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Response to Market Study MS15/2.2 – Asset Management Market Study, Interim Report (Nov 2016)

CFA UK is grateful to the FCA for the depth and range of work that it has undertaken in its Asset Management Market Study. As Andrew Bailey observed in November, investment managers are responsible for the savings of millions of people in the UK…it is important that they pursue their duty to act in their customers' best interests.

CFA Institute and its local member societies (of which CFA UK is currently the largest worldwide) share the belief that investment managers have a duty to act in clients' best interests.

As CFA Institute's President and CEO, Paul Smith, CFA, noted early last year, 'investment managers have a duty to act as stewards of investors' assets, in an environment that nurtures a culture of more ethical behaviour and promotes market integrity. If our industry is to recapture the trust of our investor base, we need to work hard to prove that we truly mean it when we say that we put their interests first. The investment management industry, its participants, and, most importantly, society at large will only prosper under these circumstances.'

The interim report on its market study demonstrates the FCA's commitment to meeting its strategic objectives to protect consumers and to promote competition. We support those objectives and welcome the opportunity to consider ways to achieve these ends.

The CFA Society of the UK (CFA UK) represents about 12,000 investment professionals working across the UK investment sector primarily as portfolio managers and buy-side 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. In our advocacy work, we take as our ultimate objective the best interests of clients.

In our work on regulations, standards and policy, our members are represented by several committees including the Market Integrity and Professionalism Committee. The MIPC has drafted this response on behalf of CFA UK members based on a survey of members and a series of roundtable discussions with investment professionals.

The CFA UK member survey showed that members are broadly supportive of the interim report's findings and recommendations. 234 members responded to the society's survey which was sent out on 13th December. 100 of the 234 members indicated that they had read the report and a further 105 stated that they had not read the report, but were aware of the main findings and recommendations in the interim report. Members provided feedback on the extent to which they supported the different findings and recommendations in the interim report and were also invited to provide comments on the findings and recommendations.

On average, two-thirds of survey participants supported the findings either entirely or largely while one-third supported them only partially or not at all. The survey asked respondents to indicate whether they felt that the findings would improve client outcomes greatly, partially or not at all. The recommendations that were most often regarded as likely to greatly improve client outcomes were those related to the disclosure of fiduciary management performance and fees. The recommendations that were most often regarded as least likely to improve client outcomes were those relating to an all-in fee.

The areas of the findings that were most strongly supported were those relating to conflicts in investment consulting from offering fiduciary management services, while respondents least strongly supported the findings in relation to the Ongoing Charges Figure (OCF) being insufficiently clear.

There was little difference between the responses from those that had read the FCA's report and those that had not. The full survey results are attached in Annex A.

Survey participants were also asked to indicate if they would be willing to participate in roundtable discussions about different elements of the findings and recommendations. Roundtable discussions on four separate clusters of findings and recommendations were held in mid-January. The four areas were:

- Duty of care, benchmarks and governance
- Fees and disclosures
- Fiduciary management
- Pensions pooling

The society's response to the interim report is based on the views and comments expressed in the member survey and in the subsequent roundtable discussions together with feedback received from members following the FCA's late January presentation to members about its report. Below, we make some general comments about the interim report before providing specific answers to the questions listed in the interim report.

The findings

The FCA's interim report from its asset management market study is a thoughtful attempt to address a perceived lack of competition within the market for retail and institutional investment management and investment consulting products and services.

Analysing competition in investment markets is a complex task. While consumers of passive investment products make decisions based largely on price (because cost will be the key differential factor between funds providing the same market or index return at similar levels of risk), buyers of active investment products take into account a variety of factors when considering value for money. Performance will be a critical item, but these might also include investment related issues such as risk, correlation, liquidity and income, as well as other factors such as brand, reporting quality and client service.

Price clustering in active equity funds should not be taken as evidence that there is a lack of competition in active investment management, but should be acknowledged as an indication that other factors also contribute to consumers' views on value. However, the difficulties that retail buyers experience in establishing comparable views on value across these other factors makes it difficult for consumers to incorporate price sufficiently heavily to encourage investment firms to use price as a distinguishing factor. Improved disclosures and more standardised communication in relation to value factors would, hopefully, lead to broader price competition.

While the FCA's interim report is intended to comment primarily on competition, CFA UK does not find that the report provides strong evidence of a failure of price competition. In passive, where price competition could be expected to function well, it appears to do so. In active, where it is more difficult for price competition to function well (because it is difficult to interpret value ex ante), retail consumers appear to pay less attention to price, but better resourced institutional investors pay close attention to price and appear able to use competition to drive prices lower. The strong fund flows to passive products seen in recent years also suggest that price competition between passive and active products is working well in investment management.

