managed in the UK, they will fall within the scope of the market study if services are provided and marketed to UK investors.

**Financial stability**

- 5.17** There are a number of domestic and global initiatives which consider the liquidity risk of products that asset managers provide, particularly in relation to fixed income instruments. In addition, there are also a number of global workstreams assessing the impact of asset managers on financial stability. The market study will consider investor awareness of the potential liquidity risks associated with investment funds.

## 6. Regulatory landscape

This section sets out some of the recent regulatory and policy work in the asset management sector and provides context to this piece of work.

Our market study will take into account all ongoing and forthcoming regulatory developments in our analysis and when identifying any possible solutions.

### Introduction

- 6.1** There has been a range of UK and international regulatory work in the asset management sector over recent years. This section, while not an exhaustive list, identifies key pieces of recent and forthcoming legislation and policy work in the asset management regulatory landscape.
- 6.2** These regulatory initiatives have focused on addressing specific issues around transparency, distribution or interaction with capital markets, for example. They have not set out to understand the structural features of the sector and the effect this has on the incentives of asset managers, or focused on understanding the investor journey – all of which will be key elements of our study. We consider that this market study will focus on issues that have not been addressed previously. We also believe there is benefit in taking a wider look at the value chain as a whole.
- 6.3** When conducting our analysis we will consider the extent to which forthcoming regulatory developments address the issues we identify. Our market study will continue alongside FCA work currently underway. In addition, we will ensure that we take account of regulatory developments and minimise any duplication. We will liaise with other relevant authorities as necessary.

### Distribution

- 6.4** The RDR, which was introduced at the end of 2012, introduced new rules for firms and financial advisers. The RDR raised the minimum level of adviser qualifications, improved the transparency of charges and services, and removed commission payments to advisers and platforms from product providers.
- 6.5** An initial assessment of the impact of the RDR<sup>71</sup> (part of a three phase cycle) concluded that:
- Product prices have fallen by at least the amounts paid in commission pre-RDR, and there was evidence some product prices may have fallen even further. The complexity of platform charging structures had also reduced through the removal of rebates and this allowed consumers to better compare prices across platforms.

<sup>71</sup> *Retail Distribution Review, Post Implementation Review* (16 December 2014) Europe Economics [www.fca.org.uk/your-fca/documents/research/rdr-post-implementation-review-europe-economics](http://www.fca.org.uk/your-fca/documents/research/rdr-post-implementation-review-europe-economics)

- The RDR had reduced product bias, with a decline in the sale of products which had higher commissions pre-RDR and an increase in the sale of those which paid lower or no commission pre-RDR.
- Retail consumers are increasingly shopping around between different D2C platforms and exerting competitive pressure on platform charges. B2B platform charges were also falling (although this was not a direct result of RDR).

**6.6** The Financial Advice Market Review (FAMR),<sup>72</sup> a joint piece of work between the FCA and HM Treasury was launched in August this year and will examine how financial advice could work better for consumers. A call for inputs was published on 12 October 2015 with responses due in December, 2015<sup>73</sup> with a view to producing proposals before the 2016 Budget.

**6.7** Earlier this year the FCA also issued guidance clarifying the boundaries and exploring the barriers to market development for retail investment advice. This guidance helps to clarify the different types of retail investment sales models, the boundaries between them and the associated regulatory requirements on retail investment advice.<sup>74</sup> This guidance was informed by the FCA's thematic review of the distribution channels firms use to sell investments to customers in the retail investment market in July 2014. The review found that, although most firms considered their customers' needs in designing services to aid informed decisions, there was uncertainty about regulatory requirements leading them to leave out those features that could reduce the risk of poor customer outcomes. The review also found that some firms had decided not to develop simplified advice services because of uncertainty about our suitability rules.

#### **Transparency and disclosure to investors**

**6.8** Since 2011, the UCITS IV Directive has introduced a requirement for firms to provide a standardised disclosure document called the Key Investor Information Document (KIID). The aim was to simplify and standardise key information about the fund, including information on past performance of the fund and information on fund charges. This should help investors choose the right product for them and enable retail investors to compare different products, leading to more informed decision making.

