Institute and Faculty of Actuaries

Asset Management Market Study MS15/2.2

IFoA response to Financial Conduct Authority

20 February 2017

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

Becky Young
Competition Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

20 February 2017

Dear Ms Young,

IFoA response to FCA Asset Management Market Study - Interim Report (MS15/2.2)

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's Interim Report on its Asset Management Market Study. Members of the IFoA's Boards for Finance and Investment, Pensions and Life Insurance have been involved in the drafting of this response. Members of these Boards participate in the asset management industry in a range of capacities, working for asset managers, investment consultants, pension funds and insurers among others. The response has also been reviewed by the IFoA's Regulation Board.

2. Given the range of roles that our members occupy relating to asset management, there are inevitably different approaches to some of the FCA's detailed proposals. The following general comments focus on areas in which we have a significant degree of consensus.

3. Regarding the specific questions in the Report, we have identified those where our members have expertise or involvement and confined our comments to those items, rather than seeking to comment on the whole Report.

General comments

4. The IFoA strongly supports the aims and direction of travel being taken by the FCA in its Market Study. In particular, we recognise that the asset management industry has not always delivered value to users (especially in relation to active management). It is therefore appropriate to consider how market reforms might remedy this.

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5. The levels of profitability highlighted in the report seem high, and it is appropriate to examine if they represent a poor deal for the end investor, or otherwise.

6. We are aware that fund objectives sometimes lack clarity, particularly on the retail side. This leaves investors without clear expectations, and manager accountability is blurred as a result. We suggest that both retail and institutional funds should have to disclose their actual and benchmark asset allocation in fund fact sheets, annual reports and other literature. The needs of both investors and providers should be taken into account to determine how frequently, and in which unusual circumstances, these documents would need to be updated. This disclosure should be on a full 'look through' basis into underlying holdings, and include information on derivative exposures. This could be further extended by disclosing the minimum and maximum permitted allocations under the fund's documentation, if this is considered practical.

7. We believe that the structure of the investment market is itself problematic. The lower end of the market suffers from multiple comparative disadvantages, which could be addressed through aggregation and further governance reform. In addition there are multiple intermediaries. The asset manager's charge is often just one of many charges and costs imposed on end investors. We would support practical measures that make it easier for people to invest, especially passively, with fewer intermediaries and compliance checks.

8. The Report extends to the non-investment advice that Employee Benefits Consultants (EBCs) provide to companies and trustee boards, in which many actuaries are involved. The FCA is considering how such advice can be monitored and assessed. We support that process but would also note that actuaries are already subject to rigorous professional standards which will continue to evolve in response to market dynamics. The IFoA's Regulation Board is already considering possible changes to its current system of regulating its members involved in these activities as well as other changes to enhance its monitoring of compliance with relevant technical and ethical standards by our members. It would in our view be appropriate for any additional regulation of financial services to complement the professional standards already in place to avoid duplication and a disproportionate response.

9. The FCA is considering referring investment consultancies and EBCs to the Competition and Markets Authority for a market investigation. We accept that conflicts of interest may lead to insufficient comparison of management options. We therefore think there is a good argument for having a separation between advice and management, and we support the FCA's referral.

10. The IFoA's view is that measurement of advisers - like that of other professional advice - should have a meaningful judgemental component, which should be a part of the trustees' duties.

11. The impact of regulation on fund costs should not be ignored, as this can reduce returns for the end investor. Additional regulation which adds costs to the investment process must be justified on the grounds of better protecting investor interests. We believe a review of this extra layer of cost would be worthwhile, to examine whether some of the regulatory burden could be simplified or removed.

12. The IFoA is very supportive of a number of measures set out as 'remedies' in Chapter 10 of the Report, which focus on improving transparency and information for customers. These include more transparency and standardisation of institutional costs and charges, improved disclosure of fiduciary management fees and performance, more clarity around retail objectives and benchmarks and clearer communication of fund charges.

13. We believe that clearer disclosure of realised performance and fees could be beneficial, especially if it became easier to compare and contrast across managers. A league table published by the FCA could be worth considering.

14. One measure which could improve competition would be to allow fund managers and fiduciary consultants to compete on an equal footing for both fund management and advisory work.

15. We note that transaction costs are a drag on performance and are generally hidden. Instead, we believe all direct and indirect fees received, if an investment is to proceed, should be disclosed by all investment advisors and platforms. We have recently commented at greater length on this area in our response to the FCA's consultation on transaction cost disclosure[1]. We suggested that tables comparing rates per transaction would be more meaningful than comparing absolute costs. We would also support improved disclosure of total costs, but stop short of requiring full disclosure of both individual and total costs.