We have two broad observations to make about the findings. First, we believe that some of the evidence is weak. On the institutional side, the number of responses received from pension schemes, insurance companies and charities is small and may not be representative of their universes. We are also concerned about the reliance that the FCA places on qualitative research undertaken with just 40 retail investors. Further, we believe that the much used statistic that less than half of investors know that they pay fund charges is ill-founded and is contradicted by other evidence within the FCA's quantitative research. It is disappointing enough that 23% of the more than 2,000 retail investors whose views were captured in the quantitative survey do not look at charges when investing (para 71 Annex3), without the FCA needing to stretch the qualitative data to prove its point.

As we have also mentioned in prior conversations with the FCA, we think it is unfortunate that the data cannot be broken down to show the different flows and pricing patterns that are emerging post-RDR. We also note that the price data for retail funds is likely for the 'list price' and is unlikely to reflect the prices actually paid through platforms or advisers. In addition, we believe that it would have been useful to be able to see the price paid by consumers on a money-weighted basis. Many members have also expressed concern that the supply-side evidence was drawn from a relatively limited number of large investment managers. While this should mean that the analyses reflect the experiences of a large number of consumers, it may also mean that the picture that is painted of the sector is inaccurate as it fails to reflect the activities of the small and mid-size investment management firms.

Despite the weakness of some of the evidence used to support the findings, we agree with many of the report's broad conclusions: that price competition does not always work well across the market; that the transparency of charges and clarity of objectives could be improved; that investor and adviser behaviour could be improved; that it should be easier to switch between funds and that the investment consulting market is relatively concentrated and that investment consultants may be conflicted when offering fiduciary management services and due to their approach to charging. We share the FCA's opinion that 'there is room for improved outcomes in both the institutional and retail parts of the market'. As the FCA observes in its report, competitive pressures are building and much good work has been done in both the regulatory and commercial spheres to address some of the challenges listed above. Nevertheless, there is much work still to do and CFA UK welcomes the FCA's study and report as an opportunity to concentrate minds on potential solutions to those challenges.

The recommendations

The FCA's interim report proposes a series of remedies that could improve the way in which investment management products and services work for retail and institutional investors.

These measures relate primarily to the transparency, standardisation and clarity of costs, objectives and performance measures. They also attempt to address the quality of demand and, lastly, deal with investment consulting and fiduciary management.

We comment about each of the set of recommendations later in our response, but have these general comments.

Duty of care and governance

The proposal to introduce a strengthened duty of care on investment managers to act in the best interests of investors is well intentioned and closely reflects CFA Institute's Code of Ethics and Standards of Professional Conduct in terms of its intended outcome. However, the duty addresses symptoms and not the cause.

Rather than imposing an additional duty on investment managers that we believe would be difficult to describe with sufficient accuracy to make it supervisable and enforceable, we believe that the governance of fund structures should be improved so that all directors of fund Boards are subject to the Senior Managers and Certification regimes and so that fund Boards contain independent members. CFA UK suggests that the FCA consider the application of requirements similar to those contained within the ALFI Code of Conduct.

We believe that it should be the fund Board's role to determine how it will define value for money in the context of that fund's operation. It might be useful for the Board to provide an annual summary of its performance in delivering value for money for investors.

All-in fee

We reject the FCA's stated rationale for the introduction of an all-in fee. Investment managers are incentivised to control costs because costs act as a drag on performance. However, as we have stated previously, we would welcome greater variation in fee structures so that market forces could then determine preferred practice.

We have also said before that it is not possible to know all of the costs that will be incurred in managing a fund ex ante. While the charges for fund management and for the administration of the fund can be known, the implicit and explicit costs of transactions within the fund cannot.

It is clear that investors – both retail and institutional – find costs hard to identify and to compare. It should be easier for consumers to see the estimated all-in cost of investing composed of the known, ongoing charges and a standardised estimate of the additional (transaction costs) and these should be provided. The actual cost charged to the fund would be calculated based on the OCF and the actual transaction and other contingent costs incurred. In any offer document, it might be helpful for potential investors to be provided with both a % figure and a £s and pence figure (per £1,000) for the actual total charges incurred in investing in the fund in the prior year together with the OCF and an average of prior transaction costs.

We do not support the proposals that investment managers should become liable for the fund's contingent costs. As we have stated previously, such a move would lead to a number of adverse consequences. First, investment managers would require additional capital to hold against the risk of higher than anticipated costs. Investment managers are not banks. They are agents. Imposing capital requirements on investment managers would add cost for little added protection for investors. Secondly, requiring investment managers to own the difference between the forecast trading costs priced into their all-in fee and the actual trading costs would create a disincentive for investment managers to transact in clients' best interests. There are no longer any incentives encouraging investment managers to trade more than required. It would be a shame now to introduce incentives for investment managers to trade less than required. Last, there is a risk that investment managers would inflate their all-in fee to accommodate the highest foreseeable level of trading costs. It should be possible to improve price competition in active investment management, but possibly not to the extent that would be required to prevent managers from passing the risk of higher than expected trading costs to clients through an inflated all-in fee.

