THE TRANSPARENCY TASK FORCE

20th February 2017
Transparency Task Force Response to the FCA's Asset Management Market Study, Interim Report

1. The purpose and status of this document

This document has been put together by members of the Transparency Task Force (TTF) to provide input to the FCA's Asset Management Market Study, Interim Report. Please note that whilst several members of our community have been involved in producing this submission it should not be assumed that the views given reflect those of all members of the TTF as not all members of the TTF have been involved in producing it and some may have contrarian views.

Of course, many of our members and the organisations they represent may feed in their thoughts to you independently of the TTF.

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2. About the Transparency Task Force

The Transparency Task Force is the collaborative, campaigning community dedicated to driving up the levels of transparency in financial services, right around the world. We believe that higher levels of transparency are a pre-requisite for fairer, safer and more efficient markets that deliver better value for money and better outcomes to the consumer.

Furthermore, because of the correlation between transparency, truthfulness and trustworthiness, we expect our work will help to repair the self-inflicted reputational damage the Financial Services sector has suffered for decades. We seek to effect the change that the financial services sector needs and the consumer deserves.

The TTF is free to consider what is ultimately best for the consumer without commercial conflicts and we are perhaps unique in being made up of a truly pan-industry cross-section of individuals that includes market participants, researchers, academics, those representing trade bodies and professional associations and legal professionals. As such we are well-placed to establish consensus that does not merely reflect the wishes of one particular "tribe" or another.

Our approach is collaborative - we seek a win/win/win; whereby consumers, market participants and the efficacy of government policy can all benefit from the work we do. Market reaction has been extremely responsive to our clarion call for collaboration for the benefit of the consumer and the benefit of the reputation of the sector; so much so that in

just 22 months we have developed six teams of volunteers, each team focused on a set of transparency-related issues and desired outcomes:

- The Market Integrity Team
- The Foreign Exchange Team
- The Banking Team
- The Costs & Charges Team
- The Stewardship & Decision-Making Team
- The International Best Practice Team

3. Previous involvement

The Market Study has been of great interest to our community as it deals head-on with many issues that undermine the competitiveness of the asset management and investment industries in the UK; many of which have a lack of transparency at their heart.

This is the second submission we have made to the FCA on the Market Study, the first being our comments on its scope, submitted on 18th December 2015.

The high level of interest we have in the subject-matter is further evidenced by the meetings we have participated in:

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- The FCA workshop held on 22nd April 2016
- The FCA workshop held on 16th May 2016
- The well-attended Transparency Symposium that we ran on 14th December 2016 which was entirely dedicated to the Market Study. It was an event that was highly successful from our point of view as it gave us the opportunity to listen to explanatory presentations on the FCA's Interim Report from Becky Young, Robin Finer and Anthony Daughton; their presentations were very well received. Furthermore, we hope that the other speakers and resultant discussions held on the day will have provided the FCA with useful comment and feedback.
- The FCA workshops held on 23rd January 2017

We are very grateful for the highly inclusive and highly engaging manner in which the FCA has conducted its Market Study and we hope our input thus far has been of some value.

4. General comments on the Market Study

We are extremely pleased that the FCA embarked on its Market Study and we are impressed by the highly detailed and forensic analysis that it has undertaken. In general terms we believe that the Study and the remedies proposed have the potential to significantly improve the workings of the market for the benefit of the consumer and the reputation of the sector.

We believe that the market as a whole has failed to work competitively for decades and we hope that the Market Study will provide the much-needed impetus for change. Whilst the Study is rightly highly critical of the way some parts of the market works, we hope that all the market participants that will need to make changes in light of the FCA's findings and proposed remedies will be able to adjust their commercial objectives and modus operandi, to better align with providing optimised outcomes to the consumer.

Particularly in a post-Brexit world, our country and its citizens need an asset management and investment sector that is transparent, truthful and trustworthy. As such, the FCA's Market Study needs to be seen as a big step in the right direction; with more work to be done.

We would request that the FCA, whilst continuing to maintain its independence, works collaboratively with The Pensions Regulator, The Prudential Regulatory Authority, HM Treasury, the Department for Work and Pensions, the Work and Pensions Committee, the Bank of England, The Government Actuarial Department, The Department for Business, Energy and Industrial Strategy and all other relevant Government Bodies to continue to build on the momentum that their Market Study has now created. In particular, we would hope that the FCA seeks to drive the cultural transformation that is so desperately needed in the sector.

For example, a subsequent piece of work by the FCA might look at the sector from the perspective of 'values-based leadership' because if we want a market that 'has its heart in the right place' the hearts that matter most are those in the leaders of all relevant market participants, trade bodies and professional associations; within which there appear to be conflicts between what is good for the commercial interests of their members; with what is good for the consumer and the long-term reputation of the sector.

An excellent point made by one of our members that is made later in this submission is so important it is also worth mentioning it here:

"What has been the role of trade associations in fostering such an anti-competitive environment so focused on asset manager enrichment at the expense of clients?'

…it may be wise for the FCA to give some serious thought to that excellent question.

5. The risk of relying on Trade Bodies regulating the market

We urge the FCA to avoid at all costs being sold the idea of a 'patchwork quilt of protocols' on vital issues such as costs disclosure; whereby different parts of the industry introduce 'codes of conduct' designed to take care of just their part of the market. An example would be the asset management industry's trade body in the UK, the Investment Association, attempting to introduce a costs disclosure code for their own members to use. We believe this type of approach may result in inconsistency, confusion and even the potential for 'gaming'; issues so serious that they have the potential to undermine the efficacy of a robust regulatory framework.

