FCA Asset Management market study: Terms of Reference

Comments from The Investment Association

18th December 2015

Introductory comments

1. In the context of the FCA market study, The Investment Association[1] sees the asset management industry as a diverse group of competing firms, who will engage with the regulators directly. However, we would like to take the opportunity to provide some initial observations on the Terms of Reference (ToR).[2]

2. At a general level, we believe that an internationally competitive market where firms compete on both price and quality is in the interests of industry, savers and investors. We welcome the recognition in the ToR of the importance of the industry, both domestically and as a significant export sector which helps to support UK overseas earnings, tax revenue and jobs.

3. It is essential that in conducting the market study the FCA takes a proportionate and targeted approach, which recognises the diversity of firms operating in the UK market, both in terms of firm size and different client geographies served from the UK. This links to a fundamental issue raised in more detail below about the need to define better the geographic scope and competition objectives of the study.

4. We echo the point made in the introduction to the ToR about the significant level of current and forthcoming regulatory activity affecting the asset management sectors, both as a result of UK and EU initiatives. This should be taken into account in the sector analysis and given time to work through.

5. Our response below is in five sections:

    - <u>Value chains and the asset management industry</u>. Asset management activities are both highly intermediated in the customer delivery chain and extend beyond the manufacture of investment products and services. In this regard, any study of competition and value should acknowledge that the contribution to well-functioning capital markets, sitting between UK savers and capital issuers, is fundamental. It is also important to emphasise that patterns of product development and selection are increasingly sophisticated, with active management defined far more broadly than stocks and securities selection in direct competition to an index. This is seen in both the UK institutional and retail markets. Asset managers may therefore be in competition not only with each other, but with other players in the value chain in areas such as asset allocation or delivering specific client outcomes.

    - <u>Scope of study and the international nature of the UK industry</u>. We would welcome clearer delineation of scope. IA members operate in both the UK client market, where they manage £3.3trn for UK savers and investors, and in a broader European and international market. This raises two points with respect to analysis and potential remedies. First, it is important to ensure that UK asset managers competing internationally are not put at a competitive disadvantage by being subject to additional regulation that does not apply to local firms. Second, we also note the fact that the UK

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[1] The Investment Association represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the in-house managers of occupational pension schemes. They are responsible for the management of around £5.5 trillion of assets in and from the UK on behalf of domestic and overseas investors.

[2] We have limited our comments herein to those relating to the substance of the ToR. The IA will raise any concerns or comments about the process and timing of the Review separately.

client market is itself served by overseas-domiciled managers and funds, subject to different local supervision and oversight, who are able to offer products and services into the UK. The FCA should guard against any assumption that overseas domiciled funds are not in fact an inherent part of the UK investment management market.

- Retail market structure and the role of advisers and platforms. Given existing levels of intermediation, there is a critical distinction to make between investment costs and performance as measured at a fund level, and the end experience of an investor or saver. In the post-RDR retail market, the total cost of investment and the total cost of ownership are also structurally very distinct. This is not currently clear in the ToR analysis on charge patterns and net consumer experience within the industry. We also identify specific areas in relation to pre-RDR share classes where the regulator and industry could work together to help secure the best outcomes for savers and investors.

- Institutional market structure and the role of investment consultants. We note the intermediated nature of the institutional market and the need to examine the relative roles of all players, including asset managers and investment consultants. The presence of the latter has significant implications in the institutional market for the way asset managers compete and innovate. The intermediation of asset managers can lead to less innovation reaching the market and can be a barrier to entry for them. The emergence of fiduciary management services in the institutional market changes the competitive dynamic between consultant and asset manager, and the potential conflicts of interest arising merit further exploration. In addition, many of the costs which are borne by the end investor or member of pension scheme will not be under the control of the asset manager.

- Industry delivery and regulatory change. The market study takes place in the context of major regulatory changes that will impact both patterns of competition and transparency of delivery. Clear disclosure across the markets served by UK asset and fund managers is essential, with charges and costs assessed in the context of the specific service and performance delivered. On charge and cost transparency, the IA and its members have led the way in seeking to promote consistent and meaningful disclosure of product charges and costs. Looking ahead, we see the scope to join up forthcoming UK pensions requirements with MiFID and PRIIPs changes to create a more unified reporting environment for asset managers and their clients.