Disclosures

We agree that disclosures could be improved so that investors have a better idea at the outset about a fund's purpose, objectives (both relative and absolute), its level of risk and its capacity. We are concerned about requiring much stricter regulation of benchmark selection and recommend instead regulatory guidance on best practice in benchmark selection, management and application. We are also interested in the possibility of triangulating across various measures to provide some broad indication of funds that are or are not achieving their intended outcome. This is an area where we believe considerable further work could be done.

Switching

As we have commented before, CFA UK believes that it should be easier for investors to switch out of funds and for investment managers to close funds to which they are no longer significantly committed. Legacy product governance was less robust than current product governance and many of the concerns that the FCA has about price and value appear to relate primarily to legacy assets. We welcome the FCA's proposals in this area.

Pooling

Savings are available from pooling pension scheme assets. However, these savings are unlikely to be all that substantial and may take some time to be realised because of the upfront costs incurred. Scheme mergers, while difficult to achieve, may present greater opportunities for savings with the opportunity for cost reduction from administrative efficiencies.

While there may be some relationship between scheme size and investment expertise, the relationship is not necessarily consistent. Some small schemes have high levels of investment knowledge and skill, while some large schemes are reported to be relatively inefficient. The critical issue is to ensure that schemes have access to appropriate skill and resources as broadly as possible. CFA UK believes that it would be helpful to review the requirements around trustee knowledge and also suggests that further research should be conducted into the relationship between scheme governance and outcomes.

Investment consulting and fiduciary management

CFA UK believes that areas of investment consulting that are not yet within the regulatory perimeter should be brought within it.

The society also believes that it would be helpful for investment consultants to provide standardised performance data with respect to the performance of their recommendations. The way that the GIPS standards work in the investment management sector could be a potential model for the development of a standardised approach to investment consulting performance reporting. We also agree that trustees spend too much time on manager selection and would be better advised spending more time with their consultants on asset allocation and risk.

As we are unclear about the implications of a market investigation reference (and to some extent about the potential benefit of a MIR), we do not have a clear view on this proposed remedy, but believe that the conflicts of interest in the provision of investment consulting and fiduciary management are significant and should be addressed.

Conclusion

While we do not believe that the argument for a failure of price competition is made, we welcome the FCA's interim report. While some of the evidence for the findings is weak or misinterpreted, the society is broadly supportive of the general observations made and of the consequent recommendations.

However, we would caution the FCA against placing too much weight on the evidence for the findings in future. It will be important that the detailed work that will now need to be done to take these recommendations forward is based on sound cost-benefit analysis and broad discussion about how to capture the benefits and avoid unintended consequences. We hope that the recommendations will give rise to more detailed individual consultations so that their implementation can be achieved as effectively as possible.

We also note that a number of the issues identified in the findings and some of the recommendations being considered to address them are already in train through other regulatory measures. It will be important to consider the overlap between the interim report's recommendations and the measures being implemented through MiFID II.

Last, many members have noted that the increasing burden of regulation is acting as a barrier to competition. We note the interim report's findings in this area, but suspect that this is a topic where further research could usefully be undertaken. It appears to CFA UK that the sorts of recommendations being proposed are likely to lead to increased scale provision of investment management. If so, it will be important to ensure that there is still an opportunity for small managers to be established so that they can help to ensure the quality of the market for investment management in future.

Irrespective of the qualifying comments made above, CFA UK warmly welcomes the interim report's publication as it has stimulated thought and debate and provides an opportunity to introduce changes that could lead to substantial improvements in client outcomes.

Below we provide our responses to the proposed remedies outlined in section 10 of the interim report.

1. A strengthened duty on asset managers to act in the best interests of investors

   1.1. What is the likely effectiveness and proportionality of:

      1.1.1. the FCA setting out its expectations about how AFMs [Authorised Fund Managers] should demonstrate that they are acting in the best interests of unitholders

      1.1.2. governance reforms to help ensure firms comply with their responsibility to act in the best interests of unitholders

      The understanding that we have a duty of care towards investors and beneficiaries is a core value held by the investment profession. Not only is this duty held individually by investment professionals, but they and the firms that they work for also owe those sorts of duties under a number of different regulatory regimes. As a consequence, we do not recommend that there is a new or strengthened duty of care imposed on asset managers because of the difficulties of integrating this into the current regulatory framework and separately identifying these duties so that they can be supervised and enforceable.

      Our preference is for the governance regime applied to AFMs to be strengthened to address the issue at source. As we mention in our initial comments, we believe that governance structures could and should be strengthened, but that this should be done in a way that does not generate significant additional costs.

      Governance in firms and for individual funds already plays an important role in ensuring better outcomes for investors. Where there are clear issues, for example in DC plans, we note a strong awareness within the industry to develop improved trustee education.

      1.1.3. the specific options (A-F)

         1.1.3.1. A: Keep existing governance structure but clarify their duties. The AFM Board could be expected to demonstrate how it has complied with the strengthened duty to act in investors' best interests.