**6.9** The KIID requires that firms include entry and exit charges, performance fees and a single OCF representing all annual charges and other payments taken from the assets of the UCITS. However, our 2014 thematic review into the Clarity of Fund Charges found that some fund managers, while using the OCF in the KIID, were still using the AMC in some marketing material, which may confuse investors and hinder their ability to compare charges. The work concluded that using the OCF consistently in all marketing material for UCITS funds is likely to help investors understand and compare charges.<sup>75</sup>

**6.10** From 31 December 2016, under the EU PRIIPs regulation, manufacturers of PRIIPs will be required to draw up a Key Information Document (KID) for each PRIIP manufactured. Furthermore, firms that advise on or sell PRIIPs will be required to provide retail investors with a KID for each PRIIP advised on or sold. Due to exemptions, the regulation will not apply in relation to UCITS schemes until 31 December 2019, so firms will continue to need to produce the UCITS KIID for these schemes.

<sup>72</sup> *The Financial Advice Markets Review* [www.fca.org.uk/news/financial-advice-market-review](http://www.fca.org.uk/news/financial-advice-market-review)

<sup>73</sup> *FAMR Financial Advice Market Review – Calls for input* (October 2015) [www.fca.org.uk/your-fca/documents/famr-cfi](http://www.fca.org.uk/your-fca/documents/famr-cfi)

<sup>74</sup> *FG15/1 Clarifying the boundaries and exploring the barriers to market development* (January 2015) [www.fca.org.uk/news/fg15-01](http://www.fca.org.uk/news/fg15-01)

<sup>75</sup> *TR14/7 Clarity of Fund Charges* (May 2014) [www.fca.org.uk/news/tr147-clarity-of-fund-charges](http://www.fca.org.uk/news/tr147-clarity-of-fund-charges)

- 6.11** For both UCITS and PRIIPs, firms must give clients information about costs and charges, but in different ways. For UCITS schemes, firms are required to disclose performance fees, one-off charges and ongoing charges using the OCF as the headline figure. In relation to PRIIPs, both one-off and ongoing charges are required to be disclosed using a summary cost indicator. The PRIIPs regulation also requires the additional disclosure of indirect costs such as transaction costs.
- 6.12** Importantly, pensions are currently not covered by the PRIIPs regulation, although the European Commission will, as part of its review of PRIIPs in 2018, consider whether to extend its scope to include other retail investment products, including pensions. The FCA and DWP joint call for evidence on 'disclosure of transaction costs' information for workplace pension schemes explores types of transaction costs, how they should be captured and reported, and whether to include other factors of investment return. It will also consider the best method to present costs to Independent Governance Committees (IGCs), pension trustees and scheme members.<sup>76</sup> Responses to the call for evidence will be used to shape proposed rules which will be consulted on later this year.
- 6.13** MiFID II is scheduled to come into force in the UK on 3 January 2017 and some of its provisions will apply to investment firms in the asset management sector. Like PRIIPs, MiFID II will require firms to include transaction costs in addition to the OCF. MiFID II will also touch upon and introduce changes to other aspects of the provision of asset management products and services. MiFID II is expected to further enhance investor protection standards, including new rules on product governance, the ability to receive research linked to dealing commissions, and disclosure of costs and charges.
- 6.14** We recognise that it is the quality of disclosure, rather than the quantity, that is most useful for investors. As part of this, we published our discussion paper on Smarter Consumer Communications in June.<sup>77</sup> In this, we considered consumer communications across financial services markets more generally. We sought views on how to improve consumers' access to high quality, appropriate information to help them buy the right products or services for their needs, including how to improve the disclosure of information on costs and charges to encourage better consumer outcomes. We are currently reviewing responses to determine next steps on this work.
- 6.15** We have conducted a thematic review to assess whether UK authorised investment funds and segregated mandates are being operated in line with investors' expectations as set by marketing and disclosure material and investment mandate agreements. The results of this project will be published in 2016.
- 6.16** In 2016, we also intend to look at investing in authorised funds through nominees. We will review our Conduct of Business Sourcebook (COBS) rules and guidance that require certain disclosures and interactions between firms and the beneficial owners of units in authorised investment funds. Our consultation<sup>78</sup> on the proposed changes to the COBS rules concluded in July this year and we will undertake further work on the rules and guidance during the course of 2016.