These concerns are particularly valid if:

- There is no effective quality control over the cost data being gathered
- There has not been any open scrutiny of the way in which the code is developed
- The code is merely voluntary
- The terms used to describe costs do not have legally-binding definitions
- The code is developed as a separate activity to the rest of the industry; with a different approach, language and philosophy behind it
- There has not been any real attempt to produce the code as part of an integrated, industry-wide effort
- Steps are not taken to avoid 'regulatory whack-a-mole' whereby costs can be gamed from one part of the market to another

Understandably, trade bodies have a primary duty to care for the commercial interests of their members; that in itself is absolutely fine, but given that reality, they are clearly too conflicted to be responsible for the development of a costs disclosure code; especially if they are unable to wholeheartedly support the idea of putting the investors' interests first.

We believe that it is far better if the sector as a whole works togethor to produce a 'blanket' solution rather than a 'patchwork quilt of protocols' and for all that work to be properly led by the FCA; regulators are best placed to regulate.

The shocking findings of the FCA's Asset Management Market Study is all the evidence that could ever be needed that entrusting the financial services sector to self-regulate has been wishful thinking to the point of naivety on the part of previous Regulators. Decades of pseudo self-regulation has failed to prevent the terrible miss-selling scandals that have caused extensive consumer detriment and sapped the public's trust in the sector; therein is a systemic risk that needs to be mitigated, by the FCA.

It is absolutely vital for the public to have confidence in the financial services sector and they are more likely to have confidence in the financial services sector if the sector's Regulator leads regulatory activity and does not allow itself to be sold the idea that highly conflicted trade bodies might do the job for them.

6. Responses to questions for feedback

We have selectively responded to some of the questions asked, leaving some unanswered on the basis that they are outside our area of interest and/or insight.

10.16 Questions:

➢ **What is the likely effectiveness and proportionality of:**

- ➢ **the FCA setting out its expectations about how AFMs should demonstrate that they are acting in the best interests of unitholders**

- We believe this should have a positive impact on market behaviour and outcomes

achieved; and given the importance of ensuring AFMs are operating in the interests of their unitholders this would be an appropriately proportionate step.

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

- Again, we believe this should have a positive impact on market behaviour and outcomes achieved; and given the importance of ensuring AFMs are operating in the interests of their unitholders this would be an appropriately proportionate step.

- **the specific options (A-F) set out above**

- For the reasons explained later we do not believe a 'single charge' solution is the best approach to take. However, of the Options A to D described we believe that Option D is the most suitable; it is an adequately robust approach, is relatively straightforward and is the least likely to be gamed.

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

- There is a general lack of transparency in the market. By firms providing full transparency on their decisions and actions, interested parties can then scrutinise what has happened and decide for themselves whether firms have acted in the best interests of investors. The information provided would comprehensively cover objectives, costs, performance achieved, and risks taken.

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

- Again, there is a general lack of transparency. Full transparency on decisions and actions will improve governance as it opens up scrutiny and accountability. Governance frameworks should be constructed that have very high levels of transparency 'hard-wired' into them. If politicians can be made to be happy with the level of scrutiny they are under (in the House and when involved with Select Committee Meetings, for example) why not those responsible for other people's money?

- On that basis it is worth noting that there is growing interest in the USA in the meetings of Pension Boards and so on being video'd, recognising how powerful a driver transparency can be for achieving god governance. Such an approach would surely also have a positive impact on the levels of engagement.

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

- There are likely to be numerous challenges and potential unintended consequences. We suggest a small pilot be considered to iron these out ahead of a wider roll-out, with say one or more progressive pension schemes volunteering to operate in a highly modern and highly transparent way. If videoing meetings was thought to be impractical then at least full minutes should be taken and published online; with scope for commercially sensitive points being redacted. Either way, there needs to be much greater transparency on decisions being made and actions taken.

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

- Yes, a fiduciary duty through statute would be a powerful driver for correcting imperfections in market behaviour and it would help to eradicate many of the conflicts of interest that exist. Providers should be explicitly required to act in the best interests of their clients. In the main, asset owner driven solutions have not worked - as would be fully expected given the severe and extensive information asymmetries between client and fund manager.

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

An area of particular concern relates to how Non-disclosure (ND) and most favoured nation (MFN) (clauses) are used.

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The comments below are from an individual within the TTF community who has valuable expertise and experience in relation to these areas; that individual would be happy to elaborate on these very important points with the FCA if required:

"I have been on both sides of these issues; so, poacher and gamekeeper. My experience is limited to segregated mandates. The pooled funds we ran had fixed schedules and there was no negotiation at all.

MFNs: The first thing to understand is that little if any of this gets included in the investment management agreement (IMA). It is in this sense unverifiable and not auditable. I have though used it as a reason cited for stopping fee negotiations with trustees. Only once in about fifty such presentations and mandate gains was I ever asked to document my words. I did this by way of a side-letter, a comfort letter, of dubious legal standing.