         1.1.3.2. B: Strengthen the requirements on senior managers of the AFM. The duties of the AFM board members will be strengthened by extending the Senior Managers and Certification Regime (SM&CR) to AFM board members, which is currently due to be applied to asset managers in 2017. We could seek to require that senior managers consider value for money as part of the introduction of this new regime.

         1.1.3.3. C: Change composition of existing governance bodies to create more independence. The existing AFM board structure could be reformed to mandate having a majority of independent members and an independent chair.

         1.1.3.4. D: Create an additional governance body: A separate independent body could be introduced, modelled on the Independent Governance

Committees for DC pension funds, to carry out the new duties, leaving the existing AFM board with its current responsibilities. The new body's obligations would be enforced by extending the SMCR to its members.

1.1.3.5. E: Replace existing governance structures with new body. Replace AFM Boards with majority independent fund boards, similar to the US Mutual Fund structure, with their responsibilities underpinned by the SM&CR.

1.1.3.6. F: Greater duties on trustees and depositaries. An alternative approach would be to leave current AFM governance structures unchanged and impose greater duties on trustees and depositaries to assess whether the fund manager is delivering value for money.

A This option is unlikely to lead to any significant change in behaviour.

B This option seems practical though we note some ambiguity about the definition of value for money given the uncertain nature of investing. We agree that it would be helpful for AFM directors to be required to define value for money in the context of their fund and to express how they intend to deliver it.

C We believe that it would be helpful to strengthen the composition of AFM Boards by requiring the participation of some independent directors. We have not had sufficient opportunity to assess the value of a majority independent Board as against a Board containing independent members and recommend closer consideration of other fund governance codes, specifically the ALFI Code of Conduct. We suggest that where directors are employees of the AFM, that potential conflict of interest should be disclosed to investors and there should be a description of how such conflicts are managed.

D seems like a costly approach – the costs of which might be passed on to consumers.

E Similar to C above, this could add cost without necessarily obtaining significant benefits.

F We are sceptical that trustees and depositaries would have the capacity to take on this role and they may be subject to conflicts because of their appointment and compensation by the fund manager.

1.2. Do you have views on how firms should demonstrate that they have acted in the best interests of investors?

Duty of care is a core value for asset managers and sits alongside acting in the best interest of investors.

It will be important for AFMs to be clear about the purpose of their fund and to hold to that purpose. Their objectives should be set in accordance with the fund's purpose and there should be regular, clear reporting

against those objectives.

In addition, CFA UK practitioners would point to the Investment Policy Statement that sets key objectives, including return expectations and risk tolerance, as an important starting point in acting in the best interests of investors. For Duty of Care, we believe that adherence to the CFA Institute's code of ethics and standards, in particular III – duties to clients, is a helpful approach for firms.

The CFA Institute's guide to Investment Policy Statements may be found here:

https://www.cfainstitute.org/learning/products/publications/ccb/Pages/ccb.v2010.n12.1.aspx

The CFA Institute's code of ethics and standards of professional conduct may be found here:

https://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx

1.3. Do you have views on how governance should work to ensure firms act in the best interests of investors?

Please see our response above.

1.4. Are there any logistical challenges and unintended consequences that should be taken into account? If so, how could these unintended consequences be overcome?

We would require additional time and further consultations to be able to answer this constructively. In short, there are likely to be unintended consequences, but we are unable to identify these immediately.

1.5. Are there advantages to the FCA recommending the government introduce a fiduciary duty by statute which could not be achieved through regulatory reforms?

No. As we stated in our response to the Law Commission's review of this question in 2014, our view is that the law of fiduciary duties as such should not be reformed by statute. Fiduciary duties are difficult to define and inherently flexible. Any attempt to change fiduciary duties through legislation would result in new uncertainties and could have unintended consequences.

Our January 2014 letter points out that investment practitioners are unable to meet every requirement of fiduciary duty because of having multiple clients. The behaviour of CFA UK member investment practitioners is guided by CFA Institute's Code of Ethics and Standards of Practice and is consistent with a "duty of care". This ensures that CFA UK members act for the benefit of their clients and place their clients' interests before their own. Where fiduciary duty in the more formal sense does apply is for trustees who have a clear fiduciary responsibility to a specific pension/investment vehicle. The 2014 letter recommends that the regulator should make use of the regulations that already exist to hold firms to account so that they act in the best interest of their clients.

It is also important to point out that the chain of intermediaries that extends from the coalface of portfolio management to the actual fund beneficiary makes it difficult to assign fiduciary duties at any given point. Arguably, UK law is unclear about where fiduciary duty lies along the investment chain.

1.6. Are there better alternative supply side remedies that would encourage asset managers to demonstrate that they are providing value for money?

If AFM directors were required to state how they believe their fund will provide value, it would be easier to assess how they performed in delivering value against their own definition. They would be incentivised to do so if they felt that consumers were better able to assess their relative performance in providing value. We continue to believe that it is important that consumers are better educated so that they can provide better demand side discipline.

