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UK Asset Management Under New Regulatory Pressure

The Financial Conduct Authority (FCA) in the UK published a report in early July on the state of competition in the asset management industry, and, as RANE expert David Lawton of Alvarez & Marsal's Financial Industry Advisory Services practice puts it, the conclusions "do not make for happy reading." Lawton highlights key takeaways from the market study:

- Even though price competition is weak, especially for retail active asset management, profitability is high.
- Neither actively-managed nor passively-managed funds outperform their own benchmarks after fees, on average. In fact, investors who pay more end up with worse performance on average.
- Investors struggle to identify which funds are going to do well because past performance is not a good guide for future performance.
- Investors have a mixed awareness of fees they are paying and there are some retail investors who are not even aware they are paying fees.

Given the FCA's grim assessment, Lawton comments that its remedies, which focus primarily on strengthening governance, may seem tame. Nevertheless, given the FCA's overriding concern that end-investors are not getting value for money, **Lawton** believes that asset managers need to "up their game" – which will be as much about mindset as having the right processes in place. Under new FCA rules for authorized fund managers:

- Managers will now have to assess and document, at least once a year, whether value for money has been provided to investors.
- Authorized fund management boards will need to include a minimum of two independent directors.
- The board chair will have to ensure the firm complies with the obligation to act in the best interest of investors.
- **Lawton** expects the FCA to soon focus on standardizing the approach to disclosure of fees.

Lawton notes that the FCA's recommendations are likely to reinforce the restructuring trend in the UK asset management industry. Sustained, low nominal interest rates and other regulatory changes are already forcing the sector to consolidate in order to drive down unit costs through economies of scale or to seek to identify niche offerings to justify premium fees.

- Aberdeen Asset Management Plc and Standard Life Plc are progressing toward a merger to create the UK's biggest active fund manager, according to Bloomberg.
- A State Street survey from June 2017 found that 76 percent of asset managers view M&A as an "essential strategy" to compete with ETFs and other index strategies.

Lawton says that the FCA has designed its package of remedies taking full account of changes from the Markets in Financial Instruments Directive (MiFID) II. He expects implementation of the FCA's recommendations to kick-in starting next spring. But he notes that it will be important to align the timing of rule changes to fit with the MiFID II timetable in order to avoid unnecessary disruption for firms.

- *The Financial Times* reported on 28 June that private equity funds and hedge funds could be next on the FCA's list for in-depth scrutiny.
- **Lawton** explains that the FCA's attention will focus next on investment consultants and platforms. The FCA recently published the terms of reference for a market study on investment platforms with a focus on whether these services help investors make good investment decisions.

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