I did try to do some analysis a few years back and asked some 50 schemes about this. About one third claimed this was part of their understanding with the fund manager, but none had documentary evidence. I am told that written MFN clauses are seen with local government schemes, but again these are usually in ancillary documents, but local government schemes did not figure in the sample of schemes that I polled. I did have a few responses which had common fund managers, in active UK equity. When I looked at the fees paid I found two clear indications that others had better terms than them notwithstanding the fact that they thought they were getting best terms. Looking at it overall I came to the conclusion that most were simply being quoted from a standard fee schedule, with only occasional variations above or below that schedule.

NDs: These are documented. Part of the issue, in my research attempt, with some, was that their IMAs prohibited disclosure of the terms of management - in some cases even to beneficiaries of the fund. It was not uncommon for the IMA to limit disclosure even of performance figures. Our model IMA restricted disclosure to the scheme and members – no third parties. Our stated rationale was to ensure that any information in the public domain, for example with investment consultants was accurate. The truth is that we were keen to avoid disclosing the fact that broadly similar mandates could have starkly different results.

There was a lot of cherry picking going on all over the place in advertising and marketing documents - and that led us to the original GIPs [Global Investment Performance] *standards. They eliminate some, but far from all of those practices. One of the oldest was reporting the average return on a mandate class – we could tinker with the membership; we could report average by number; we could report average by value. We always reported numbers in terms of the most recent year, the average over two years, the average over three/five and so on – this appears to be open but it confuses what you achieved in any one year or sequence. This is still standard today. I made this point to* [the name of a friend] – *he owns a* [name of an Asset Manager] *fund that has just had a stellar year, and was two or three in the two and three year averages among eight funds. When you look at how they did in each year, going backwards in time they were 1, 7, 8, which is far from as impressive.*

The real abuse from a transparency standpoint concerns complaints and legal actions. There is usually some publicity at the start of the process but that is where it ends. Settlements are invariably subject to a non-disclosure of terms clause; most settle on the steps of the court. I have tried asking fund managers how many such complaints and settlements they have had, and got nowhere. We should be pressing for full disclosure as part of the marketing materials. I have even come across what I refer to as super NDs. Here the terms of the settlement denied the parties disclosure even of the fact that a complaint had existed and been settled.

The investment consultants are frankly [not very good] *in this; they simply take the numbers fed to them by the asset managers and regurgitate them. I have seen one instance where there was a maximum loss limit – 2% and then there were three consecutive months in which losses exceeded this, but the fund manager had reinterpreted this as a "value at risk" limit, was reporting compliance and the investment consultant accepted this. The terms of investment consultancy agreements usually make it impossible to take action against them, and it is not uncommon for these to include non-disclosure of the advice they have offered".*

We believe that the FCA ought to propose remedies that deal with the adverse impact that Non-Disclosure and Most Favoured Nation clauses are having on the workings of the market generally and the achievement of value for money specifically.

10.21 Questions

We would welcome views on:

- **The likely effectiveness and proportionality of the:**

- **Single charge remedy to incentivise asset managers to control the charges taken from funds**

- We don't think a single charge will adequately incentivise asset managers to control the charges taken.

- Substantive and transparent disclosure is likely to be more effective so that asset owners, and their representatives, can see where the money is being spent and how much in each area rather than using universal figures that incentivise cross-subsidy.

- If asset managers are required to set a budget, this will likely be set so as not to compromise the manager's profitability and would thereby be to the detriment of the consumer.

- If a single charge were introduced whilst also introducing mandatory comprehensive costs disclosure them many of the unintended consequences of the 'single charge' approach would not apply.

- The decision of 'single charge' and 'comprehensive costs disclosure' should not be seen as an either/or decision; we can have both, and as such would have 'the best of both worlds' This combination may be the best overall solution to motivating asset managers to manage cost properly on one hand whilst also providing asset owners with a means by which they can properly scrutinise costs, compare options in the market and seek value for money.

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- **The specific options (A, B, C, D) set out above**

- The OCF regulations: https://www.esma.europa.eu/sites/default/files/library/2015/11/10_674.pdf

- A – partially effective. It provides more certainty than is currently the case but many charges are not covered by the OCF so there is still an unacceptably high level of uncertainty.

- B – ineffective and potentially harmful. An estimate is likely to be wrong and misleading as no-one can predict how much they are going to trade (not even Tracker Funds) Consumer detriment likely.

- C – ineffective. The option for overspend renders any control meaningless.

- D – ineffective and potentially harmful.

- **Any unintended consequences of:**

➢ **Single charge remedy to incentivise asset managers to control the charges taken from funds**

- The nature of the remedy will dictate the unintended consequences (see below).

➢ **The specific options (A, B, C, D) set out above**

- A – Charges likely to go up somewhat as managers protect themselves from having to give a firm price.

- B – Charges likely to go up somewhat as managers protect themselves from having to give a firm price.

- C – Charges are likely to increase materially. Conflicts are likely when overspend is exercised and explanation disputed.

- D – The charge will be set to protect the Asset Manager. It is likely to result in very expensive funds, sub-optimal management or financially weak managers.

➢ **How we can overcome any of these unintended consequences**

- Don't impose any of the four proposed measures.

- Impose a legal duty on managers to act in the interests of their clients, including the duty to not incur unnecessary and/or inflated costs when acting on clients' behalf.

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- Define the costs that can be incurred on savers' behalf.

- Establish templates for the reporting of these costs such that there is consistency of disclosure across the entire market; beyond just the Asset Management sector.

- Mandate regular disclosure of the costs incurred in monetary terms as well as percentage terms.

➢ **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?**

- All investors should be treated in the same way as far as the regulations are concerned.