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

We would welcome views on:

2.1. The likely effectiveness and proportionality of the:

2.1.1. – single charge remedy to incentivise asset managers to control the charges taken from funds

CFA UK believes that the introduction of an all-in fee might be helpful in enabling investors to observe the potential all-in cost of investing more easily, but dispute the apparent reason that the FCA has for suggesting it. Investment managers are incentivised to control the charges taken from funds because those charges ultimately act as a drag on performance.

We sympathise with the FCA's consideration of an all-in fee as a way to make it easier for consumers to understand the entirety of the costs involved in investment management, but believe that there is no way to do so in which the potential benefits for the consumer are not outweighed by the likely costs.

2.1.2. – the specific options (A, B, C, D)

2.1.2.1. A: The current OCF [Ongoing Charges Figure] becomes the actual charge that is taken from the fund. Under this option, asset managers would have to cover any variation between the OCF, which is currently an estimate, and the actual ongoing charges currently taken from the fund. Under this option, transaction costs (stamp duty, dealing commissions paid to stockbrokers and the 'bid-offer spread') and other charges not currently included in the estimated OCF would not be included in the single charge taken from the fund. This option would require the least change from the current way of deducting charges.

2.1.2.2. B: The current OCF becomes the actual charge, with managers providing an estimate of any implicit and explicit transaction costs. This would be similar to A, above, but would oblige asset managers to provide an estimate of the transaction costs the fund will incur. This option would enable easier comparison of the likely total charges across different funds.

2.1.2.3. C: There is a single charge which includes all charges taken from the fund, including both implicit and explicit transaction costs, but with an option for 'overspend'. Under this option, the single charge would cover all costs, although in order to compensate asset managers for trades in exceptional circumstances, managers could have discretion to take additional transaction charges from the fund which would then be clearly explained to investors in the annual statement.

2.1.2.4. D: There is a single charge which includes all charges taken from the fund, with no option for overspend. Under this option, the asset manager would be bound by the single charge figure and pay any additional investment-related or administrative expenses occurred (including transaction costs). Under this option, the asset manager would bear all the risk of a difference between forecast and actual trading costs.

Option A does not provide the opportunity to fulfill the two main aims of the FCA study, namely to improve competition and ensure value for money. Option A misses the opportunity to help investors understand alternatives by standardizing fees to make better comparisons across funds as the main variable costs (transactions) are excluded. We think there is scope to help consumers understand value for money without impeding competition or creating unintended consequences.

B is our preferred option because it enables better comparisons by standardizing fees for comparison without impeding competition. It allows managers the ability to provide estimates of total costs ex-ante. Holding managers to these estimates (options C and D) may drive unintended consequences of trading or managing trades to ex-ante estimates rather than to fund strategy. In addition, the additional accounting and complications in the process (how to prorate annual estimates, what about clients that have more flows than others) required for options C and D would incur higher costs that would most likely be passed on to investors.

Per C, while a single charge (albeit an estimate) would be simpler for retail investors to understand, it may lead to unintended consequences as discussed above.

D is our least favoured option as it would create a conflict of interest with the fund manager potentially penalised for trading even when it believed that doing so was in clients' best interests.

2.2. Any unintended consequences of:

2.2.1. –– single charge remedy to incentivise asset managers to control the charges taken from funds

2.2.2. –– the specific options (A, B, C, D) set out above

2.2.3. –– and how we can overcome any of these unintended consequences

The potential unintended consequences have been described above. We would address different means of tackling these in a more detailed consultation.

2.3. Do you think that the scope of this remedy should be limited to retail investors or should it be extended to other types of investors?

Non-retail investors would also benefit from the clear presentation of an all-in fee though they are better placed to obtain and analyse the information that is required to estimate the total costs.

2.4. Whether there are better alternative remedies or pricing models that would encourage asset managers to control the charges taken from funds?

No comment.

2.5. Do you agree that risk-free box profits should be used solely for the benefit of the fund and not be permitted to accrue to the asset manager?

Yes.

In dual priced funds the bid-offer spread between prices to buy and sell the fund reflects the costs of buying or selling the underlying securities needed to create or cancel units. This means that when customers enter or exit the fund, the costs of their transactions do not dilute the value of existing unit holders' units. Where there are buyers and sellers of the fund on the same day, buy and sell orders can be matched with each other without incurring transaction costs. The resultant spread profit from matched orders should accrue to the fund, not the fund manager.

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

3.1. Would it be proportionate and effective to require fund managers to be more specific with investors by clarifying an upfront objective and tracking performance against that objective over an appropriate time period?

We agree that it would be helpful to require fund managers to be more specific with investors by clarifying objectives ex ante. However, it is not yet clear to us how the manager's performance in achieving those objectives can necessarily be consistently and comparably tracked. We believe that it would be helpful if the purpose of a fund, its objectives and the methods that will be used to track its performance against those objectives could all be established upfront, but would value more time to consider how this could be achieved. We would also have concerns about the potential establishment of different time periods for funds with apparently different purposes and objectives. Without sufficient care and forethought this is an area that could easily cause consumer confusion.