1. Value chains and the asset management industry

6. We note that the ToR focus particularly on competition at product level between asset management companies. This is what we would expect of a market study. However, given the questions raised not just about product-level governance and price-setting, but about the operating margins and profitability of asset management companies, it is important to set out the broader economic context in which our industry operates.

7. In a simplified manner, we see this through the optic of three central value chains:

    (i) Distribution and advice. As a highly intermediated industry both in the institutional and retail (including wealth) markets, asset managers depend upon a number of other components of the supply chain for delivery. This involves not only distributors and advisers, but market data providers, benchmark indices providers and rating agencies. In reality, distribution (platforms) and advice (independent financial advisers and investment consultants) by third parties are a feature both of the traditional retail and institutional markets. In the latter, where defined contribution schemes blur the boundaries, platforms may be used to deliver pooled investment or insurance funds. Ultimately, the end experience of the saver or investor is seen as performance net of all delivery costs (total cost of ownership). In a pre-RDR world, the retail share class reflected this in a bundled form. In a post-RDR world, investment fund charges represent only the cost of investment and not the cost of ownership. In both worlds, the role of platforms and advisers is an important component of fund market competition and end consumer outcomes.

    (ii) Product manufacture. Within an authorised investment fund, a very specific delivery and legal structure exists, laid out in domestic and European regulation. This reflects the strong consumer protection and disclosure regimes, which require professional oversight provided by a corporate trustee or depositary, the safekeeping of assets provided by a custodian, and audit and reporting requirements which translate into fund-level accounting governed by a Statement of Recommended Practice (SORP). Where different manufacturing processes are used, for example, insurance delivery (very common for pooled investment services in the pensions market), the structure is quite distinct. Analysis of product cost structures should therefore take into account different specificities.

    A key point on manufacture and procurement costs in the fund value chain is that there is a significant incentive for managers to control both direct costs experienced by firms and operating costs charged against the fund. At the same time, this is balanced by the need to minimise operational risk and therefore ensure high quality service delivery. A low quality ancillary service delivered along the value chain may result in operational risks being realised. It is the asset manager – and ultimately its clients – that carry this risk and so managers do consider the cost of ancillary services alongside their quality.

    (iii) Capital markets. While client-facing services are often the main focus when analysing asset management industry activity, the monies invested by UK and other savers are deployed in a variety of ways across capital markets globally. The economic function of capital allocation in both primary and secondary markets is complemented by associated functions of stewardship and oversight which make asset managers a critical part of the capital market value chain.[3] The operation of

[3] See, for example, http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/files/insights/financial-services/2014/September/the-capital-markets-industry.pdf

such markets has been the subject of separate inquiries, including the Rights Issue Fees Inquiry.[4] However, when assessing overall value – and hence the balance sheet operations and profitability of asset management companies – this capital market function should not be overlooked.

8. Overall, this creates a set of activities that are complex in scope and sometimes in nature. The length of some of these value chains should not in and of itself be perceived as a problem. Organisational theory of manufacturing and services products more generally points to value chains that are based on multiple inputs and outputs: for example, the automobile sector. The critical point is the clarity of service delivery and of cost for a given outcome at the relevant point in the process.

9. With respect to fund product manufacture and distribution, we are concerned that focusing so heavily on the relative prices of active and passive ignores different objectives and patterns of competition that are based on services such as asset allocation or specific outcomes (see also paragraphs 16-17 below). Cost is an important determinant of net performance, but it should never be considered in isolation from investment objectives and performance. In that regard we are concerned by the FCA's comment in paragraph 3.23 of the ToR that *"despite the higher annual management charge (AMC) for active management (average AMC is 1.2% compared to 0.5% for passive) the majority of the UK market still favour it (78% compared to 22% passive)"*. The implication of this comment is that cost should be the sole determinant of choice between active and passive strategies.

Capital allocation and asset management

10. The capital market value chain raises an important issue about the nature of asset management that is relevant to the competition study because it highlights features of the products and services that have a bearing both on cost of delivery and overall outcome.

11. The IA would define asset management broadly in three ways, with a distinguishing point being investing on behalf of clients:

    - Capital allocation in primary markets (supporting company equity and debt financing).
    - Stock and security purchase in secondary markets (and closely linked to primary market activity in areas such as price discovery).
    - Asset allocation and/or a specific focus on a client outcome.