- This approach creates economies of scale for providers.

- This approach creates a single set of outputs for users, whether they're wearing a retail or institutional hat; and they are often the same people

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

- Please see 'overcoming the unintended consequences' above
- Publish the results for all funds annually in a searchable and rank-able form
- Require compliance for any fund sold to any UK investor

➢ **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, indeed. It is impossible to understand how the retention of box profits can be seen to be in any way consistent with Treating Customers Effectively, Outcome 1 (fair treatment).
- If it does breach Treating Customers Effectively, Outcome 1 (fair treatment) what has been/will be done to penalise accordingly?

10.28 Questions:

We would welcome feedback on the following questions:

➢ **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?**

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- Yes

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

- Yes

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

- Yes. The Asset manager should be mandated to communicate the persistent underperformance in a prescribed manner to investors, thereby alerting them to that underperformance.

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

- Yes. The Asset manager should be mandated to communicate the persistent underperformance in a prescribed manner to investors, thereby alerting them to that underperformance.

10.32 Questions

- **Do you agree that the focus of any remedies in this area should be on investors in scenarios 2 and 4 outlined above?**

- Yes

10.44 questions

- **What is the likely effectiveness and proportionality of:**

  - **Remedies which aim to introduce further cost transparency and aim to encourage retail investors and their advisers to become more price sensitive**

- The effectiveness and proportionality will be determined by the measures enacted

- In general, steps to encourage transparency are likely to be beneficial. Disclosure is likely to lead to managers not wanting to be 'named and shamed'. Greater information might well lead to better buying decisions

- The key is to have consistent disclosure across managers/products so that users can gain familiarity and comparisons can be made on a level playing field

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- **The specific options (A, B, A+ and B+) set out above and alternative remedies that could be introduced**

  - A (monetary fund charges, before investing) – Monetary amounts are helpful but the challenge is then to identify what amounts to illustrate. A balance needs to be struck between providing helpful illustration points and overloading users with too many data points. Disclosure at the point of sale might require projections, which need to be provided on a consistent basis in order to be meaningful.

  - B (monetary total cost of distribution, before investing) – Total costs of distribution are likely to be helpful but require disclosure beyond that which the fund manager can provide. A mechanism needs to be created to incorporate the distribution costs easily. Monetary amounts are helpful but the challenge is then to identify what amounts to illustrate. A balance needs to be struck between providing helpful illustration points and overloading users with too many data points. Disclosure at the point of sale might require projections, which need to be provided on a consistent basis in order to be meaningful.

  - A+ (monetary fund charges, after investing) – Show the actual costs of investing incurred by the specific client.

  - B+ (monetary total cost of distribution, after investing) – Show the actual costs of distribution incurred by the specific client.

- Educate savers that fees are being charged and that they should look to understand what the fees are. Fees cover (necessary?) services. Having a consistent approach to disclosure, ideally through a template and an agreed list of legally defined costs and charges simplifies the education process and improves the efficacy of costs disclosure.

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

- Disclosing fees alongside related performance in consistent terms (whether % or £) will increase awareness of the impact of charges.

➢ **Would there be unintended consequences of:**

➢ **Remedies which aim to make investors more price sensitive and, if so, are there ways in which unintended consequences could be overcome?**

- Might create a focus on cost rather than value. If possible, the FCA should give an indication of 'reasonable' cost for the service concerned.

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- The greater volume of data disclosed might overwhelm investors. If possible, tier disclosure so that those who want more detail can access it easily but are first shown summary information (e.g. total cost as a single number)

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➢ **The specific options (A, B, A+ and B+) above and ways in which we could overcome any unintended consequences?**

- A (monetary fund charges, before investing) – Unrealistic expectations of the cost of investing. Provide indicative ranges of realistic rates as well as comparison with others in the market

- B (monetary total cost of distribution, before investing) – Unrealistic expectations of the cost of distribution. Provide indicative ranges of realistic rates as well as comparison with others in the market.

- A+ (monetary fund charges, after investing) – If costs spike for legitimate reasons, investors might redeem. Explain the reasons for the spikes and why it was in members' interests

- B+ (monetary total cost of distribution, after investing) – If costs spike for legitimate reasons, investors might redeem. Explain the reasons for the spikes and why it was in members' interests.

- **Are there better alternative options that would encourage investors to become more price sensitive?**

- Disclosing fees alongside related performance will increase awareness of the impact of charges.

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

- All, because it is absolutely vital that a level playing field is created for comparison purposes. The failure to create a level playing field on cost disclosure would distort the market to the detriment of the consumer and would thereby undermine the very purpose of cost disclosure. Consistent comparability is key.

10.51 questions

- **Whether institutional investors would benefit from standardised disclosure of asset management fees and charges?**

- Yes, they most certainly would.

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- **What fees and charges information should be included in a standardised disclosure framework?**

- All costs deducted from the investors' capital, particularly where these are paid by agents' on the investors' behalf. The disclosure framework should show aggregated information and allow drill-down, in stages, to more detailed information for those that want it

- The Transparency Task Force has been developing an approach to comprehensive costs disclosure that has the potential to be detailed enough to be very difficult to game

- We believe that ALL the costs that adversely impact the investor need to be disclosed; not just those relating to asset management

- **What would be the cost to asset managers of providing information?**

- Not known, but the greater the standardisation, the lower the cost due to economies of scale within and across managers and investors as well as related service providers. The costs to provide disclosure should not be given as justification to not disclose; the 'costs to disclose' and the 'administrative burden' have been used as an excuse to help avoid disclosure for decades, from which the sector has profited (36%!), to the detriment of the consumer. This must now stop, please.

