Institute and Faculty of Actuaries

CP17/18: Consultation on implementing asset management market study remedies and changes to our Handbook

IFoA response to Financial Conduct Authority

28 September 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

Karen Northey
Asset Management and Funds Policy
Financial Conduct Authority
25 The North Colonnade
London E14 5HS

28 September 2017

Dear Ms Northey,

IFoA response to FCA Consultation Paper 17/18 – Implementing asset management market study remedies

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's Consultation Paper 17/18 'Implementing asset management market study remedies'. Our comments on this CP follow on from our [1]response to the interim market study. Members of the IFoA's Finance and Investment Board have led the drafting of this response, with involvement also from the Life Insurance and Pensions Boards. 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. We have limited our response to those specific questions where the IFoA can provide specific expertise.

Chapter 3 - Measures to improve fund governance

Value for money

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

1. We are concerned about the differing models being introduced for Authorised Fund Managers (AFMs) as compared to With Profits Funds and workplace pensions. In these cases the approach to addressing similar issues has been via an Independent Governance Committee (IGC) which advises the responsible Board. These arrangements were arrived at because it was recognised that Boards have specific Company Law responsibilities, and that managing value for money requirements in addition to acting in the interests of the Company would be difficult.

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

2. In general, assessing value for money on a broad basis is a positive thing. We also welcome the fact that value for money assessments will look to include objective measures such as assets under management and market rates for fees and charges. However, it could be a challenge to ensure that investors give sufficient prominence to qualitative aspects (such as quality of service) as well as more quantifiable ones. There is a risk that using many criteria could make it difficult for investors to compare fund managers on value for money, and that in practice they will base decisions only on the more quantifiable criteria such as fees.

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?

[1] https://www.actuaries.org.uk/documents/02-20-ifoa-response-fca-asset-management-market-study

3. We would be cautious about assuming that AFM value for money self-assessments will benefit consumers. It may be more realistic to assume instead that any such document is written from a self interested rather than objective perspective. As such it will increase costs for consumers and not improve their outcomes.

4. If, however, the FCA was to benchmark key criteria for comparison, such as fees and quality of service, from time to time, and if it was mandatory to disclose this benchmarking information at point of sale, we believe this could offer some benefits to consumers.We believe that such mandatory disclosure would be in the public interest and would also be consistent with the FCA's aim of encouraging firms to treat their customers fairly.

Independent directors

> ***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?***

5. We agree that having independent directors is a reasonable requirement but, as noted in 3.43, the legal duties of independent directors are no different from those of executive directors. This leaves an inherent conflict and may limit the benefit achieved from the appointment of independent directors. As noted earlier, it may be worth considering an independent advisory committee model such as introduced for workplace pensions.

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

6. A minority of independent members on Boards may in practice make relatively little difference.

> ***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?***

7. Directors should certainly be able to serve on more than one Board. In our view potential conflicts can be managed, and there are benefits from the skills and experience gained from serving on multiple Boards.

> ***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?***

8. We do not believe that 12 months is long enough to meet the challenge of recruiting the required number of independent directors. It will be important to ensure the appointees have appropriate skills and capabilities to be effective in a challenging role. This is a very major change to governance arrangements, and the FCA should allow a generous period for these changes to be implemented to minimise the risk of poor quality candidates being appointed to roles.

> ***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?***

9. We think it is reasonable to allow firms to decide whether to appoint an independent or executive chair. However, it would be appropriate to review this at a future date.

Chapter 4 - Moving fund investors to better value share classes

> ***Q11: Do you agree with the proposed modification of FG14/4? If not, what alternative(s) would you propose?***

10. We support the proposals as a balanced approach to dealing with a complex issue. It will be important to ensure that investors are appropriately informed about the level of ongoing charges, alternative share classes that might be available to them, and what renewal commission is paid and to whom.

We note that this is an area where unit-linked customers are currently potentially benefiting, as insurers can negotiate access to better value share classes or higher rebates on their customers' behalf without them having to make changes to their investments themselves.

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?

