SCM Direct/True and Fair Campaign Response to the FCA Consultation Paper (CP17/18) - Implementing Asset Management Market Study Remedies and Changes to Handbook

September 2017

Before answering the consultation questions in detail, we would urge the FCA to re-consider its refusal to mandate a standardised disclosure of costs and charges to retail investors, rather than only offer this for institutional investors. How can it be fair to discriminate against ordinary retail investors by only granting to experienced, professional investors the enhanced levels of understandability and comparability afforded by a mandated format?

It is clear from the FCA's Asset Management Study that retail investors simply do not understand the fees and charges they are paying, even in the rare cases in which their fund manager or adviser is disclosing them in full. Unless there is a common, standardised template that allows investors to quickly and easily compare one provider with another or one product with another, there can never be genuine price competition in the asset management industry.

To enhance consumer choice and outcomes, we believe that the FCA should regard best practice as being the displaying of a mandated format on monthly factsheets since research has repeatedly shown that this is the purchasing literature most utilised by retail investors. As the FCA's recent Asset Management Market Study Final Report found, '*under 3% look at documents (including the KID)*'.[1]

SCM Direct has evidence that one firm recently sent out a communication to all its clients with their new MiFID II terms and conditions, in which they failed to include any link or specific example of any of the charges faced by its clients in any format, let alone a format compliant with MiFID II. This serves to support our supposition that without a mandatory template, the industry will continue to make its fees opaque and incomprehensible to its customers.

It is a basic principle of free, fair and effective competition that consumers should be able to see and understand the price charged for a product or service. Without this basic consumer right, our view is that the UK Asset Management Industry is being allowed to breach competition law. New entrants cannot compete on price, on a fair basis, with larger firms who either continue to hide significant fees or charges or show them in a highly complex and needlessly opaque manner, thereby serving to prevent transparency, comprehension and effective price competition.

For example, the UK Government itself[1] cites as an example of a cartel and anti-competitive behaviour the Local estate agents' advertising of fees by which

'In 2015, a trade association, 3 estate agents and a newspaper publisher were collectively fined over £735,000 for agreeing to prevent agents from advertising their fees or discounts in the local newspaper. The trade association introduced a rule that prevented its members from advertising their fees or discounts in the local paper, and the paper agreed to extend this agreement to prevent any agents from advertising their fees (whether they were members or not). This limited agents' ability to compete with each other on their fees,

[1] https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf

making it harder for consumers to compare prices and get value for money and may also have made it harder for new or smaller businesses to attract new customers.'

The CMA[2] stated in this case that:

'Consumers drive competition where they are able to shop around through access to readily available and accurate information about the products or services they are seeking and the various offers available in the market. Therefore, the provision of clear and accurate information on prices, products and services plays an important role in driving competition between businesses as it encourages and empowers consumers to seek out the best offers available for a particular product or service, which in turn drives sellers to be more competitive.'

It is the view of the True and Fair Campaign that true competition in the asset management industry cannot take place unless the FCA forces the industry to provide understandable and standardised templates visible on the most used point of sale literature, i.e. factsheets or on a fee section of managers' websites.

We believe that by enforcing price competition in this manner, it would enable the FCA to fulfil its 'consumer protection objective' and 'competition objective' as defined within section 1C and section 1E respectively, of the Financial Services and Markets Act 2000.[3]

Contributions

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

Yes. The AFM Boards currently have no interest whatsoever in value for money – this is evidenced by a recent article[4] highlighting poor value for money in funds run by several major fund groups:

Research from Candid Financial Advice found M&G, a fund group owned by Prudential, collected £94m in administration fees from its 15 largest funds over the past year. Of this, £34m was taken from a single fund, the M&G Optimal Income fund. The fund has underperformed its peer group over one and three years.

These 0.15pc a year fees are levied in addition to the fund's annual management charges.

The firm's research found both M&G and Jupiter levy a fee to cover administration expenses but, crucially, retain any surplus. In addition, Jupiter and Scottish Widows collected £8.7m and £8m in "registration" fees respectively…

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

We would strongly urge the FCA to reconsider the constitution of AFM Boards so that the majority are independent. This arrangement has worked effectively in the US for many years.

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2 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/431787/Open_letter_to_the_property_industry.pdf

3 https://www.handbook.fca.org.uk/handbook/glossary/G2976.html

4 http://www.telegraph.co.uk/investing/funds/mg-and-jupiter-boycotted-over-immoral-investment-fees/

Having just two independent Board members as proposed could result in the worst of both worlds:

- it would not challenge the inherent majority of the Board who will continue to operate under significant conflicts of interest
- it would serve as a barrier to entry to smaller firms who will have to shoulder such costs which may be significant in some cases.

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

We do not have an issue with the proposed time scale.

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.

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

Our view is that this proposal will not achieve its objective but will force extra costs for groups, particularly smaller ones who already find the burden of competition against larger groups difficult enough already without any noticeable benefit.

