

FCA Intervention A Turning Point For UK Asset Managers

By **Mark Taylor**

Law360, London (June 28, 2017, 11:06 PM BST) -- Britain's \$8 trillion asset management sector will undergo a series of significant reforms, regulators said Wednesday, which attorneys believe will trigger a sea change in the market as new rules confronting price collusion and cartel-like behavior prompted the push for greater transparency.

The Financial Conduct Authority wrapped up a probe it began in 2015 by proposing three stages of remedies, some of which will be phased in alongside European Union legislation on disclosures to investors and new charge structures. Attorneys say plans to introduce a single, all-in-fee for investors, new conduct and governance rules, a fresh investigation of investment platforms and numerous technical changes to share class management will be onerous and demanding to implement.

"Some in the industry will find it brutal — but it appears hard to argue with," said Jake Green, financial regulation partner at Ashurst LLP.

The sector performs a vital role in Britain's economy, but the regulator found that investors, often poorly or not at all advised, bear virtually all the risk. Antitrust officials uncovered weak price competition and sustained high profits despite the huge numbers of active asset managers.

As the U.K.'s industry is the second largest in the world, after the U.S., managing about £6.9 trillion (\$8.6 trillion) of assets, regulators believe competitive pressure is the best way to maintain its value in uncertain economic times. Over £1 trillion is managed for U.K. retail investors and £3 trillion for pension funds and institutional investors. About £2.7 trillion is managed for overseas clients.

The FCA said investors often paid higher prices for funds, on average, which achieved worse performance.

"The fact that there was found to be no relationship between charges and gross performance makes for stark reading," Green said.

The FCA's mission document published in April emphasized clearly how it would grade its own performance and impact, and this must be factored into any competition probe, said Guy Wilkes, financial services partner at Mayer Brown International LLP.

"It is therefore inevitable that the FCA will ultimately judge the success of its package of remedies on

whether and by how much it is able to cut the profit margins of firms," he told Law360. "Given that most of the FCA's proposals still require significant consultation, it will be a long time before any changes take effect."

To improve transparency, the FCA is effectively gold-plating two big incoming EU laws by going further than what is required by the European legislators, ensuring firms will be held to a higher standard than envisaged by bloc regulators. The Markets in Financial Instruments Directive, the new securities rulebook known as MiFID II, and the Packaged Retail and Insurance-based Investment Products, or PRIIPs, regulation, which covers retail investment disclosure, contain provisions on costs and charges managers are bound to inform customers of.

The FCA will widen the requirements for disclosure, Chief Executive Andrew Bailey said in a press conference on Wednesday, taking direction from how European law has moved in this direction with MiFID II and PRIIPs.

"We think the core of the MiFID proposal, the fixed costs and estimates of transactions closed, matches with the thrust of our findings," said Bailey. "The all-in-fee part of MiFID only applies when you go through an intermediary; we believe it should apply more broadly across the asset management sector."

The FCA will consult the industry on this in more detail in December, as Bailey said it wanted to ensure its rulebook was properly aligned with PRIIPs and MiFID II, knitting all three together.

"The review tells us a lot about the future of both asset management and the broader post-Brexit regulatory landscape under the FCA," said Owen Lysak, partner at Clifford Chance LLP.

He said crossover with areas such as MiFID II always carries risk of regulatory divergence, adding another burden to firms at a time of significant strain.

"Increasing independence within governance structures marks a partial move towards a more U.S.-style approach to fund governance — that could mean a cultural shift in the market," Lysak said.

While not included in the scope of the market study, the review heard a number of comments about the lack of transparency in more complex fund structures.

"Private equity funds and hedge funds are firmly in the headlights and could be next on the FCA's list," said Lysak.

Lawyers have concerns that gold-plating and forcing firms to produce reams of new disclosure information will overwhelm consumers who will simply ignore it. When pushed on the matter by Law360 at the review press conference, Bailey said ensuring firms "targeted the sensible and right type of information" for consumers was a crucial part of the reforms and something the sector must work on.