<sup>76</sup> DP15/2 *Transaction Costs Disclosure: Improving Transparency in Workplace Pensions* (March 2015) [www.fca.org.uk/your-fca/documents/discussion-papers/dp15-02](http://www.fca.org.uk/your-fca/documents/discussion-papers/dp15-02)

<sup>77</sup> *FCA Smarter Communications Discussion Paper* [www.fca.org.uk/static/channel-page/dp-smarter-comms/dp-smarter-comms.html](http://www.fca.org.uk/static/channel-page/dp-smarter-comms/dp-smarter-comms.html)

<sup>78</sup> CP15/20 *Investing in authorised funds through nominees* (June 2015) [www.fca.org.uk/news/cp15-20-investing-in-authorised-funds-through-nominees](http://www.fca.org.uk/news/cp15-20-investing-in-authorised-funds-through-nominees)

### Interaction with capital markets

**6.17** One of the recommendations of the Fair and Effective Markets Review (FEMR)<sup>79</sup> was that the FCA's Senior Management and Certification Regime should be extended to firms active in a range of wholesale markets – including asset managers. The Treasury has also announced its intention to implement this recommendation, and to go beyond it, extending the regime to all FSMA authorised firms. The Bank of England and Financial Services Bill<sup>80</sup> giving effect to the extension has been introduced to Parliament and is being debated at the moment. The Bill proposes a requirement for senior managers to take reasonable steps to prevent regulatory breaches by firms where they work.<sup>81</sup> The intention is that the regime should come into effect in 2018.

**6.18** We have also considered and contributed to the debate around changes to the rules regarding the use of dealing commissions. Our discussion paper last year presented the findings from our supervisory work and considered the European Securities and Markets Authority's (ESMA's) proposals for the treatment of research and inducements.<sup>82</sup> In our feedback statement<sup>83</sup> published earlier this year, we set out our support for ESMA's proposals, including separating portfolio managers' payments for research from execution arrangements which we consider will better align incentives to control costs and improve competition in the market for research.

### Ancillary and outsourced services

**6.19** We considered outsourcing in the asset management industry. We assessed whether asset managers effectively mitigate risks related to outsourcing critical activities and focused on two key issues: resilience risk (asset managers' contingency planning in the event of the failure of a service provider), and oversight risk (inadequate oversight of outsourced functions).<sup>84</sup> The review found that, while all asset managers who were part of our review had oversight arrangements in place to oversee their service providers, the effectiveness of the arrangements varied, primarily because of differing levels of internal expertise related to the outsourced service.

### Financial stability and asset management

**6.20** In March this year, the Financial Policy Committee (FPC) asked the FCA and Bank of England to carry out work looking at asset management and market liquidity with a focus on financial stability risks.<sup>85</sup> The research focused on the so-called 'liquidity mismatch', including any potential impact on financial stability. The market study will consider investor awareness of the potential liquidity risks associated with investment funds and will share the findings with the FPC.

**6.21** In November 2011 the G20 summit leaders asked the Financial Stability Board (FSB), in consultation with the International Organization of Securities Commissions (IOSCO), to prepare methodologies to identify systemically important non-bank non-insurer (NBNI) global systemically important financial institutions (G-SIFIs). The proposed methodologies for identifying NBNI G-SIFIs were

<sup>79</sup> *The Fair and Effective Markets Review Final Report* [www.bankofengland.co.uk/markets/Documents/femrjun15.pdf](http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf)

<sup>80</sup> Bank of England and Financial Services Bill [HL] 2015-16

<sup>81</sup> *Senior Managers and Certification Regime: extension to all FSMA authorised persons*, October 2015: [www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorized-persons](http://www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorized-persons)

<sup>82</sup> DP14/3 *Discussion on the use of dealing commission regime* (July 2014) <http://www.fca.org.uk/news/dp14-03-the-use-of-dealing-commission-regime>

<sup>83</sup> FS15/1 *Feedback statement on DP14/3 - discussion on the use of dealing commission regime* (February 2015) <http://www.fca.org.uk/your-fca/documents/feedback-statements/fs15-01>

<sup>84</sup> TR 13/10 *Outsourcing in the asset management industry* (November 2013) [www.fca.org.uk/news/tr13-10-outsourcing-in-the-asset-management-industry](http://www.fca.org.uk/news/tr13-10-outsourcing-in-the-asset-management-industry)

<sup>85</sup> News Release – Financial Policy Committee statement from its policy meeting (23 September 2015) [www.bankofengland.co.uk/publications/Pages/news/2015/022.aspx](http://www.bankofengland.co.uk/publications/Pages/news/2015/022.aspx)

published for public consultation in January 2014.<sup>86</sup> These proposed methodologies included investment funds and aimed to identify NBNI financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity at the global level.