We would encourage the FCA to follow the US example - the SEC found that it needed to change the composition from the previous rule of 40% to a majority being independent as long ago as July 1st 2002[5]. As the SEC[6] states:

'*We believe that a fund board that has at least a majority of independent directors is better equipped to perform its responsibilities of monitoring potential conflicts of interests and protecting the fund and its shareholders'… 'A simple majority requirement would permit, under state law, the independent directors to control the "corporate machinery," i.e., to elect officers of the fund, call meetings, solicit proxies, and take other actions without the consent of the adviser. Such a provision would require few funds to change the current composition of their boards, but would bring those that must change into conformity with the better practice. A two-thirds requirement, on the other hand, could change the dynamics of board decision-making in favour of the interests of investors, but may require many funds to change the composition of their boards.'*

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

No for the reasons above it simply will not work and adds cost without significant benefit to investors.

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?

[5] http://www.klgates.com/files/Publication/7daa341a-bf05-4d6b-8a37-ee173d0b20fb/Presentation/PublicationAttachment/f0b10ab2-8b90-47f6-9bc9-93945a3904cd/newrules.pdf
[6] https://www.sec.gov/rules/proposed/34-42007.htm

No as in practice 'Chinese Walls' are regularly broken. In companies, it is rare for non-execs to hold the same role in competing businesses.

The danger is that this rule will create a small independent non-exec 'club' that is hired by companies as the members become nothing more than nodding dogs when presented with decisions that may not fit well with the executive team.

Q8: Do you agree with the proposed requirements for being an independent director? If not, what alternatives do you propose?

No in respect of the ability for AFMs not to appoint an independent Chair. In practice, this is inevitably likely to swing any contentious decisions with significant conflicts of interest in favour of the Company rather than their investors' best interests.

Q9: Do you agree with an implementation period of 12 months? If not, how much time do you think AFMs will need to appoint suitable independent directors?

Yes

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

No for the reasons above.

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

Yes

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

Yes immediately. There is widespread evidence of consumer harm with consumers needlessly paying inflated charges for a service that does not even exist and which handcuffs the clients to the underlying service providers thereby creating significant consumer detriment.

As this recent article[7] highlights:

''We come across clients who have come from other firms that have had Oeics that have not been changed for four years – no rebalancing and no reviews – and that is just poor,' he said….

'There are advisers receiving trail and doing little for it,' he said. 'If a client understands what they are paying for what they are getting, then they would also have no problem signing an ongoing charge client agreement. So, in a way, any client happy to pay trail should also be moved off it.

'I remember hearing the Financial Services Authority was planning to ask firms to justify their trail income as part of the Treating Customers Fairly initiative. This was in 2008, three or four years before the RDR. To my knowledge that never happened, which seems a shame now.'

Q13: Do firms face contractual or other barriers in switching off trail commission without regulatory intervention? If not, what alternative reasons are there for continued trail commission payments?

[7] https://citywire.co.uk/new-model-adviser/news/ifas-support-end-of-unforgivable-trail-commission-practices/a1030869?ref=new-model-adviser-most-popular-list

We believe that at the very least, the FCA should require firms to only be allowed to receive such trail payments if they have received prior written approval from clients.

Q14: What would be the impact on other financial markets where trail commission payments continue to be paid?

This is not our expertise but this appears an intellectually dishonest debate as whether or not shoddy practices are found elsewhere, should not prevent malpractice in another area being properly addressed.

Q15: Do you agree with our proposal to allow box profits to be retained by the AFM when they have been earned through an 'at risk' exposure, but not when they are achieved risk- free?

The problem with this exception is that it will be used by companies to game the rules through the precise interpretation of what is or isn't 'risk-free'.

Q16: Do you have any comments on whether risk-free profits should be passed on to investors in the fund or given back to subscribing/redeeming investors?

It should go back in the fund.

Q17: Do you have any comments on our proposed approach to include the proposed changes to

risk-free box profits as part of the existing monitoring requirements on depositaries?

No

Q18: Are current arrangements, particularly for with-profits business, fit for purpose and can they achieve the same outcomes? If so, please elaborate on how they achieve these outcomes.

No view.

Q19: Would additional or alternative approaches be more appropriate or cost-effective for tackling the same issues? For example, would the independent governance committees set up by life insurers and used for workplace pensions be appropriate for other products as well?

No view.

Q20: What would the costs, challenges and resource implications be for firms if we applied the proposals in Chapter 3 to life insurers?

No view.

Q21: What would the potential benefits be for consumers and firms of introducing any additional governance requirements for unit-linked funds and with-profits business?

No view.

Q22: Would there be a risk of investor harm or disruption to the market if we did not extend our proposals for authorised funds to unit-linked or with-profits business?

No view.

Q23: Do you agree with our proposed approach to pension products?

No view.

Q24: What are your views on whether it would be appropriate and proportionate for the FCA to consider introducing similar rules to those proposed for authorised funds for investment companies?

These should be the same across investment products - they are all available to retail investors so the rules and protections should be the same.

Q25: Is there a risk of investor harm or disruption to the market if we do not extend our proposals for authorised funds to investment companies? If so, how would this risk affect investors?

It cannot be regarded as fair to improve the outcomes for consumers investing via OEICs, but not apply such improvements to the very same investors who might be investing through a closed ended investment fund.

Q26: Do you agree with the conclusion and analysis set out in our cost benefit analysis?

No View