12. Closely allied to the first two areas is the role of stewardship and oversight in the context of corporate governance responsibilities exercised by the asset management industry on behalf of clients. These responsibilities are a theme for both active and passive approaches.

13. The capital allocation and stock and security selection activities contribute broadly to a public good that is well functioning capital markets. There is a tendency sometimes to discuss the role of asset managers and the choice between active and passive management as if it were connected only to client choice and delivery. Active stock and security selection is an important part of the process that enables pricing in the market itself.

14. Quantifying this in economic value terms is exceptionally difficult, although we intend to publish some estimates of the scale of funding provided by the industry in the coming

[4] An investor led inquiry into underwriting commission paid by companies during equity capital raising. http://www.theinvestmentassociation.org/assets/files/research/20101213-rifireport.pdf

months. The capital allocation and stock and security selection function extends beyond a public good in that the clients of the asset management industry collectively benefit from the returns that the allocation function helps to generate in terms of supporting private and public sector economic activity.

15. To be clear, this does not diminish the importance or relevance of the questions being asked within the market study. However, any study of the economics of asset management business needs to be cognisant of the fact that these businesses act as conduits of capital through the economy, and not simply as product providers interfacing uniquely with different sets of investors.

Patterns of competition in product markets

16. The third part of the definition of asset management above raises a broader question about the dynamics of competition. The fund and asset management industry is characterised by a wide range of product choices, both in the context of geographic exposure to a given asset class, and in the context of strategies focused on asset allocation and/or specific outcomes such as volatility control or income generation. Growth in recent years in outcome-focused products reinforces the importance of considering the question of value as being broader than simply cost.

17. In such a market, patterns of competition become more complicated and cannot be characterised, as is often the case, as a direct choice between an actively managed fund and a passive fund offering to deliver a market return. A more nuanced approach would recognise asset allocation or outcome-focused products as being active by definition, but often delivered using a variety of underlying building blocks, both actively-managed specialist funds (e.g. emerging market debt or global fixed income) and passive funds (eg. North American equity).

18. This necessarily means that some fund managers are competing not only with each other in relevant product segments, but with other asset allocators or product designers. The definition of the relevant supply side market, therefore, may be wider than it first appears since asset allocation is a key service offered by multiple players including asset managers. To provide two examples:

- *A financial adviser with a retail or private wealth client looking for a diversified portfolio*. Broadly speaking, the adviser could choose between (i) building this themselves using components from the fund management industry; (ii) outsourcing the construction to a discretionary fund manager (DFM); and (iii) using a multi-asset fund from an asset management firm. From a customer delivery perspective, these are three routes to obtain a desired outcome; all involve the asset management industry, but in different ways and with different patterns of competition involved in the delivery to a saver or investor.

- *An asset management firm building a strategy aimed at a default arrangement in the DC automatic enrolment market, for example a target date fund (TDF)*. The TDF would be in competition potentially with (i) a range of other asset management firms; (ii) consultants with product offerings; and (iii) a consultant-intermediated default arrangement constructed at scheme level, which might involve a number of investment funds. Again, from a customer perspective, this involves patterns of competition that go beyond a simple choice between asset manager products.

Liquidity and market dynamics

19. While we recognise the importance of liquidity issues associated with investment funds, and the broader debate about the impact of asset managers on financial stability, we are surprised that this is being treated as a competition rather than a broader regulatory question.

20. The FCA is already assessing liquidity risk issues in asset management as part of the financial stability work mandated by the FPC. For example, in response to the FPC's March 2015 Statement, Bank and FCA staff conducted a joint information-gathering exercise on 17 asset management firms and 143 of their funds, focusing on liquidity risk issues. Similar work is ongoing.

21. We think that it would be duplicative to cover the issue again in the FCA asset management market study. Moreover, the issue is primarily one of financial stability, not the conduct and competition issues that are rightly the focus of the market study.

2. Scope of study and the international nature of the UK industry

22. As the ToR note, the United Kingdom has one of the largest and most successful asset management industries in the world. Of the £6.6trn managed from this country, some 40% is managed for overseas clients, half of whom are European. UK-headquartered firms are estimated to manage a further £800 billion abroad on behalf of a mixture of domestic and overseas clients. Coupled with a highly international fund market, which sees both UK-domiciled and overseas-domiciled funds sold in the UK and operated by UK-based firms, this makes for a highly diverse set of supply and demand dynamics.