- **Would there be unintended consequences if trustees were required to publish costs and charges?**

- There will be a much greater focus on costs and charges which in general terms is a very good thing, but it might lead some to make decisions purely on the basis of cost rather than value. There is an important education piece to be done on this point.

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

- Most definitely, all types of investments should be included, especially Private Equity and Hedge Funds which tend to be expensive. Excluding certain categories of investment encourages gaming of the system via re-classification to an excluded type; i.e. the FCA would inadvertently be encouraging yet more 'Regulatory Whack-a Mole'.

10.66 Questions:

- **We would like your comments on our provisional decision to make an MIR. Please see the publication which sits alongside this report and sets out our consultation questions and the period within which to respond.**

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- We believe that a Market Investigation Reference to the Competition & Markets Authority is a good idea; it will help to shine a light on the workings of the Investment Consultancy sector and it therefore has the potential identify and deal with issues that prohibit the efficient workings of the market, including conflicts of interest.

- It will also provide investment consultancies to evidence if and how they add value.

- **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**

- Yes, the FCA should do this; there is no basis for such an important part of the market operating in an unregulated way. The Market Study provides ample evidence that such a step is both necessary and proportional.

- The fact that the institutional investment consulting sector has not been regulated to date may explain many of the sub-optimal market practices that have been taking place

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

- Yes, the FCA should do this; there is no basis for such an important part of the market operating in an unregulated way. The Market Study provides ample evidence that such a step is both necessary and proportional

- Again, the fact that the EBC sector has not been regulated to date may explain many of the sub-optimal market practices that have been taking place

7. Other areas for consideration

In this section we cover a range of points not directly included in the Market Study that still represents worthwhile input all the same:

The Senior Manager and Approved Persons Controlled Functions Regime:

We believe there is merit in the FCA looking into how the Senior Manager Regime and the Approved Persons Controlled Functions Regime might improve accountability and governance; and thereby outcomes achieved.

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The ‘Sophisticated Investor’ status

We believe there is merit in the FCA looking into what impact the ‘Sophisticated Investor Status’ is having. We are concerned that it is inadvertently removing regulatory protections from those that need it. Are all individuals deemed to be sophisticated investors truly sophisticated investors?

Irregularities regarding fees and invoicing

There are numerous issues regarding the charging of fees that we encourage the FCA to fully investigate and provide remedies to:

- There are far too many errors on invoices – the vast majority of these errors have meant higher than expected fees

- Invoice payment dates don’t match the IMA invoice payment date leading to invoice payment earlier than contractually stated, sometimes by up to 2 weeks each quarter. The loss of many days’ interest on high fee amounts, in some cases on hundreds of thousands of pounds, four times per year (if quarterly invoicing). A considerable issue.

- Many invoices seen were not even “legal invoices” – essential information missing (such as the name of the pension fund client, what the invoice is for, which period it covered, the payment date and what currency the invoice is in etc.)

- Some invoices seen for a contractual period (i.e. quarterly invoices for Q4) include a

number of days for Q1 of the next year. Clearly this is a breach of contract and/or FCA rules. Again, a serious issue.

- Use of Performance Fee calculations that have clearly been modelled to give the asset manager the highest possible fee. A 13-step performance fee calculation has been seen that a pension fund had signed up to but could not replicate when checking the invoice. It was too complex and essential data was missing. Clearly, a problem

- A general concern is that asset owners do not appear to scrutinise invoices properly; with material detriment to them/their scheme members.

- We would encourage asset owners to consider retrospectively scrutinizing all invoices paid and seek compensation if it transpires that they have been overcharged

A reluctance for there being more regulation is unjustified

There is sometimes criticism that increased regulatory requirements and their associated costs have led to little consumer benefit. We believe this point alone should not discourage more regulation, but we seek to encourage the FCA to introduce regulations that are going to positively impact the market in as efficient a manner as possible.

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Furthermore, we believe that principles-based regulation can be highly effective; for example, the creation of an explicit legal duty for all market participants to act in the interests of the client could cut through swathes of ‘red tape’. On that basis it is particularly disappointing that only a minority of the members of the trade body for the asset management industry, The Investment Association, found themselves able to sign up to a set of principles that included the idea of putting the interest of the client first. For those of us that have a pro-consumer outlook this was a very worrying development; and the fact that the Investment Association now seems to have dropped all efforts to encourage their members to accept the principle of putting the interests of the client first is disappointing to the extreme; so much so that it makes one question whether they are a suitable Trade Body for representing Asset Managers that are more enlightened; more progressive and more truly client-centric.

As mentioned earlier it is certainly one very good reason why the FCA should not allow themselves to be sold the idea of a ‘patchwork quilt of protocols’ designed by conflicted Trade Bodies, whose priority is to care for their members’ commercial interests.

Also, it would seem that Regulators have sometimes failed to make full use of their powers in enforcing existing regulations; for example, one wonders whether the entire Treating Customers Fairly regime has been used as effectively as it could have been?

In a ‘perfect world’ a highly elegant regulatory regime based on a handful of key principles would be wonderful, but given where we are it would seem that a rules-based approach is necessary; it shouldn’t be, but it is.

