Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Karen

This is the response of the Financial Services Consumer Panel (the Panel) to the Financial Conduct Authority's Consultation CP17/18: Implementing asset management market study remedies and changes to handbook.

The Panel has supported the work of the Asset Management Market Review team. This response concentrates on the measures outlined in CP17/18. We also confirm our commitment to working with the team to ensure all the measures needed to correct the market failures outlined in the final report are implemented in full. We again urge the FCA to resist any effort by the asset management market to water down the proposed measures.

General comments on the measures to improve governance

In our response to the interim report the Panel suggested that the only way to compel providers to act in the best interest of their customers was to introduce a statutory duty of care. Our arguments for a duty of care are well known and we do not propose to repeat them here. Suffice to say that we were disappointed that, despite the severe failings of this market and consequent detriment for its customers, the FCA is still not proposing a statutory duty of care.

However, we acknowledge that the proposed measures, along with the strengthening of the Senior Managers and Certification regime (SM&CR), are a considerable improvement on current practice.

We welcome the FCA's commitment to keep the new approach under review and to consider further changes if necessary. However, we would like to know how the FCA will assess change, e.g. through supervision, thematic reviews, and what it would regard as a trigger for further action. This industry has failed its customers for too long. It is important to set a clear timeline against which to hold it to account.

Yours sincerely

Sue Lewis
Chair, Financial Services Consumer Panel

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

Yes. The FCA will have to enforce this rigorously: the current obligation does not appear to work consistently.

It is also worth noting that Independent Governance Committees (IGCs) and Trustees overseeing pension schemes are already required to demonstrate value for money for members. However, there is no consensus for how this should be done.

The FCA has set out specific elements that must be assessed, but there are still areas of ambiguity or subjectivity. For example, on fees and charges the FCA will require authorised fund managers (AFMs) to assess whether charges *"are reasonable in relation to the costs incurred"*. But what is "reasonable" to one AFM Board may be very different to another. Will the FCA issue further guidance to AFM Boards on the assessment?

The assessment should demonstrate engagement by the fund group operating Board in the performance and operation of the fund. This should be part of their senior managers and certification obligations. There should be documented challenge of business models including product development, further share class issuances, etc. This needs to address the tendency of managers to issue multiple products which generate more fees for the manager but provide investors with little benefit.

We welcome the fact that AFM Boards must publish the results of the assessment at least annually but it is not clear what the FCA will do with the information. The Panel suggests that the FCA should review the assessments and evaluate the impact of the other measures a year or so after the new rules have been implemented.

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

Yes. The main issue is supervision and enforcement.

We believe there should be clear cost allocation principles. For example, the fund Board should assess how costs incurred in the running of the fund are allocated between the manager's overhead and the fund on the one hand, and the fund and other separate funds under management on the other. The AFM Board should be satisfied that the allocation principles are fair, especially for distribution and third party costs.

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

No, 12 months is too long. Given that AFM Boards are already obliged to assess whether their products and services offer value for money, they should not need another year to deliberate how to do this. The customers of funds not offering value for money (which findings from the market review indicate are many) should not have to wait. There is nothing in the proposed measures that should take AFMs 12 months to implement. We would suggest three months as a maximum.

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, this is the minimum they should do. But it needs to be clear what the FCA will do with the information.

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?

Yes, the Panel strongly supports this proposal. It is imperative that the Boards are diverse in terms of ethnicity, gender, experience and background, including having at least one individual with experience promoting the interests of consumers or investors.

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

Yes. It is difficult to be the sole challenge to a strong executive. We would also urge the FCA to be more prescriptive about how independent Board members are recruited.

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?

We agree that independent directors should be able to serve on more than one Board, as this will allow the availability of a wider 'pool' of suitable candidates. However, we would not want to see a similar situation to IGCs, which employ mainly corporate or professional trustees as the independent Board members. Independent directors should be just that – individuals who do not have a mandate other than to serve the investors in the fund and provide them with value for money. If individuals can demonstrate a proven background in consumer finance and promoting the rights of consumers, so much the better. Expertise in fund management is not essential for the independent directors as the rest of the AFM Board should have this expertise in abundance. However, what is required is the confidence to question the Board on its activities and on its assessment of value for money and to disrupt 'group think'.

The Panel feels strongly that Boards should be encouraged, or better still mandated, to recruit openly and transparently to ensure they are considering candidates from the widest possible field.

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

The FCA should mandate an independent Chair. Executives are often conflicted and cannot advocate effectively for investors.

In addition, the FCA should look at what can be learned from With Profits Committees and IGCs. What aspects of these committees have resulted in better consumer outcomes?

Q11: Do you agree with the proposed modification of FG13/4? If not, what alternative(s) would you propose?

