FCA Asset Management Market Survey

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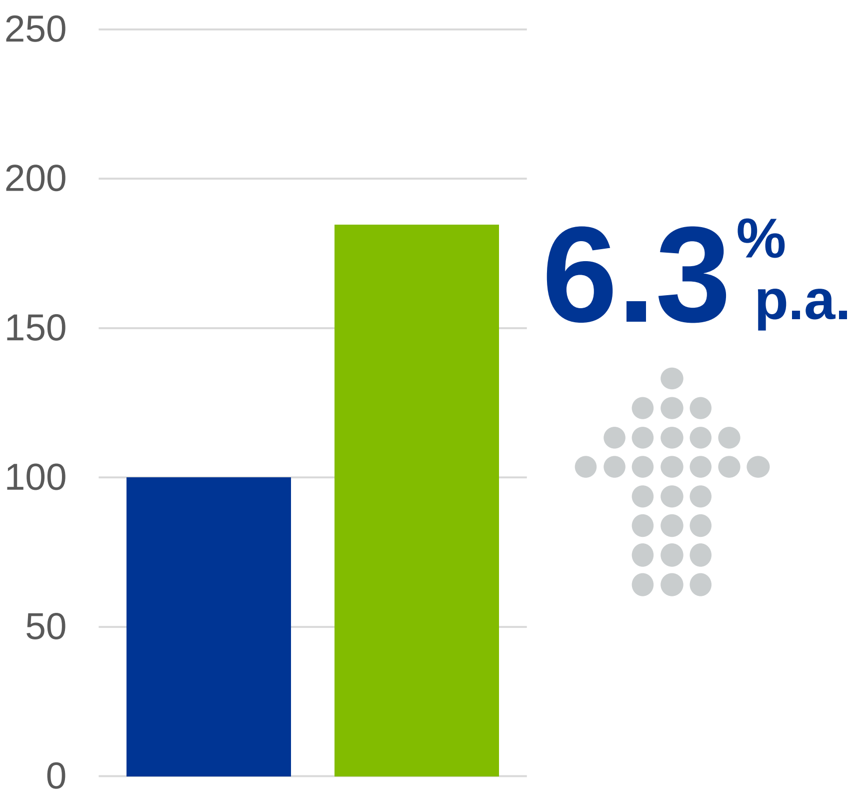
Interim Findings

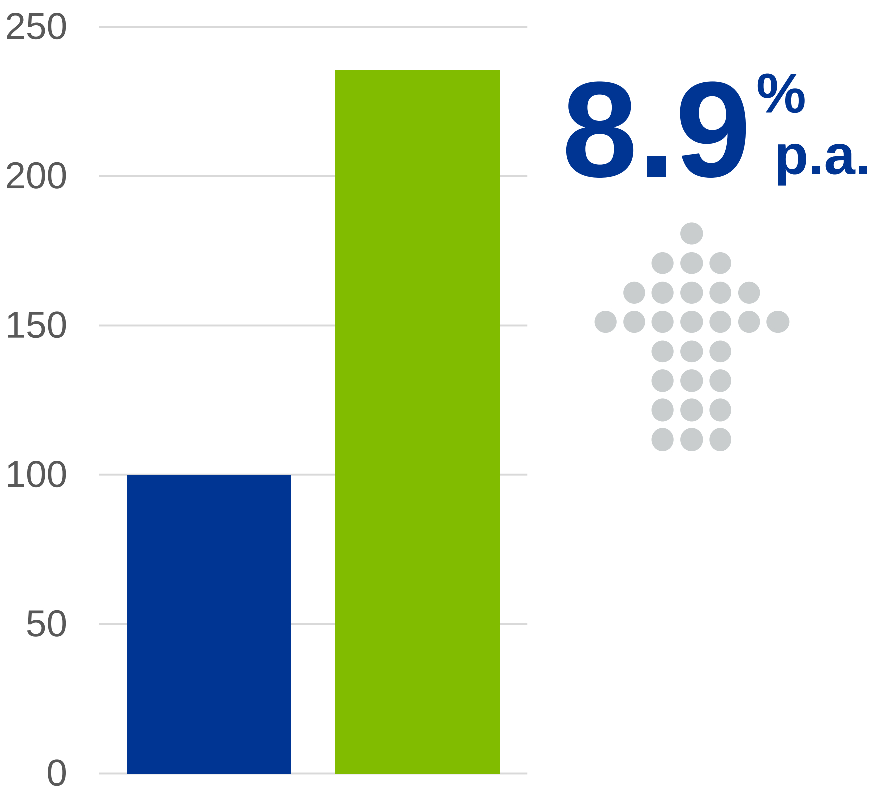
- The UK's asset management industry manages nearly £7tn of institutional and individual assets.
- Over three quarters of UK households with occupational or personal pensions use the services asset managers offer.
- The FCA found that price competition is weak in a number of areas of the industry. While the price of passive funds has fallen, active prices have remained stable. Despite a large number of firms operating in the market, the asset management industry has seen sustained, high profits over a number of years.
- Investors are not always clear what the objectives of funds are, and fund performance is not always reported against an appropriate benchmark.
- There are a wide range of investors in the institutional market. This includes many small pension schemes which rely heavily on the advice of consultants. The FCA have found concerns about the way the investment consultant market operates.