The choice of time periods can vary depending on the time horizon of the investor, and this shows how important it is to have both improved investor education and a well thought out investment policy statement to guide the investor to the right areas of investment from which to choose funds.

3.2. How should fund managers and other market players communicate to allow investors to judge success over an appropriate time period? In what circumstances would it be appropriate to provide comparators, for example, performance of passive funds in the relevant market?

It is standard practice among large asset managers to judge performance over 1, 3, 5, and 10 years for key funds/strategies. Funds are judged in terms of a "triangulation" of a) alpha generation vs benchmark, b) absolute return, and c) performance against peers. Great performance means delivering on all three of these metrics over a long period of time.

Including passive funds in the comparison would add further rigour and depth to the equation and is similar to comparing against the benchmark. Including a passive equivalent in quartile performance competitor rankings might be helpful, but care would need to be taken to ensure that the comparisons were fair (i.e. apples to apples).

3.3. Should we set out our expectations on using benchmarks, particularly when benchmarks are used to trigger performance fees?

We would welcome a broader market agreement (supported by the FCA) on best practice in benchmark selection, application and management.

3.4. Should managers be required to take action when funds are persistently underperforming and, if so, what form should this action take?

Given that past performance is no guide to future performance it does not seem appropriate to force fund managers to take action. Improving how funds are managed is the job of the leadership teams within an increasingly competitive industry. We would also have concerns about how to define persistent underperformance in a way that might allow useful supervision, but that would take into account the different return profiles of different types of funds across different asset classes.

3.5. Is there a role for the regulator in 'shining a light' on poorly performing funds and if so what form could this take?

We are unconvinced that there is a role for the regulator in shining a light on poorly performing funds. First, it would be necessary for the regulator to have a high level of confidence in its ability to identify correctly funds as poorly performing. Second, the question assumes that the regulator has the capacity to inform the market effectively. These are ambitious assumptions.

We welcome the regulator's intent to limit consumer detriment, but suspect that this might be better achieved by challenging advisers and platforms as to why they might be recommending funds that appear to have the characteristics of a poorly performing fund. A more extreme alternative

would be to require funds that underperformed a set of comparators by a pre-established margin to notify investors of that underperformance.

However, we note there is a risk of unintended consequences such as has been observed in the debate around funds that have an apparently low active share, where some funds with low active shares have been 'named and shamed' despite having a good performance record.

3.6. Are there likely to be any unintended consequences and, if so, how could they be overcome?

No additional comment

3.7. Are there other metrics/indications/pieces of information that could give investors better insight into likely future returns?

No additional comment

4. Making it easier for retail investors to move into better value share classes

4.1. Do you agree that the focus of any remedies in this area should be on investors in scenarios 2 and 4 outlined in figure 10.1?

Figure 10.1: Reasons for being in a more expensive share class

1) Investors are in a pre-RDR share class which is more expensive because they continue to pay trail commission
2) Investors are in a pre-RDR share class which is more expensive but the manager has 'turned off' trail commission
3) Investors are in a more expensive share class than others available through alternative distribution channels
4) The fund manager has launched a cheaper share class (but not for the reasons listed above) which would be available without switching distribution channel. This could be because an investor bought units in a legacy share class and subsequently a cheaper share class was launched. Alternatively, multiple share classes could have been distributed at the same time and the investor ended up in a more expensive one

We believe that all of the scenarios in figure 10.1 should be addressed but agree that scenarios 2 and 4 should be prioritised.

4.2. What would be the most proportionate and effective way of moving investors into cheaper share classes? Can you provide an estimate of the cost of moving investors to cheaper share classes and how these costs would arise?

Investment firms report that they find it difficult to move investors into lower cost, equivalent share classes as investors may be unwilling to incur the potential tax cost and may also be unclear about the benefit of replying to the administrative communications in relation to the time required.

Where investment managers can demonstrate that they have made substantial efforts to communicate with unitholders and where they can

demonstrate an evident benefit to unitholders from moving to a new share class, they should be free to impose the switch on unitholders so long as they taken care to canvass unitholders on the proposal. Bulk transfers should be made easier to institute. Potential consumer detriment would be reduced if it was possible to make such moves without causing investors to realise a taxable event. This is an area where further investigation and consultation is required.

4.3. Are there any potential unintended consequences of remedies in this area?

No additional comment

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

5.1. What is the likely effectiveness and proportionality of:

5.1.1. – remedies which aim to introduce further cost transparency and aim to encourage retail investors and their advisers to become more price sensitive

5.1.2. –– the specific options (A, B, A+ and B+) set out above and alternative remedies that could be introduced

Ideally, investors should be shown the total cost of investment (fund charges plus distribution and advice) at the point of sale and on an ongoing basis. However, it is unclear to us how investment managers might be able to provide this information if they do not have access to information about the platform being used and the advice fee that might be applied. It appears to us that as advisers should be able to provide information about the total cost of investment at the point of sale and on an ongoing basis as they would know the investment approach being used and have access to the necessary information. Similarly, a platform could provide information about the aggregated cost of the platform and fund charges at point of sale and on an ongoing basis.

