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UK Financial Conduct Authority Makes First Market Investigation Reference

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Financial Markets; Antitrust/Competition

On September 14, 2017, the Financial Conduct Authority (FCA) confirmed that it was making a Market Investigation Reference (MIR) to the Competition and Markets Authority (CMA) in relation to services for investment consultancy and fiduciary management. This is the first time the FCA, which has significant numbers of competition lawyers within its ranks, has exercised its power to make a reference to the CMA.

The MIR is part of a proposed package of remedies, and represents the culmination of a two-year FCA study into the UK asset management industry, which concluded that the market was affected by a weak demand side, concentration among providers, high barriers to entry, and vertically integrated business models.

The scope of the MIR covers the supply and acquisition of investment consultancy services and fiduciary management services to and by institutional investors and employers in the UK.

Background

The UK's asset management industry manages around £6.9 trillion of assets. Of this, £3 trillion is managed for UK pension funds and other institutional investors.

In November 2015, the FCA launched its market study into the UK asset management industry. An interim report was published in November 2016, in which the FCA concluded that there was weak price competition in the asset management industry. The report also concluded that actively managed funds did not outperform benchmarks after costs and that some actively managed funds offered similar market exposure to passive funds, but with significantly higher costs.

The report found that the investment consultancy market was relatively concentrated with the top three firms accounting for roughly 60 percent of the market, and the advice of the 12 largest advisers potentially affecting £1.6 trillion of assets.

The market was also found to be characterised by low levels of switching between providers. Institutional investors surveyed revealed that 91 percent of them had not switched consultant in the preceding five years.

The FCA also raised concerns over the expansion of investment consultants into fiduciary management, and the potential for resulting conflicts of interest.

As a result of the findings in its interim report, the FCA proposed remedies, including increased transparency surrounding costs and charges, as well as announcing a provisional decision to make a MIR.

In response to the interim report, the three largest investment consultant firms offered a series of Undertakings in Lieu (UIL) of a MIR with a view to addressing the FCA's concerns.

However, in its June 2017 final report, the FCA proposed to reject the UILs offered, on the basis that they would not provide a full solution for the structural problems it considered were constraining competition in the market.

In its final reasoning for making a MIR, the FCA concluded that it had reasonable grounds for suspecting that a feature, or combination of features, of the market prevents, restricts, or distorts competition. The decision to make a MIR is therefore based on considered and continuing concerns of the FCA. The FCA noted in particular that the large scale of the problem, the wide powers of the CMA to effect structural remedies, the insufficiency of the UILs offered, and the absence of FCA supervision of significant elements of the market meant that a referral to the CMA was necessary. This latter point (the absence of FCA supervision of significant elements of the market) explains why the FCA decided it was necessary to make an MIR rather than take action itself.

Potential industry impact

The FCA identified some potential remedies that the CMA could impose, including:

- Requiring consultants to provide more standardised performance information to their clients and produce a template for reporting this information.
- Requiring consultants to make their performance and fee information publicly available to enable investors to compare across the market.
- Making recommendations to trustees and employers on best practices when managing investments or schemes.
- Improving redress mechanisms when consultants underperform or when investors receive unsatisfactory advice.
- Requiring trustees to periodically review and re-tender contracts with their investment consultants.
- Prohibiting certain fee structures that risk misaligning incentives for consultants when advising clients.

Whilst the final outcome of the CMA investigation is uncertain, investment consultants and fiduciary management firms should expect (amongst other changes) increased competition over pricing as pressure grows for increased transparency surrounding costs and charges.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Antitrust/Competition practice:

Louise Freeman	+44 20 7067 2129	lfreeman@cov.com
Charlotte Hill	+44 20 7067 2190	chill@cov.com
Gregory Lascelles	+44 20 7067 2142	glascelles@cov.com
Elaine Whiteford	+44 20 7067 2390	ewhiteford@cov.com

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