UK DB Pensions – the “improvement in funding”

Assets



Liabilities



Source: PPF 7800 index

The analysis focused on 6 questions

1. How do investors choose between asset managers?
2. How do intermediaries and fund governance bodies affect competition between asset managers?
3. What do prices, profits and performance tell us about how competition is working?
4. Are asset managers willing and able to control costs and quality along the value chain?
5. How do investment consultants affect competition for institutional asset management?
6. Are there barriers to innovation and technological advances?

So what has worked?

Passive …

- Five fold growth in passive investing since 2005
- Now represent 23% of the AUM in the UK market
- Passively managed funds have fallen in price over the last 6 years

LDI …

£741 **bn in LDI**

1,287 **mandates**

- “generally happy with the product and price paid .”. LDI is a scale business

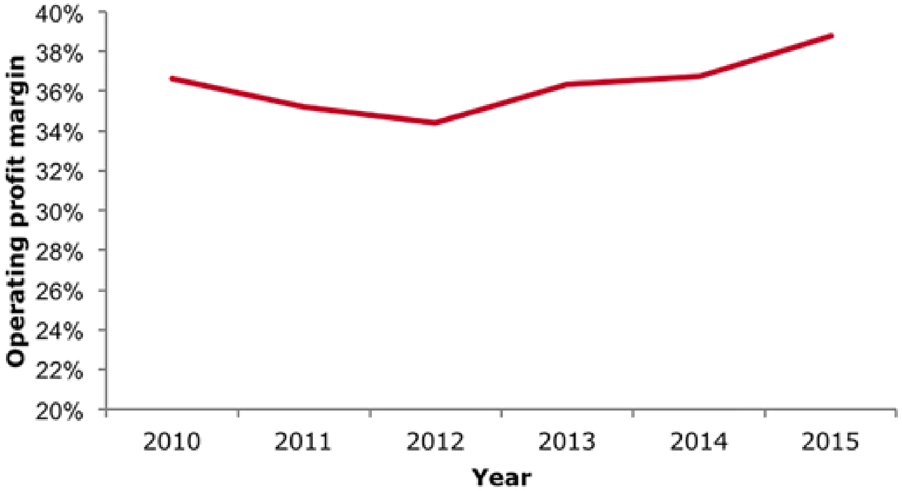
Evidence of outperformance in institutional

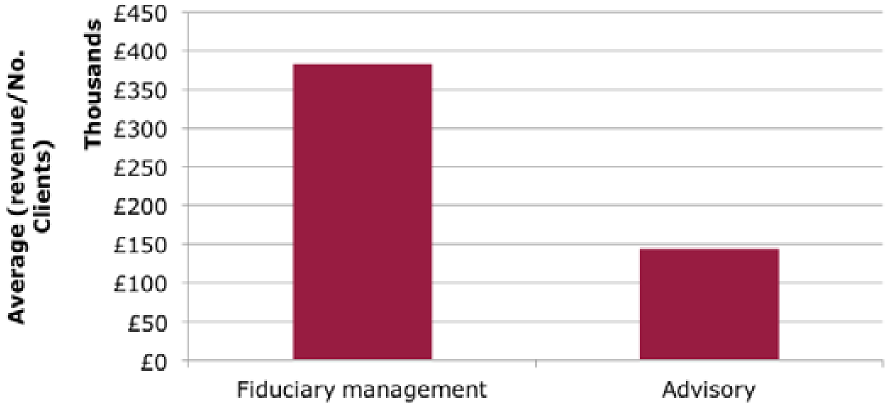
- Evidence suggests actively managed investments do not outperform … after costs
- But …
- Products available to pensions ..are not significantly above the benchmark

?????

Analysis of Profits

Average operating profit margin





Fiduciary Management vs Advisory

Proposed Remedies

1	a strengthened duty on asset managers to act in the best interests of investors	6	**Requiring increased transparency and standardisation of costs and charges**
2	introducing an all-in fee	7	**Potential benefits of greater pooling of pension scheme assets**
3	helping retail investors identify the best fund for them: — requiring asset managers to be clear about the objectives of the fund and report against these — clarifying and strengthening the appropriate use of benchmarks — providing tools for investors to identify persistent underperformance.	8	**Greater and clearer disclosure of fiduciary management fees and performance**
4	making it easier for retail investors to move into better value share classes	9	market investigation reference to the CMA on the institutional investment advice market
5	requiring clearer communication of fund charges and their impact at the point of sale and in communication to retail investors.	10	**Recommend bringing … the provision of institutional investment advice within the FCA's regulatory perimeter.**

Transparency and standardisation of costs and charging

A

The current OCF becomes the actual charge that is taken from the fund.