23. From a competition perspective, therefore, we see IA member firms competing in multiple markets across the world, interacting with a range of regulatory authorities. Their competitiveness is defined in a number of ways, both relative to other European peers and regulatory jurisdictions (eg. Ireland or Luxembourg) within the EU single market, and relative to international peers and regulatory jurisdictions. With respect to this extra-EU dimension, competition plays out both in terms of the UK regime, but also the EU regime itself given the successful international brand that is UCITS.

24. For these reasons, we believe that it would be helpful to define more clearly the geographies and boundaries of demand and supply. There are two core issues here:

    (i) The way in which UK firms operate internationally. While we understand the interest of the FCA is looking at how UK institutional and retail/private client markets are served by the domestic asset management industry, we see this encompassing a different market analysis to that which looks at how UK firms compete internationally.

    (ii) The international nature of services sold within the UK client market. The ability of overseas asset managers to sell products and services into the UK market from other jurisdictions underscores the need to consider carefully the scope of both analysis and remedies, since the dynamics of competition and consumer protection cannot be solely analysed through a UK client and a UK supplier perspective.

Size of UK market

25. Based on detailed IA data on our membership base (£5.5trn under management in the UK), we have provided in Figure 1 a stylised view of the international and domestic client split, as well as the broad product split.

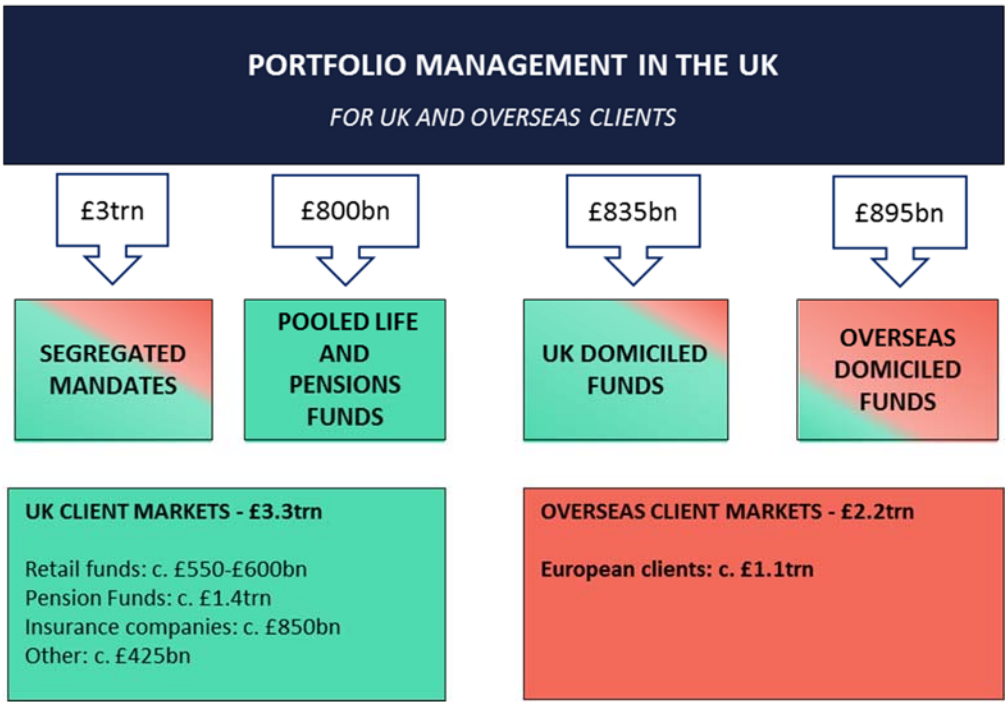
26. This highlights a number of significant points about the operations of the UK industry, notably:

    - Overseas clients interact with UK-based managers in a wide variety of ways, both through segregated mandates and UK and overseas-domiciled funds.

    - UK clients invest in multiple ways, including through overseas domiciled funds (as opposed to the number of those with passporting permissions). The IA estimates that around £84bn of UK client money is invested in this way as at September 2015, but this covers only IA members and the true figure is therefore likely to be higher.

    - A significant proportion of UK client money is invested via insurance delivered vehicles. These vehicles are used in the DB, DC and personal pensions markets as well as for life insurance products with investment links.