- 6.22** A second consultative document was published in March 2015<sup>87</sup> with revised methodologies which included considering asset managers and investment funds as separate G-SIFs. Following responses to this consultation, the FSB announced that it would wait to finalise the assessment methodologies for NBNI G-SIFs until the current FSB work on financial stability risks from asset management activities is completed. The ongoing work on financial stability risks from asset management activities started in March, and is focused on risks associated with market liquidity as well as potential structural sources of vulnerability associated with asset management activities. This work will evaluate the role that existing or additional activity-based policy measures could play in mitigating potential risks, and make policy recommendations as necessary.

#### Other relevant work

- 6.23** UCITS V, which must be transposed into national law by 18 March 2016, will enhance the rules on the responsibilities of depositaries and introduce remuneration policy requirements for UCITS fund managers that will be broadly in line with those applicable to alternative investment fund managers.<sup>88</sup> As part of these changes each UCITS management company (or manager) will be required to put in place remuneration policies that do not encourage risk-taking which is inconsistent with the risk profile of the fund. All UCITS managers must also disclose information regarding their remuneration policy, in an effort to improve transparency over pay practices. It is difficult to comment on the full impact of these new requirements because this will depend on what the final ESMA guidelines look like. These guidelines clarify a number of significant matters, such as the application of the principle of proportionality and of different sectorial rules.
- 6.24** ESMA's recent consultation on proposed changes to its Alternative Investment Fund Managers Directive (AIFMD) Remuneration Guidelines sought views on the introduction of a common definition of performance fees and the requirement for Alternative Investment Fund Managers (AIFMs) to disclose their remuneration policies and practices to investors.<sup>89</sup> ESMA intends to finalise the Remuneration Guidelines and publish a final report by early Q1 2016.
- 6.25** In November 2014, we conducted a review of wealth management firms and private banks to assess how they managed conflicts of interest arising from including in-house investment products in client portfolios.<sup>90</sup> The review found that firms generally recognised potential risks to their customers arising from conflicts of interest and took steps to manage them.
- 6.26** As we seek to understand the topics covered in this market study, we will take into account any findings of previous relevant work in related areas. We will also consider the extent to which any recent or forthcoming regulatory changes will address any concerns identified.

<sup>86</sup> *FSB and IOSCO Consultative Document Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions Proposed High-Level framework and Specific Methodologies*, 8 January 2014: [www.financialstabilityboard.org/wp-content/uploads/r\\_140108.pdf](http://www.financialstabilityboard.org/wp-content/uploads/r_140108.pdf)

<sup>87</sup> *FSB and IOSCO Consultative Document (2<sup>nd</sup>) Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions Proposed High-Level Framework and Specific Methodologies*, 4 March 2015: [www.financialstabilityboard.org/wp-content/uploads/2nd-Con-Doc-on-NBNI-G-SIFI-methodologies.pdf](http://www.financialstabilityboard.org/wp-content/uploads/2nd-Con-Doc-on-NBNI-G-SIFI-methodologies.pdf)

<sup>88</sup> We are currently consulting on changes to the proposed rules needed to implement the directive in the UK and amendments to the FCA Handbook later this year, see CP15/27: *UCITS V implementation and other changes to the Handbook affecting investment funds* (September 2015) [www.fca.org.uk/news/cp15-27-ucits-v-implementation-and-handbook-changes](http://www.fca.org.uk/news/cp15-27-ucits-v-implementation-and-handbook-changes)

<sup>89</sup> Consultation Paper *Guidelines on sound remuneration policies under the UCITS Directive and AIFMD* (23 July 2015) 2015/ESMA/1172 [www.esma.europa.eu/content/Guidelines-sound-remuneration-policies-under-UCITS-Directive-and-AIFMD](http://www.esma.europa.eu/content/Guidelines-sound-remuneration-policies-under-UCITS-Directive-and-AIFMD)

<sup>90</sup> TR14/19 *Wealth Management firms and private banks – Conflicts of interest: in-house investment products* (November 2014) [www.fca.org.uk/news/tr14-19-wealth-management-firms-private-banks-conflicts-of-interest](http://www.fca.org.uk/news/tr14-19-wealth-management-firms-private-banks-conflicts-of-interest)



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