B

The current OCF becomes the actual charge, with managers providing an estimate of any implicit and explicit transaction costs.

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’.

D

There is a single charge which includes all charges taken from the fund, with no option for overspend.

Asset Pooling

It is likely that smaller pension schemes could achieve significant cost savings from consolidating their assets.

In some cases fiduciary management can work well; smaller clients in particular (such as smaller pension schemes) are attracted to this kind of investment solution.

It allows them to employ more complex strategies and gives them access to products they could not access otherwise (e.g. alternative investments) without having to increase their scheme governance.

Smaller clients are also able to benefit from scale, as the consultants can negotiate deals based on assets across their fiduciary management clients. Therefore, even taking account of the additional costs of fiduciary management it may be cheaper for some clients.

What do you pool? Assets? Strategies? Decision making? Advice?

Limited or variable experience on a board of trustees can result in:

- accepting investment strategies proposed by advisers without challenge
- delays to decision making
- limited consideration of asset allocation
- limited challenge of the charges incurred

33%

no challenge

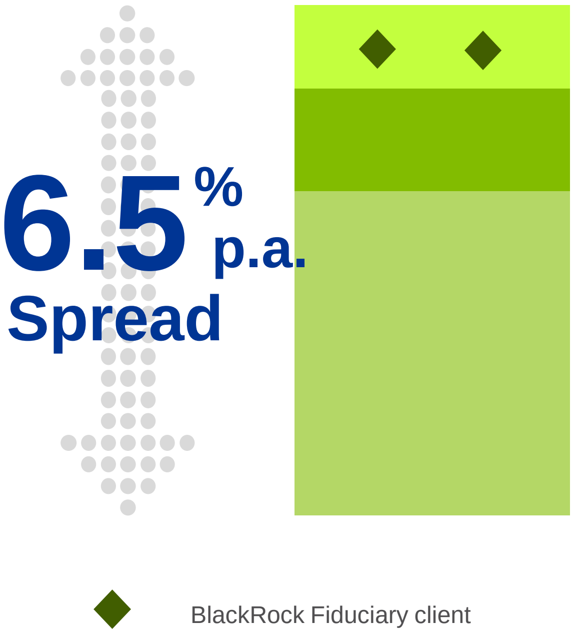
Trustees have a tendency to rely heavily on investment consultants …this dependency can result in trustees accepting proposed investment strategies without critique or challenge.

Fiduciary: Fees and performance measurement

“The FCA would like views on:

- Ways to provide trustees with clearer information about the charges and performance of fiduciary management.
- What information on fees and performance information should be made”

Range of Relative Returns
Top 50 dutch Plans: 2007 - 2015



Advice: regulate to not?

Do Investment Consultants add value?

Investment consultants rate asset managers and the FCA found their ratings do influence which asset managers institutional investors choose. While investment consultants' due diligence means that institutional asset managers are likely to meet minimum quality and operational standards, The FCA have found that these ratings do not appear to help institutional investors identify better performing managers or funds.

Investment Advisory Relationships

91%
no change

Over the last 5 years Trustees not changing their investment advisor

25%
no change

Proportion of those tendering who could only find 1 suitable advisor

Source: FCA Interim Report

What drives outcomes?

Hedging ratio

Asset Allocation

Manager selection

Fees and Costs

Other Snippets

Asset allocation is one of the most important elements of an investors' investment strategy that can impact returns over time.

The advice and recommendations made by consultants to clients on strategic asset allocation is **unregulated**.

Some asset managers felt that this presented a **conflict of interest**, whereby the asset manager was required to share all of the details of their products with the investment consultant in order to receive a rating, but the investment consultant could take the ideas generated by the asset managers and use them to develop their own product. They felt that this reduced their incentive to innovate

In order to sell one product, such as fiduciary management, consultants may be compromising the quality of the 'first' product, in this case advice. This is aggravated by the **inability of clients to assess** the quality of advice they receive

Even though fiduciary management offerings compete with asset managers, fiduciary managers **do not face the same level of scrutiny**. Asset managers suggested that the quality of due diligence for fiduciary managers is lower than for traditional asset management products, although the same operational robustness is required for both.

There is an absence of a standardised market-wide methodology to assess the performance of an investment consultant.

The following notes should be read in conjunction with the attached document:

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