We support the use of £s and pence figures to show the impact of an all-in fee or fund charges, alongside information about the percentage level of costs.

We believe that it might be better to start with these elements before considering moving to any more extreme approach as there is a danger that the emphasis on costs discourages individuals from investing at all.

5.2. What would be the most effective format and mechanism to increase investor awareness of the impact of charges?

In addition to showing the total charges in the KIID, these should also be prominent in fund manager literature such as the factsheet.

It might be helpful for investors if the charges were shown not only as a percentage of the investment, but also as a percentage of prior returns on a one and three-year basis.

5.3. Would there be unintended consequences of:

5.3.1. – remedies which aim to make investors more price sensitive and, if so, are there ways in which unintended consequences could be overcome?

Fees are important but investors need to understand fees within the context of the objectives of the fund and value for money. Fees should not drive the whole investment decision.

5.3.2. – the specific options (A, B, A+ and B+) above and ways in which we could overcome any unintended consequences?

No additional comment

5.4. Are there better alternative options that would encourage investors to become more price sensitive?

5.5. What funds should be in scope of any remedies which encourage greater focus on charges?

This should apply to all investment vehicles available to UK retail investors.

5.6. What would be the most effective ways to communicate with investors?

No comment

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

6.1. Whether institutional investors would benefit from standardised disclosure of asset management fees and charges?

6.2. What fees and charges information should be included in a standardised disclosure framework?

It is clear that institutional investors would benefit from standardised disclosure of investment management fees and charges and we are supportive of the framework that is being developed by the Investment Association.

6.3. What would be the cost to asset managers of providing information?

No comment

6.4. Would there be unintended consequences if trustees were required to publish costs and charges?

No comment

6.5. The scope of fund/products that this disclosure template should cover? Should it cover private equity strategies and hedge funds as well?

Ideally yes. Although private equity and hedge funds are not usually available to retail investors, institutional investors would also benefit from greater transparency on fee disclosures for these investment types.

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

7.1. Are there better ways in which information could be presented to trustees, particularly member nominated trustees, in order for them to assess the performance of their scheme? How could this be achieved?

No comment

7.2. What format should simplified and comparable disclosure take and who should be responsible for providing the information?

No comment

8. Exploring the potential benefits of greater pooling of pension scheme assets

8.1. Are there ways in which parts of the institutional demand side (DB trust, DC trust and DC contract based schemes) could more effectively pool assets together?

See comments below

8.2. To what extent would pooling result in better outcomes for investors?

We believe there could be benefits from pension fund pooling; for instance, larger mandates have the ability to negotiate lower fund management fees. Possibly more important is that a larger scheme can professionalise decision-making.

Asset allocation is the biggest driver of performance and yet currently few trustee boards are really equipped in terms of resource (time and expertise) to give this subject the attention it deserves.

Pooling should not necessarily involve the creation of a regulated asset management firm. Running regulated entities involves a significant compliance burden and with it costs. These costs could negate any savings from lower fund management fees.

If ways are not found to ensure pensions can be pooled cheaply and efficiently, payback periods may be well over 5 years. Regulation of pensions is renowned for change. It might be reasonable to expect hesitation on the part of schemes to embrace pension pooling if the payback period is 5-10 years and further changes are anticipated.

Pooling that is simply designed to pool investments may lead to relatively modest savings. Significant savings would come from legally merging schemes and, therefore, saving on actuarial valuations and administration. However, the issues surrounding funding and member security would need to be addressed to make this option more widely viable. With regulation as

it is, the joint and severable liability of sponsoring employers and the potential reduction in security for beneficiaries of better funded schemes or ones with stronger sponsor covenants, mean merger is rarely a practical solution for DB.

In terms of DC schemes, Master Trusts could deal neatly with the challenge of pooling, but the proliferation of Master Trusts could keep the benefits of pooling from being realised. It is possible that natural competition will resolve this in time. The Australian experience may be worth reviewing.

At the CFA UK we believe that better outcomes will be driven by improvements in investment decision-making. Since the Trustee Knowledge and Understanding (TKU) requirements were introduced, trustee boards should have made significant efforts to improve, but further work could still be done on professionalising trustee boards. For example, there could be a requirement for at least one member of a board to have a relevant pension/investment qualification.

Trustee boards, perhaps more than most other boards, can have individuals serving with a big range of experience and varying socio-economic status. In such circumstances, the role of the chair, while challenging, is extremely important. A strong chair is required for good decision-making. It would be worth paying particular consideration to the prerequisites for the role and ensuring the chair has adequate training on running a board alongside technical training.

Trustee training must be of suitable quality. There is a risk that training events for trustees deliver subliminal sales messages. Trustee training provided by the advisers to the scheme may fail to provide any alternative outlook that would equip trustee boards to challenge their advisers.