Figure 1: Asset location, product and client summary – IA membership



Source: Investment Association, *Asset Management in the UK 2014-2015*

Competitiveness metrics

27. There are a number of ways of measuring concentration at firm and product level. One established metric is the Herfindahl-Hirschman Index (HHI), which is consistently below 500 across the IA membership base, as measured both from a total UK AUM perspective and a UK fund management market perspective.[5] Another way of looking at the question of concentration is to examine flows into funds. Here again, patterns of gross retail sales over the past two decades present little evidence that the market share of the largest funds is leading to significant concentration.[6] At asset class level, there is some evidence that concentration has fallen as the number of funds has increased, pointing to a strong dynamic of competition in the market.

28. With respect to the question of levels of profitability, we would welcome more clarity about what the objective of the regulator is here and what the appropriate comparators are. The source cited in the ToR suggests that UK average profitability is below the global average. We would also emphasise the need to consider the asset management business model in the context of volatile market cycles. A significant proportion of the operating cost base is fixed, while revenue is predominantly collected on an ad valorem fee basis. In order to consider profitability, the FCA will need to ensure a full business cycle is captured.

[5] This metric is calculated as the squares of the market shares of firms within an industry. It is extensively used in antitrust analysis, with a figure of below 1,000 indicating an unconcentrated sector.
[6] See, in particular, IMA, *Asset Management in the UK 2013-14*, pp. 74-78.

3. Retail market structure and the role of advisers and platforms

29. The UK retail market has moved from a bundled fee model to a mostly unbundled approach under the RDR, with funds, platforms and advisers charging separately for services. The direction of travel in the UK market in recent years has been towards greater use of platforms, with direct to consumer propositions by fund management companies representing a very small part of gross retail flows. Financial advisers still play an important role in the distribution and selection of retail funds, but we note a shift in dynamics in recent years that has seen increasing outsourcing in areas such as portfolio construction and fund selection.

30. Taken together, these trends have major implications for competition in the market. Competition at the level of providing an investment service to a retail saver needs to be examined more widely than through the lens of a set of competing fund products. It needs to take account of where and how asset allocation / strategy design and fund selection takes place. This may be within an investment fund offered by a fund management house, or it may be put together elsewhere by advisers or discretionary managers. In other words, the charges for a multi-asset fund may be relevant relative to other similar funds, but crucially, they will also be relevant relative to the cost and delivery process of others offering a competing service.

Impact of RDR and ToR data presentation

31. Given the level of intermediation in this market, RDR fundamentally changes both the dynamics and the measurement of the consumer experience in the retail market. The choices available to retail investors, and the fees they pay, will vary according to the distribution channel that they use and the extent to which they take advice. This should, we believe, be taken into account in analysing retail investor choices and outcomes. We support the inclusion of platforms in the Market Study in the terms outlined by the FCA: ie. to understand the impact of platforms on competition between asset managers and how funds are purchased. Equally, for the same reason we do not understand the rationale of applying a different test to what is included or excluded between wealth managers and IFAs; and particularly the exclusion of any IFA activities.

32. One issue that is apparent from the fund charging analysis in the ToR is the need to distinguish the pre and post-RDR pricing comparison. Figure 2 of the ToR refers to average active and passive charges of 1.5% and 0.3% respectively, but the methodology behind these figures is not clear. This raises an additional issue of how to compare funds where adviser commission was included in a bundled cost against those where it was not. We would suggest that the competition analysis should recognise the distinction between the two regimes, and the overlap that still exists as a result of the ongoing existence of pre-RDR share classes.

Legacy share classes

33. The IA is concerned about the co-existence of bundled and unbundled share classes, and has called on a number of occasions for a sunset clause to be applied for the payment of adviser as well as platform commission from fund products. A number of fund managers would like to ensure that their customers can benefit from the best value share classes available in the market. The reality is that the legacy share classes reflect the economics of a bundled model (ie. incorporating payments to advisers as well as platforms), not the economics of a more expensive fund management offering.

34. It has not been possible to date to agree with regulators a framework under which fund management companies could act systematically to facilitate the movement of end investors into post-RDR share classes. The reasons for this relate to a number of complexities of the

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retail distribution chain as well as legalities of unit ownership. The IA would welcome a renewed dialogue with regulators to facilitate a process of transition.

4. Institutional market structure and the role of investment consultants

35. This section of our response to the ToR focuses on the market for institutional asset management services and the role played by investment consultants in the purchase of these services by their clients.