11. Many firms will give high importance to respecting contractual arrangements, particularly as financial advisers could lose out substantially if their contractually agreed remuneration were removed. In addition, some firms may fear that switching off trail commission when others do not could make them relatively uncompetitive.

Chapter 5 - Ensuring fairer treatment of dealing profits

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?

12. We believe that the FCA's stance on the treatment of dealing profits is reasonable.

Chapter 6 - For discussion: extending the scope of our proposals to other retail investment products

13. The FCA notes that authorised funds could become less competitive if they alone have to implement the proposals for value for money and independent directors, and that investors could be drawn towards lower-cost unit-linked and with-profits funds with weaker governance. The FCA would therefore like to implement a similar approach for such funds.

We would contest the view that unit-linked and with-profits funds have weaker governance. Value for money assessments are a core part of the responsibilities of both insurers' IGCs and Trustees of workplace pension schemes (many of which will cover both unit-linked and with-profits assets). This has led to many insurers developing frameworks and processes to support these bodies in making their (independent) assessment.

While the focus of FG16/8 was primarily on long-standing/closed-book customers, the requirement to consider value for money as part of the wider assessment of a product's performance will not typically be restricted to closed-book customers in practice.

It should also be noted that a value for money assessment for a unit-linked or with-profits product will be different to that for an authorised fund as a result of the charges for unit-linked and with-profits covering more than just the investment management of the underlying assets.

We believe it is sensible to consider with-profits governance holistically rather than adding new requirements on a piecemeal basis. In our view it would be better to consider whether any additional measures are required as part of the FCA's Thematic Review of the Fair treatment of With Profits Customers planned for later this year, rather than extending a requirement designed for business with different characteristics.

Q18: Are current arrangements, particularly for with-profits business, fit for purpose and can they achieve the same outcomes? If no, please elaborate on how they achieve these outcomes.

14. We believe that the arrangements for with-profits and workplace pensions are fit for purpose and are able to achieve FCA objectives. If it is deemed necessary, similar arrangements could be extended to other types of life and pensions arrangements. In our view it would be very unhelpful to introduce a different type of governance solution – indeed in the asset management sector full consideration should be given to independent arrangements like IGCs.

We note that the corporate structure for life companies is different from that of AFMs. Life Company Boards are ultimately responsible for the life and pension funds and in this respect are equivalent to AFM Boards. However, Life Company Boards generally have independent non-executive members who are in the majority.

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?

15. We would support either the continuation of current arrangements or, if change is deemed necessary, an extension of the With Profits Committee concept. We suggest that it should be left to firms to decide on the best means of introducing independent challenge, rather than mandating a single solution.

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

16. Costs might include setting up additional governance bodies, recruiting independent members, MI and reporting requirements, duplication, and managing conflicts.

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?

17. The most likely goals of additional governance requirements would be increased consumer confidence and, potentially, lower costs. However, we are aware that progress is already being made to improve confidence, and also that there would be a risk of increasing rather than lowering costs.

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?

18. We believe that the risk of additional harm here is very low. The markets are distinct and the likelihood of firms seeking regulatory arbitrage on these grounds is minimal. Other factors such as tax are much more likely to dominate decisions.

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

19. Yes – but this should be extended such that the FCA looks at arrangements for unit-linked, with-profits and pension funds holistically. Any final view should be informed by the current work on with-profits and the non-workplace pensions market - noting that non-workplace pension products may already be covered by the processes that firms have put in place as a result of FG 16/8 or in support of their ongoing product management.

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?

20. It would seem disproportionate to introduce additional arrangements for investment companies given the existing governance arrangements and the alignment of the interests of the investment company Board with the shareholders.

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?

21. In our view it is very unlikely that this would cause investor harm or disruption to the market. The differences between these products are significant, and much more important than any potential changes to governance arrangements.

22. There may be an indirect benefit to unit-linked customers as a result of authorised funds improving their governance arrangements if accessed as an external fund link.

Should you want to discuss any of the points raised please contact (Matthew Levine at Matthew.Levine@actuaries.org.uk) in the first instance.

Yours sincerely

Marjorie Ngwenya
President, Institute and Faculty of Actuaries