We would hope, however that the FCA gives a great deal of thought in ensuring that the potential for unintended consequences is minimised, and on that basis we suggest the FCA may want to liaise with a few key, highly knowledgeable individuals who might perform a very valuable sense-check for the FCA on potential unintended consequences before new rules are introduced. I am sure that there are several ideally-suited individuals within the TTF who would be ideal for such an exercise (and acknowledge of course that there are many others that are not involved with the TTF at all).

Given the wide-ranging nature of the Market Study we think it is absolutely essential that such a sense-check was completed.

The importance of definitions

It is vital that the terms used in regulations are properly defined in law, particularly when seeking to create a framework for the consistent disclosure of costs and charges incurred when investing. There is a myriad of over-lapping regulatory and industry body initiatives that are underway. These initiatives include the new Investment Association Disclosure Code, PRIIPS, the FCA's Consultation Paper 16/30 on Transaction Costs in Workplace Pensions, MiFID II and others. Some of these initiatives clearly define the terms that they have used and certain terms may be defined in different ways.

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Clear definition of each term will ensure consistency across regulatory and industry body initiatives which will, in turn, lead to a strong set of regulations that reduces the risk of ambiguity and, therefore, the risk of the regulations being gamed/undermined; and consumer confidence being lost.

The Transparency Task Force is part way through a definitions exercise and would welcome specific dialogue with the FCA on this work; we believe that a centralised and systematic approach to establishing definitions is a worthwhile aim and we shall follow up with some ideas on this separately; we think it is vital that the FCA is directly involved in this work.

The impact of the media

We would encourage the FCA and/or the Competition & Markets Authority to look into the role of the media within the asset management and investment sectors. There are concerns that the business models of some publications may have become over-dependent on revenues from these sectors; so much so that it may be having an impact on what gets written about and how it is covered. If this is the case it is a significant problem that needs dealing with. The difference between editorial, advertorial and advertising can sometimes get blurred.

The impact of unregulated advertising by market participants

There does not appear to be any regulation or policing of the advertising issued by some market participants in some parts of the market. Perhaps this is due to the fact that not all parts of the market are properly regulated yet? We would like a regime in place that ensures that all advertising by all market participants adheres to a set of rules or codes; at the heart of which is the idea that no advertising should be misleading in any way and that all costs, risks and so on are properly disclosed; with any reference to investment performance claims being wholly justifiable and includes assessment over an appropriate period of time.

Litigation risks

We are concerned that some existing market practices may lead to litigation against, for example, trustee boards who are shown to have not acted in the best interest of their scheme members, by, for example, not doing what they should do to optimize costs and charges.

Excessive costs and charges adversely impacts members in DB schemes indirectly and in DC schemes directly; either way they can lead to material detriment to investors; particularly in pension schemes where the corrosive effect of excessive fees has a substantial impact because of the ‘compounding’ effect over time.

This is more than just a theoretical possibility. The FCA might wish to look into the multi-million-dollar class actions won by pension scheme members in the USA that have been represented by the law firm Schlichter, Bogard & Denton (and others). Could similar cases be brought in the UK by disappointed pension scheme members in years to come?

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The following text is from the website of Schlichter, Bogard & Denton:

In recent rankings of the most influential people in the 401(k) industry by 401kWire.com, Jerry has repeatedly ranked in the top 5. This is due to his handling of nationwide class actions on behalf of employees and retirees in large 401(k) plans alleging excessive fees and conflicts of interest that reduce employees’ and retirees’ retirement assets.

Throughout his career, he has also handled major precedent-setting class action and mass tort cases on behalf of individuals. He currently represents employees and retirees of large companies with claims of excessive fees in their retirement plans. He and the firm have ***obtained settlements in these 401(k) excessive fee cases of more than $300 million for employees and retirees****, in addition to significant improvements in their 401(k) plans. He also was lead attorney for the firm in the first and only full trial of an excessive fee case in the country. This trial* ***resulted in a substantial eight-figure verdict on behalf of employees and retirees in the ABB 401(k) plan.***

Jerry has been featured in numerous national publications, including the New York Times, Reuters, Bloomberg, USA Today, and the Wall Street Journal, for his success in obtaining precedent-setting results involving claims of excessive fees against large employers, and for the reduction in fees his cases have caused throughout the 401(k) industry. According

to a recent article published in Reuters, the CEO of Brightscope, an independent company which evaluates 401(k) plans, stated, speaking of Mr. Schlichter's national impact on 401(k) plan fees, that "[h]is impact has been humongous." The New York Times has referred to Jerry as "a Lone Ranger of the 401(k)'s," and he has been referred to by Investment News as "public enemy no. 1 for 401(k) profiteers" and by Chief Investment Officer as "the industry's most feared attorney."

In 2014 and 2015, Mr. Schlichter's firm obtained the two largest 401(k) excessive fee settlements in history. The first was a settlement for ***$62 million against Lockheed Martin on behalf of Lockheed Martin employees****, which included significant changes to the Lockheed Martin 401(k) plan. The second was a settlement for $57 from Boeing, which likewise included significant non-monetary relief.*

Also in 2015, Mr. Schlichter won a unanimous 9-0 decision in the U.S. Supreme Court in ***Tibble v. Edison, the first U.S. Supreme Court case to consider fees in 401(k) plans.***

In an order in the case of Nolte v. Cigna Corporation in 2013, the U.S. District Court judge stated: " . . . Mr. Schlichter and the Schlichter, Bogard & Denton firm's actions have led to dramatic changes in the 401(k) industry, which have benefited employees and retirees throughout the country by bringing sweeping changes to fiduciary practices."