16. We have some concerns about the proposal requiring asset managers to demonstrate that they are providing value for money. We believe this proposal is not about realised performance but about ensuring that prospective expected

[1] https://www.actuaries.org.uk/documents/ifoa-response-financial-conduct-authority-cp1630-transaction-cost-disclosure-workplace-pensions

performance is aligned, in some reasonable way, with the fees being charged. This would be a desirable outcome; however, we suggest that it could be difficult to implement because many asset managers could construct a reasonableness argument to justify their current level of fees.

Specific questions

Whether the FCA should recommend that HM Treasury brings the provision of advice provided by investment consultants to institutional investors within the regulatory perimeter

17. Before commenting on the specific question, we first note that in our view it could be of benefit for the FCA to review and update its perimeter guidance to make it clearer which activities it regards as regulated, and which qualifications (or licences) would be necessary to give the advice or operate in the regulated area. Exceptions should be minimised, whether they relate to specific assets such as property, or specific kinds of adviser such as actuaries.

18. We believe it is important to ensure that regulation of institutional investment advice provided by investment consultants is delivered in a proportionate way. In particular, we note that a number of actuarial firms have chosen to use the Designated Professional Body (DPB) regulatory regime, which both the firms themselves and the IFoA consider to be a proportionate and appropriate framework. We would encourage the FCA to recognise the continued value of the DPB regime in framing its recommendations to HM Treasury.

19. In particular, we note the possibility that, by increasing the range of activity which is within the regulatory perimeter, it is possible that some professional firms will as a result find it more difficult to satisfy the 'incidental' and 'complementary' tests for the purposes of establishing DPB eligibility - because more of their work is now regulated. One unwelcome effect may therefore be that their compliance costs increase (because they require to undertake full FCA regulation instead), with increased knock-on costs for clients as a result.

20. We have concerns over which new activities will be regulated. Many pension scheme actuaries include some form of high level generic investment advice within their work on scheme funding; for example, advice on the appropriateness of assets held against specific liabilities. Liability actuaries must be able to give such advice. However, many of their firms will not currently be regulated at all, and even where the firm is regulated, many pension scheme actuaries will not be authorised to provide regulated advice. If investment strategy advice is regulated, the actuary may not be able to comment on the appropriateness of the strategy; clients will not know

whether the strategy is reasonable or not, unless they pay additional fees for separate advice. The result will be that assets and liabilities are considered entirely separately, with very little joined up thinking.

21. We are also concerned that many firms would feel obliged to change their business model in order to satisfy any new requirements. Some firms that are not currently authorised may decide to continue without authorisation and so be unable to provide generic investment advice. Authorisation costs and complexity would then become a barrier to their entry into that particular market. That may result in more work being channelled through a smaller number of firms, typically the larger ones. Inevitably, this would worsen the issue of high concentration that the FCA has highlighted.

22. This type of investment consultancy work can be very technical and actuarial in nature, and is largely carried out by firms that are either managed and controlled by actuaries, or whose history, culture and ethos stem from an actuarial background. These firms are already subject to considerable regulatory oversight through the IFoA, the Financial Reporting Council and (to some extent) the Pensions Regulator. It may be more suitable for regulation to continue to be channelled through the IFoA and the DPB regime rather than the FCA directly. We would welcome the opportunity to input into the design of the new regulatory framework so that these concerns around appropriate and proportionate regulation might be met.

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

23. Again, we agree that certain aspects of the advice provided by EBCs should be brought within the financial services regulatory perimeter. In particular, we welcome closer financial services regulation of pension products such as Group Personal Pensions where regulation is currently avoided because advice is generally given to the employer, and not to the holder of the product (the employee).

24. We do however have similar concerns over how financial services regulation could best be achieved, and over the extent to which advice should be brought within that regulatory perimeter. Similarly, we would encourage the FCA to consider whether the current professional oversight framework (including the DPB regime) is, or could be, sufficient in relation to those professionals and firms to which they apply.

Are there alternative remedies that we should also consider to allow better monitoring and assessment of advice provided by investment consultants and employee benefit consultants?

25. The alternative (or complementary addition) to FCA regulation (whether direct or indirect) is profession-led regulation. We would be pleased to discuss how the current professional regulatory framework applicable to actuaries might help to support the FCA's objectives.

26. If you wish to discuss any of the points raised in further detail please contact Matthew Levine, Policy Manager (Matthew.Levine@actuaries.org.uk / 0207 632 1489) in the first instance.

Yours faithfully

Colin Wilson
President, Institute and Faculty of Actuaries