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Response to Consultation Paper 17/18 – Consultation on implementing the Asset Management Market Study remedies and changes to Handbook

The CFA Society of the UK (CFA UK) represents about 11,000 investment professionals working across the financial sector including portfolio managers, buy-side analysts, sell-side analysts and credit rating analysts, among others. Our mission is to educate investment professionals, to promote high ethical and professional standards and to explain the profession to our stakeholders. For advocacy purposes, our members are represented by several committees including the Professionalism Committee. The Professionalism Committee welcomes the opportunity to respond to the FCA's consultation paper 17/18 on the implementation of the Asset Management Market Study. As we said at the time of the report's final report's release, 'The report gives the UK investment profession a great opportunity to improve the way it works with customers and to move the debate on from costs and charges to focus on the vital role that the sector plays in the economy. This is a sensible and positive outcome to an important exercise.'

We limit our comments in this response to the proposals to improve fund governance and to move investors into better value share classes. As we have noted before, there has been too little independent oversight of the way in which investment vehicles are managed. Strengthening the governance requirements – dealing with the root cause rather than with the symptoms – will improve client outcomes. We welcome the proposals for greater independence and for the extension of the SMCR to fund Boards.

Questions on measures to improve fund governance

Your study found that Authorised Fund Manager (AFM) boards do not robustly consider value for money, occasionally fail to take appropriate steps to address underperformance and can lack the authority to challenge commercial strategy. As a consequence, you propose to introduce a new rule to require an AFM to assess whether value for money has been provided to fund investors. You propose that an assessment should consider economies of scale, fees and charges, share classes, quality of service and transparency.

Q1: Do you agree that we should introduce a specific rule requiring AFM boards to assess value for money?

Yes. However, it is important to acknowledge that this is a difficult assessment to make. Different fund boards may place greater value on some characteristics than on others. AFM boards should be required to assess value for money, but there should be relatively few regulatory controls around how this is done. The more regulatory constraints that are put in place around this requirement, the likelier it becomes that AFM boards will rely on a standard form of legal language through which to meet the requirement. The information value of the board's report on how they have assessed value for money will then be minimal (limiting the potential for analysts and platforms to use this) and investors will probably be little better off.

Q2: Do you agree with the specific requirements of the assessment? If not, what additional or alternative elements should be included?

We believe that the points proposed are useful and that AFM boards should be guided to include these in an assessment, but also believe that AFM boards are more like to take ownership of value for money if they are given some leeway to define it. So long as there is a strict requirement for the board to publish the criteria that they have used and their assessment of their performance against those criteria, we feel that the risk that boards may abuse a more flexible approach is limited.

In addition, we have some concerns that assessing charges against comparable market rates (rather than against expected performance and service quality) might encourage the sort of price clustering that the FCA hopes to discourage.

Q3: Do you agree with the planned implementation period of 12 months? If not, what alternative timeframe would you suggest?

We believe that a planned implementation period of 12 months following the finalisation of new rules should be adequate. However, we would also recommend the development of an informal working group to develop best practice guidance on setting value for money criteria, analysing value for money and reporting on value for money. It would be helpful for AFM directors if there were educational programmes available to help them meet these new requirements.

Q4: Do you agree with the proposed requirement for the AFM to publish a report on the findings of the assessment and the steps taken?

Yes. There would be little point in the AFM board spending governance time on assessing value for money – the ex ante framework for the assessment (with the weighting of different factors), the process taken and the ex post findings – if this information was not to be shared with investors and other intermediaries. The new rules should specify how a report should be published in terms of timing and venues. A failure to publish a report in accordance with the requirements should be considered a serious regulatory failure.

Q5: Do you agree with our proposal to require AFMs to appoint independent directors to the board? If not, what alternative would you propose?

Yes, as we commented in our response to the interim report, we believed that 'governance structures could and should be strengthened, but that this should be done in a way that does not generate significant additional costs.' We supported recommendation C and called for the requirement to appoint independent directors.

Q6: Do you agree with the proposed proportion of independent directors (at least two and not less than 25% by number)?

Yes, we believe that this should improve governance without imposing significant additional costs that would likely be borne ultimately by investors. In our response to the interim report, we commented that there was insufficient evidence to assess the benefit of a board containing a majority of independent members versus one with independent director participation. We encourage the FCA to monitor the relative performance of fund boards in different jurisdictions (in terms of relative outcomes for investors) and would be interested in collaborating in this work.

Q7: Do you agree with our approach that independent directors may serve on more than one board, provided that they comply with existing rules? If not, do you think a ban on serving on more than one board is necessary?

Yes, not only may there initially be a fairly limited pool of candidates to draw from, but it might also benefit directors to be able to draw from their experience across more than one board. That said, it would clearly be important when selecting an independent director for the nominating committee to consider any conflicts and we would also recommend the implementation of a rule imposing an upper limit (of, say, three or four) on the number of boards on which an independent director may serve. It is important that these roles are not simply inhabited by corporate trustees, but are held by individuals who will understand their personal responsibility (and accountability) to serve on behalf of investors.

Q8: Do you agree with the proposed requirements for being an independent director?

The proposed eligibility requirements are sound, though they create a risk that independent directors may be individuals that have had long-standing relationships with the AFM or its parent company – even if these ended more than five years ago. We recommend that at least one of the independent directors has never been an employee, received remuneration or had any material business relationship with the AFM. In addition, we recommend term limits for independent directors so that their independence is not compromised by working closely with the AFM over a long period of time. We recommend that the FCA might wish to consult informally with AFMs and fund governance experts to determine an appropriate term limit.

Q9: Do you agree with an implementation period of 12 months?

Yes, though the FCA might wish to notify the market that this would not become an enforcement matter within the first two years of the rule's application. As mentioned earlier with respect to value for money, we believe that directors (and potential directors) would find it useful to have access to educational programmes on the roles and responsibilities of directors of investment vehicles (companies and AFMs). We would be interested in helping develop such programmes and would value the opportunity to discuss how the FCA might be able to support this activity.

Q10: Do you agree that it should be up to the AFM to decide whether to appoint an independent director or an executive director as chairman?

Yes, the AFM board should decide for itself on who should chair the board. In time, it might be possible for fund ratings agencies and analysts to assess the relative performance (both in terms of return and value for money) of boards with independent chairs and those with executive chairs. It would be better for this decision to be evidence-based and in the hands of the AFM board.

Questions of moving fund investors to better value share classes

Q11: Do you agree with the proposed modification of FG14/4?

Yes, it would be helpful if the FCA would clarify its guidance on hard to reach unitholders so that AFMs can have a better understanding of their capacity to undertake mandatory conversions. The costs associated with trying to locate unitholders combined with the legal concerns about conversions inhibit AFMs enthusiasm for doing the right thing by the majority of their clients.

Q12: Should the FCA consider stopping the payment of trail commissions on the distribution of asset management products? If so, over what time period?

Our primary concern around the issue of moving fund investors to better value share classes was for it to be made practically easier for AFMs to do so. Nevertheless, we recognise that the ongoing payment of trail commission on pre-RDR classes may also inhibit conversions. We agree that the FCA should gather more evidence about this issue in order to assess its scale and to determine whether additional steps are required.

We trust that these comments are useful and would be pleased to discuss them in person.

Yours sincerely,

Will Goodhart,
Chief Executive
CFA Society of the UK

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