The U.S. District Court in Tussey v. ABB similarly found of "special importance . . . the significant, national contribution" made by the team led by Mr. Schlichter, which has "educated plan administrators, the Department of Labor, the courts and retirement plan participants" about the fiduciary obligations of 401(k) plan administrators

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We believe there is a chance that similar litigation may happen in the UK and if so it would further undermine confidence in the system. The list below is not exhaustive but it may represent the sorts of areas in which litigation might occur:

- Closet trackers
- Stock lending
- Soft commissions
- Inappropriate benchmarks
- Foreign Exchange
- Invoicing
- Unfair contract terms
- Undeclared income
- Unresolved conflicts of interest
- Transaction costs generally; and Portfolio turnover specifically

The challenge of sourcing accurate data

The issue of sourcing accurate data from asset managers for the purposes of transparency on costs is a challenging area. Asset manager's systems have a set of data – but they only "shadow" the Net Asset Value (NAV) to within a few basis points of the "official" Net Asset Value using investment ledger-based systems. DB Pension funds have a custodian that is paid to cut the official NAV of the segregated mandate(s) – custodians use general ledger-based systems which capture ALL relevant costs.

The custodian provides the monetary figures used by the pension fund in their annual report and accounts – not the asset manager. For pooled funds, the fund custodian also cuts the official NAV (some alternative funds have an administrator that performs this function). From the many comparisons one of our members has undertaken of asset manager valuations V custodian valuations, the asset manager valuation has always come out higher than the official "books and records" valuation of the custodian (due in the main to the use of different marks/prices that are higher than the custodian's). This valuation issue is exacerbated for assets that are illiquid or Over the Counter (OTC) in nature.

On that basis, where is the sense in asking an asset manager to provide figures on costs when their data is "shadow" NAV-based and is correct to within "X" basis points only? It is not the "books and records" data of the fund. Our member who has particular insight and expertise in this area has seen pension funds agree to using asset manager valuations for the purposes of AMC/performance fee calculation in their IMAs. No pension fund should ever be doing this as it leads to higher than expected fees and raises the issue of Fiduciary Duty – why have the trustees agreed to pay a fee based on a valuation that is not the official "books and records" of the fund? All pension funds that use asset manager valuations for fee calculation purposes will be paying these invoices based on a "tolerance" (i.e. within 2% of the official valuation/fee amount) as the asset manager's valuation and, therefore, the fees are higher than those produced by their own custodian.

For pooled fund investments, no investor has any rights when it comes to requesting data from the pooled fund/asset manager concerned – unless they have contractually agreed this at the time of investing. Coming back to the asset manager post the investment and asking for transparency on certain cost items will not generally work.

Securities Lending

We believe that far greater emphasis and investigation into the practice of Securities Lending is required, for the following reasons:

- Collateral management is one of the key pillars of mitigating counter-party risk, however the trading, settlement and margining practices haven't changed in 40+ years

- the current market structure is opaque and hasn't changed since its evolution into today's collateral markets as a fails activity designed to support settlements. The advent of derivatives and the globalisation of the financial markets has expanded the market place from $250mn in the late 1970's to a value exceeding $4trn today and sustains an industry

encompassing over 40,000 employees globally, across banks, brokers, consultants and technology providers

- The current market pricing structure is opaque and restricts Managers from fully optimizing client assets

- Managers are excluded from the process of full price discovery and price transparent price discovery in collateral transactions due to the vested interests of the Intermediaries involved in Securities Lending

- There is a lack of price transparency in collateral lending transactions which gives rise to underperformance, and the subsequent regulatory and fiduciary implications for Managers in ensuring the best interests of their clients

- The Retail Consumer is not allocated a fair share of revenues from stock lending in the current market structure

- Many Managers are not even attempting to engage in Securities Lending as an activity to optimize their client's assets. They do not provide any form of substantive information for their exclusion from this activity which further disadvantages the end investor

- These practices could be modernised without recourse to any changes to guidelines or legislation that the current FCA Code of Conduct and the Fiduciary obligations provide. All that is required to effect immediate change is the promotion of best practice by the FCA.

Discussions and interactions with Asset Managers regarding their participation or non-participation in Securities Lending has concluded with their universal acknowledgement that they are excluded from the price discovery process and are disadvantaged in the current market structure. They agree that they don't have a fair "route to market" under the present process. This raises quite legitimate concerns about the nature and form of risk they may be exposing their clients to when the returns on offer are so small.

The lack of access to a transparent and fair market gives rise to many serious questions about the nature of the collateral markets and the systemic risk they create in the financial markets. The inability of Managers to readily access fair and open pricing whilst determining risk and returns leaves Managers open to a charge that they are in breach of their Fiduciary obligations and the FCA Code of Conduct guidelines. This has subsequent implications for the retail consumer who is dependent upon the protection of both their Asset Manager and the FCA as the prevailing regulatory authority.

Considering the many dimensions involved in the Asset Management market and that Securities Lending is one of many activities, we would suggest that the FCA resolve this issue quickly, given the existence of the necessary legal and regulatory framework. Managers support the concept of better access and greater price and risk transparency but need a signal from the FCA that this issue is a priority. We believe that immediate direction from the FCA to the member firms in the form of a Guidance Note would allow member firms to act promptly and reflect the needs of the Retail clients in securing optimal returns whilst correctly measuring, reporting and managing risks.