Yes. We also suggest that the FCA mandate AFMs to consider the use of commercial services to trace customers they have lost contact with. The Panel understands that services exist where costs are borne by the asset management company and not the customer, but that only a minority of AFMs use them. All financial services providers should be compelled to work harder to trace lost or hard to find customers and reunite them with their money.

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

The Panel supported the banning of commission in the Retail Distribution Review, including trail commission on new products. The time has come also to ban this for investments and products sold before 2012.

The FCA should investigate how many customers still paying trail commission are getting a continuing service from their adviser. It could do this by requiring all financial advisers in receipt of trail commission to declare this and to confirm whether they have regular (i.e. at least once a year) contact with that customer.

We urge the FCA to undertake this analysis as soon as possible. We would also suggest the FCA investigates the 'unintended consequences' of stopping trail commissions, including the possibility of increased costs to consumers. If this were the case, there should be a specific requirement on firms to ensure customers understand what's happening and why.

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

The evidence set out in the FCA's report, particularly that pre-Retail Distribution Review (RDR) classes pay 90% more in fees than post-RDR classes for no value added to investors, is compelling enough to warrant a review on the banning of trail commissions for pre-RDR classes.

Customers should not have to pay for services they do not receive irrespective of which investment or savings market they are being served by. Those consumers who are paying for a service through trail commission should have the option of paying for it through advice fees deducted from the investment. The benefit of paying a fee rather than through commission is that the fee must be agreed and is transparent – and consumers can choose not to pay this and take their business elsewhere.

The Panel believes it is now time for the FCA to review this practice not only in asset management but across retail product distribution.

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?

Yes. However, this is another example where the principle of Treating Customers Fairly (TCF) has failed, with those firms currently retaining risk-free profits.

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?

Passing risk-free profits appears to be the simplest model in terms of operational impact and the activity seems a natural part of the day to day dealing of 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?

Managers and ineffective fund Boards have failed. The FCA rules were not clear enough to prohibit the retention of risk-free profits, TCF hasn't prevented gaming the system. The depositaries can continue to monitor the risk-free box profits taken by managers as part of their current administration and oversight responsibilities, but the level of profits should be included in the assessment of value for money by the Board.

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. This is evidenced by various regulatory interventions and thematic reviews. The Panel has long been critical of the opaqueness of with-profit funds and of the ineffectiveness of with-profit committees. With-profits fund holders would benefit greatly if the measures proposed by this market study were extended to with-profit funds. It is high time these funds (which are now mainly closed to new investors) were brought into the same regime as other retail investment funds and made to demonstrate how they are placing their customers' interests first.

We support the upcoming review of the fair treatment of with-profits customers, and hope that it addresses some of the concerns we have highlighted.

Q19: Would additional or alternative approaches be more appropriate or cost-effective for tacking 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?

The proposed re-structuring of AFM Boards alongside the new proposals for the SM&CR are the minimum that should be imposed on unit-linked and with-profit funds. The regulatory requirements on IGCs could be strengthened to bring them in line with those for AFM Boards, although the overall supervision of a provider's pension scheme and funds would require either a much larger committee or more than one committee (purely from a resource viewpoint). The current practice whereby many IGCs meet four times a year would not be enough.

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

This is about good governance. As the FCA has pointed out in CP17/18 consumers who save or invest through unit-linked and with-profits life assurance products would also benefit from the increased protections it expects its proposals will deliver for authorised funds. It also points out that if the measures are not extended this could promote regulatory arbitrage as providers could choose to focus on those products where the regulatory regime does not force them to consider investor's interests. In light of this, it is hard to see an argument against extending these measures and proposals to unit-linked fund and with-profit products.

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?

Investors and savers have the right to good governance and to protection from poor value products whatever investment vehicle they are in. The measures and proposals put forward in the Asset Management Market Review should help put right a market that has been failing its customers for too long. It would be inequitable if these measures were not applied across all markets where consumers invest and save and where they could lose money through poorly managed and governed funds. TCF was supposed to address these issues but has not. It is now time that the regulator imposed these requirements on all providers of investments.

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?

Yes. Investors or savers in those products not covered by the strengthened regime would continue to suffer detriment and product providers would be encouraged to promote products that have the lighter touch. There is a real danger of regulatory arbitrage if the measures are not extended.

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

IGCs need more time to bed in. However, the governance of pension schemes should be aligned as much as possible with these new measures.

We await with interest the outcome of the FCA's discovery work on non-workplace pensions. Many of the failings of the retail investment market are likely also to apply to pension funds that have no governance in place.

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?

See our response to Q21. In summary, the Panel believes that all investments and savings that can be accessed by consumers either direct or via authorised intermediaries should have similar rules.

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?

Yes. Please see our response to Q22.