In terms of using resources wisely, it is still likely that too many trustee boards spend too much time on manager selection and monitoring and not enough time on the most financially significant decisions - those of asset allocation and risk budgeting.

Transparency of fund management fees is an idea that may be a double edged sword. Investment consultants seem positioned for the best insight into institutional fees and yet, when involved in negotiations with a fund manager, that fund manager may be wary of setting precedents that the consultant would then seek to enforce across their client base. This explains why many larger schemes prefer to negotiate fees directly and confidentially with fund managers. Forcing transparency may do little to reduce overall fees while weakening the bargaining hand of experienced trustees of larger schemes. MFN clauses can similarly prevent fund managers reducing fees.

8.3. Are there logistical challenges involved in pooling assets? How could we overcome these?

We have discussed some of the challenges in pooling assets in section 8.2.

9. Requiring greater and clearer disclosure of fiduciary management fees and performance

9.1. We would like views on ways to provide trustees with clearer information about the charges and performance of fiduciary management.

Investment consultants and the fiduciary management business should be regulated and there should be a regulatory requirement for investment consultants to report on the performance of their recommended managers and model portfolios and for fiduciary managers to report their performance. Both forms of reporting should be standardised in the same fashion that the Global Investment Performance Standards (GIPS) are used as the standard measure for investment manager performance.

9.2. What information on fees and performance information should be made public and are there ways to benchmark the performance of fiduciary managers?

We are unclear about the value of making public information about the fees and performance of fiduciary managers. If a trustee is appointing a fiduciary manager, they should take external, unconflicted advice about which fiduciary manager they should appoint. Fees and performance data will no doubt be a key factor in decision-making at that time.

Public dissemination of fee and performance data could be of value in monitoring the charges and performance of a selected fiduciary manager against others, but there is a risk that the published fees at least may not be genuinely indicative of the fees that could be secured if a client was to switch. Overall, we are unclear about the value of public dissemination of this information, but are certain that the appropriate information should be made available to those that seek it in a standardised, clear form.

9.3. What are the unintended consequences of enhanced disclosure and how can we overcome them?

No comment at this stage.

9.4. What is the likely effectiveness and proportionality of guidance to trustees on these issues?

That would depend on the nature of the guidance and the ability of the trustees to act appropriately based on that guidance. We believe that guidance from TPR and FCA on interpreting value for money in investment consulting and fiduciary management relationships would be valuable.

9.5. Are there better alternative remedies that we can put in place to empower trustees in their decision making?

The role of the investment consultant is enshrined in the '95 Pensions Act which requires trustees to obtain and consider proper advice on the question of whether an investment is satisfactory. If it appears that independent advice on this is not delivering value, perhaps it is time to review the Act's requirements? We would still suggest that trustees seek advice on asset allocation and liability management, but it appears that consideration of manager selection takes up considerable trustee time and delivers relatively limited value. It appears that the regulatory requirement

to seek advice makes many trustees wary of challenging the advice that they receive.

9.6. What could any guidance from TPR/FCA to trustees in this area usefully cover?

Guidance could deal with best practice in investment consultant and fiduciary management selection and review, but might also comment on the greater value achieved in spending time on the overall investment policy relative to a scheme's liabilities rather than on manager selection. Feedback that we have received indicates that trustees spend a lot of time dealing with the wrong questions (which US equity manager to appoint) rather than tackling the difficult, more important ones (the schemes asset allocation and overall level of risk).

10. Consultation on whether to make a market investigation reference to the CMA on the institutional advice market and bring the provision of this advice with the FCA's regulatory perimeter.

10.1. We would like your comments on our provisional decision to make an MIR.

We do not have a definitive comment to make on this question. We are unclear about the nature and cost of an MIR and while the FCA makes the case that asset owners might be too heavily influenced by consultants, we do not see evidence that consultants' charges are too high because of a lack of competition. We also observe that the market share taken by the three largest investment consultants is falling, a trend which we believe may persist.

10.2. We would also like views on whether the FCA should recommend that HM Treasury brings the provision of advice provided by investment consultants to institutional investors within the regulatory perimeter

Given the significant impact that investment consultants' strategic asset allocation advice can have on the outcome of pension schemes and other institutional clients we believe it is appropriate that this activity is brought within the regulatory perimeter in the same way that consultants' other activities already are.

10.3. Whether to bring the provision of advice provided by employee benefit consultants to employers and trustee boards within the regulatory perimeter

No comment

10.4. Are there alternative remedies that we should also consider to allow better monitoring and assessment of advice provided by investment consultants and employee benefit consultants?

No comment

As stated earlier in our response, we are grateful to the FCA for challenging us to consider ways in which investors' interests can be better served. We trust that these comments are useful and would be pleased to discuss them in person.

Yours sincerely,

Will Goodhart,
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CFA Society of the UK

James Crawshaw
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About CFA UK and CFA Institute

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