Procurement of institutional asset management services and the role of investment consultants

36. Institutional investors rely on the advice of investment consultants in making their investment decisions – indeed, pension fund trustees are required by the law to take investment advice[7]. Investment consultants therefore play a central role in the market for institutional asset management, acting as 'gatekeepers' to the client. They typically provide the following services:

- Development of client's investment objectives and investment policy statements.
- Benchmark selection.
- Asset allocation advice.
- Manager selection.
- Fiduciary management.

37. In this regard the process by which investment managers win institutional business involves them being intermediated by the consultant, which subjects them to a thorough and challenging appraisal before a mandate is won.

38. The selection of investments in DC pension schemes used for automatic enrolment – which arguably blur the line between retail and institutional investment management – also exhibits similar tendencies. Consultants (and advisers in workplace GPPs) play an important part in selecting and designing the default investment strategy (where the majority of DC investors are expected to end up) and the managers that provide them (or components of them) in these schemes. The forthcoming requirements on transaction cost disclosure in the UK pensions market will further strengthen the role of consultants in providing advice to their trustee and IGC clients.

39. It is clear why the role of the investment consultant is so important. Even where clients have the skills and knowledge to take investment decisions, they may not have the time to conduct the quantitative and qualitative research that consultants do. With so many investment managers in the marketplace, consultants are therefore an important intermediary, matching asset managers to their clients' investment needs and objectives. In this regard, just as we would argue that the retail market should be analysed through the prism of consumer outcomes, we would see a similar principle operating here with respect to how well pension schemes are served by the full institutional delivery chain, including consultants.

40. The position consultants occupy means that they have significant influence in the institutional asset management market and can have a direct impact on the fortunes of individual asset management firms since they control the latter's ability to access potential clients. If a manager does not have the necessary depth of relationship with the consultant, they can find it very difficult to access the institutional market.

[7] Section 36(3) of the Pensions Act 1995 covers advice and requires that trustees must obtain and consider proper advice on whether the scheme's investments are suitable and suitably diversified and in line with its statement of investment principles. Advice must be obtained from a suitably qualified person though the requirement for that to be from a person authorised under the Financial Services Act 1986, which is limited to specified activities and not the bulk of consultants' work.

41. Even where firms are established in the market the presence of consultants can affect the ability of asset managers to compete and innovate – distance from the client can slow the pace of innovation as it can be harder to understand clients' precise investment needs. Furthermore, by effectively controlling the distribution of products to institutional clients, consultants can also affect the shape of product innovation in the market.

42. Paul Myners, in his 2001 review of the UK institutional investment market noted a number of consequences that arise in the market as a result of the role that consultants play.[8]

43. At the time of his review, Myners noted that consultants typically prioritise their research efforts and focus where they are most likely to meet the greatest client demand. This may result in less research effort being expended on smaller managers, new entrants (both large and small) or those which have recently returned poor performance figures. In the years since the Review, this issue has diminished as a concern. However, there is a desire among asset management firms to ensure greater transparency around consultant manager selection processes and performance.

44. Past underperformance tends to be particularly damaging: many respondents to Myners' review felt that managers who underperformed their benchmark over a period were highly unlikely to be included in the list of consultants' favoured managers, and even less likely to be selected by clients.

45. The corollary of these effects is that it is difficult to be shortlisted for a mandate – and even more difficult to be selected – for a firm which is less established. If clients are concerned about being held responsible for disappointing fund performance, then investing with a well-known manager, which is also the manager for many other pension schemes, is likely to appear a safe strategy.

Incentives and the conflicts of interest faced by investment consultants – impact on competition for asset management and client outcomes

46. Unlike the asset management sector, the investment consulting industry is highly concentrated. The three biggest consultants are estimated to advise around half of UK pension funds, while the six largest consultancies advise 70 per cent of the market[9]. This concentration is likely to be important when thinking about the increasing degree of direct competition between asset managers and investment consultants, as well as the barriers to entry to the institutional market that some asset managers might face. It may also mean that asset managers are less likely to challenge consultants, for example, where they might take a different view of what might be suitable for clients.

47. The core consulting business of manager selection is a role that is uniquely fulfilled by the consultants. Increasingly, however, the consultants' business lines have moved into areas that are competing with asset managers but without being subject to the same degree of regulatory oversight and competitive processes.