We believe that the current Securities Lending market structure is opaque; and that it is broadly accepted throughout the Buy-side industry as no longer being fit for purpose in a modern global financial marketplace; whilst the current bi-lateral opaque practices continue to disadvantage Retail Consumer by restricting access to price and risk. The overall effect has created a potential legacy issue over and beyond other well publicised industry issues such as Libor and PPI. This is a serious and systemic issue. Notwithstanding that

Securities Lending is but one element of the overall Market Study, it has significant implications for the industry and where fair value and better protection of the end consumer is paramount and can be delivered immediately.

We therefore request the FCA thoroughly investigates these issues; alongside whether & how asset owners are appropriately rewarded by asset managers for their 'involvement' in Stock Lending

8. Miscellaneous comments

Some of our members provided comment through a survey we produced on the morning of the publication of the Interim Report:

- **What is your overall opinion of the FCA's Interim Report?**

- Very welcome and encouraging

- APFI (Note, APFI is the Association of Professional Fund Investors; their UK Lead is also an Ambassador of the TTF) broadly welcomes the interim FCA proposals, which should engender greater transparency of fund charges, assuming an even approach is applied to active and passive funds and captures the variation in share classes and fund charges at the fund level. These proposals should involve all impacted parties including professional fund managers, investors, consultants, consumer groups and rating agencies.

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- Surprisingly good

- **What, if anything, are you particularly pleased with?**

- Both the requirement for independent oversight of investment funds to ensure value for money and the interim decision on investment consultants and EBCs where there are self-evident conflicts of interest

- APFI support an open dialogue about the better integration of technology to improve investor outcomes. This can include capturing Fund information, due diligence process, fund monitoring, attribution and selection tools.

- Highlighting weak competition and poor benchmark selection; and, as a bonus, inclusion within [regulatory] scope of investment consultants

- Thorough analysis, recognition of importance of transparency, CMA review

- The attitude of viewing things from the consumer's perspective

- **What, if anything, are you particularly disappointed by?**

- Omission of discussion of impact of anti-competitive market behaviours on ESG Research/Governance/Voting/Stewardship role of fund managers

- We challenge the FCA's assertion that the UK fund market is not concentrated with over half of the market held by just 10 firms. The FCA should consider ring-fencing long term legacy assets from new business. We encourage the FCA to take a closer look at consolidation, smaller firm survivorship, M&A and the wider global trend. The FCA highlights investment consultants (Chapter 8), those who advise pension scheme trustees. Investment consultants do not represent the entire professional fund investor ('PFI') industry. Their proximity to the end customer will be different compared to a multi-manager, a platform or an adviser. We therefore encourage a broader study of fund selection and the sharing of best practice, not only among APFI members, but all areas of fund research including fund research agencies, insurers, local government, discretionary fund managers and multi-managers to address issues raised. Only through increasing professionalism can funds be selected effectively as innovation and tools available become ever more advanced.

➢ **If you could change just one thing what would it be?**

- Include discussion of impact of anti-competitive market behaviours on ESG Research/Governance/Voting/Stewardship role of fund managers

- The APFI calls on the FCA to consider whether business models should be reviewed, universal market standards implemented and certification be considered for professional fund investors.

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➢ **Any other comments?**

- What has been the role of trade associations in fostering such an anti-competitive environment so focused on asset manager enrichment at the expense of clients?

- The APFI asserts the need for a better appreciation for market standards and professionalism in fund selection/governance, such as due diligence. The value of quantitative v qualitative analysis is also an area the Association of Professional Fund Investors is committed to exploring with our members. Why consultation cannot be simply driven by fund manufacturers; while recognising that better U.K. and global standards may add value to customers. This may include certification and/or defined professional standards for fund research.

- More of the same please, FCA.

9. Final thoughts

The FCA is to be applauded for its whole-hearted attempt to fix many of the things that are quite obviously wrong in the Asset Management sector and related industries, many of which are rooted in conflicts of interest, opacity and incentives regimes that encourage the wrong sorts of behaviour.

We believe the FCA’s approach has been inclusive, engaging and highly analytical; an impressively professional job has been done by the FCA and we know the overall quality of

the Market Study has been noticed around the world.

This is all very encouraging.

However, the industry that the FCA is looking to change is notoriously well resourced and has extensive lobbying capabilities and it would be reasonable to expect that it wants to hold on to its 36% profit margins if it can. We hope, therefore, that the FCA will be able to withstand the inevitable pressure it will be under to dilute its proposals as a consequence of the professional lobbying it will be subjected to.

We imagine the case to maintain the status quo will include arguments along the lines of:

“If you carry out your proposed remedies then:

- Jobs will be lost
- There will be a brain drain of talent to other countries
- The Treasury will lose valuable tax revenues
- You would be undermining confidence in the sector
- You would be attacking a vital part of our economy” and so o

We believe that these kind of arguments have been used for decades to defend the profitability of the sector and they must not be allowed to prevent the progress that can now be made. We implore you to see through them.

The Transparency Task Force is built on the idea that “Sunlight is the best disinfectant” and the FCA’s Market Study, Interim Report is a glorious ray of sunshine.

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More of the same please!

Finally, we hope that our input through this submission and our previous involvement has been helpful. If required, we would be happy to discuss our thoughts further.

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