"When we mention disclosure, we talk about trying to get to some simple, pounds and pence figures," added director of competition Christopher Woolard.

Woolard said fund managers charged with looking after the money invested must consider on a long-term basis what is in the best interest of consumers. He said the complex decisions should be taken by money managers and not consumers.

This responsibility to act fairly and in the best interest of consumers will fall squarely on fund managers, who will soon find themselves enrolled in the senior managers and certification regime, a code of conduct for financial services that currently only applies to bankers and insurers but will be expanded next year. The FCA proposes to require fund managers to appoint a minimum of two independent directors to their boards.

"Again, we see the shadow of the SMCR hovering closer over the asset management sector," said Green. "It's mentioned frequently, and the FCA expects it to help draw fund managers' attention to acting with the best interests of the investors in mind. Indeed, the line between whether an investor is (legally) a 'client' (generally they are not) is eroding."

Attention must also be paid to the introduction of a new prescribed responsibility to act in the best interests of investors including a consideration of value for money, Wilkes said.

"Whilst many larger firms are currently making preparations for the roll-out of the senior managers regime to them, it cannot be assumed that any extension to the SMCR will mirror the arrangements that which currently apply to banks and insurers," Wilkes said. "Perhaps because of these proposals, the timetable for publication of the FCA's SMCR rollout consultation has now slipped, and the FCA's current plan is to consult 'during the summer of 2017.'"

The plan to introduce the changes in stages may even hint at a resource issue given the sheer weight of regulatory reform firms must deal with in January 2018.

"I think the FCA is constrained by MiFID II implementation, and I think this may be the first stage in a larger project," said Michael Wainwright, financial services partner at Dentons LLP. "We should see the market study into platforms, and the suggestion that the government brings the EBCs into the scope of regulation, as interim steps towards making a change."

He said the major issues the FCA has flagged, and its proposed solutions, were not new.

"The FCA seems unhappy with the situation, but their proposal to address level of charges and competition in pricing is simply more standardized disclosure," Wainwright told Law360. "We have been applying disclosure as a solution to consumer protection problems for quite a while without a great deal of success."

The FCA also found significant fault with intermediaries and is to launch a market study into investment platforms. It is also mulling over referring the institutional advice and consultancy sector to a full-blown antitrust probe, which will be conducted by the Competition and Markets Authority, having pushed this decision back to September.

"A CMA market investigation would run for at least 18 months, which at times would be intensive," said Robert Eriksson, senior associate in the EU and competition law team at Pinsent Masons.

The CMA often requires vast amounts of information to be provided under very tight deadlines, which can also involve third-party companies that are not at the heart of the market investigation.

Eriksson stressed that such an investigation would not be into any individual firms' potential infringements of competition law but a marketwide review at competition. And Bailey said the CMA would be best placed to handle this, but the FCA is trying to widen its net and has called for the

government to extend its regulatory powers to bring investment consultants into its perimeter.

It is also considering how it can improve pension scheme consolidation with regulation, which has thrown up more questions than answers for some attorneys.

"I don't know how realistic it is to consolidate pension schemes; each scheme has its own strengths and weaknesses, including different levels of solvency," said Wainwright. "Bringing them together would bring advantages on one side and disadvantages on the other. I will be interested to see if that is adopted and if it results in real consolidation of the pensions schemes sector."

According to the FCA's timetable, a further consultation on additional policy changes, including retail disclosure, benchmarks and performance reporting, will appear in December, giving the industry pause for breath.

"It is pleasing to see an acknowledgement by the FCA that the industry is doing much to bolster its efforts to increase transparency whilst also allowing the crucial time and consideration required to see how MiFID II would affect such measures," said Monica Gogna, financial services partner at Ropes & Gray LLP. "This is a common-sense approach to transparency."

--Editing by Christine Chun and Catherine Sum.