48. A potential conflict of interest can arise were consultants to use their client advisory relationships to sell their own funds. For example, in the DC pensions market, consultants might design their own default strategies by blending external managers' funds. There are also issues that arise with respect to transparency and disclosure, since there is no

[8] 'Institutional investment in the United Kingdom: A review', *Myners, 2001.*
[9] Source: Financial Times: *''Perverse' investment consulting industry condemned'*, 22/11/15.

requirement to publish the performance of these blended strategies, whereas managers must report the performance of their individual funds.

49. The potential conflict of interest also arises in the case of fiduciary management[10], where investment consultants can recommend their own services to their clients – without the need for a tendered mandate. This market has been growing steadily in recent years[11] with consultants providing the majority of mandates[12], apparently often winning this business without any competitive tendering process[13]. The track records of their fiduciary services are not independently audited, while asset managers in contrast are rightly subject to the scrutiny placed upon them by the consultant in providing advice to the end client. This creates a further distortion in the competitive landscape, to the detriment of asset managers.

50. The work that goes into the asset manager selection process is important and provides the client with the confidence that their final decisions are based on significant due diligence. Such standards must also apply to fiduciary managers and the risk is that this may not be the case where consultants are recommending their own services. This potential conflict of interest is exacerbated since consultants are in the privileged position of being able to pass judgment on asset managers to their clients while simultaneously competing with them for business. A number of potential remedies exist in this area, including consideration of clear use of Chinese walls.

[10] Fiduciary management is the delegation of investment decisions, previously taken by trustees, to a fiduciary manager. The manger typically manages the delegated assets on behalf of the trustees. The extent to which decisions and assets are delegated can vary significantly between clients.
[11] From just £2 billion of assets under management in 2007 to £114 billion of AuM in 2015. Source: 2015 KPMG Fiduciary Management Market Survey
[12] 2015 KPMG Fiduciary Management Market Survey
[13] According to KPMG, 75% of new mandates were awarded without a fully competitive tender in 2014. Source: 2014 KPMG UK Fiduciary Management Market Survey

5. Industry delivery and regulatory change

51. The market study notes that initiatives on fund and asset management market transparency are taking place in the context of the PRIIPs and MiFID II packages. The IA supports improved transparency across financial services, and encourages UK and European regulators to focus on meaningful as well as consistent regulatory disclosure. This is expressed in a number of key IA beliefs about how best to facilitate this:

    - The Ongoing Charges Figure (OCF) remains the most intuitive and complete measure of fund charges. The IA encouraged firms to quote the OCF rather than the Annual Management Charge in frontline disclosure as long ago as 2012, and supports the FCA's move in May 2014[14] to reinforce that. Discussions with our membership suggest there is evidence that the OCF is increasingly being requested and used in the institutional market by consultants and their clients.

    - Aggregation of product charges such as the OCF, together with brokerage fees, transaction taxes and market costs produces an indicator of economic experience of a pound or euro invested. In other words, an investor has an approximation for all friction that their investment will encounter as part of a professional investment process. Aggregation, importantly, does not tell the investor what they have paid the fund manager, nor how expensive a market or trading process may be in the context of generating a given investment return. It is, therefore, flawed and cannot serve as a meaningful indicator of charge and costs and must be expressed on a granular basis as well.

    - Measures such as OCF could both be preserved and expanded in coverage to provide a single language to describe product charges – in other words, monies paid to fund managers or other services providers such as pensions platforms. The IA favours OCF particularly because it seems self-explanatory, accounting for charges that are ongoing (unlike Total Expense Ratio whose meaning is arguably not intuitive).

52. The transaction cost disclosure process will gradually be facilitated by the introduction of improved technologies for recording and reporting, as well as regulatory requirements under MiFID II which affect brokerage firms as well as their buy side clients. While the IA has concerns about the consequences for the investment process of some measures, particularly in the area of pre-trade transparency, the availability of data is likely to increase. In such an environment, it ought to be possible to construct improved client reporting frameworks. The area where much greater discussion needs to take place with regulators is how different client and decision-making groups can access transaction information. Having facilitated detailed equity market reporting for institutional clients and corporate trustees / depositaries of funds, the IA is now exploring how to update such codes for a MiFID II world, and also to facilitate the disclosures now expected under new UK pension reform regulation.

[14] TR14/07 Clarity of Fund Charges