20th February 2017

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

Dear Ms Young,

I am writing to you in my capacity as Chief Executive of the UK Sustainable Investment and Finance Association ("UKSIF") to respond to the FCA Asset Management Market Study ("AMMS").

About UKSIF

UKSIF is the membership network for sustainable and responsible financial services in the UK. Our mission is to promote and support sustainable and responsible investment ("SRI") and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF has around 240 members and affiliates including financial advisers, institutional and retail fund managers, pension funds, banks, research providers, consultants and NGOs.[1]

We responded to the previous consultation on the terms of reference for this study, and appreciate the opportunity to have been able to speak to colleagues within your team on our views directly.

Why is UKSIF responding?

UKSIF views the UK asset management sector as core to the delivery of its mission. The asset management sector plays several distinct roles:

- It develops products that help owners[2] of all types meet their growing obligations/ambitions with respect to SRI
- It funds/carries out research on issues which are central not only to SRI but to wider society such as the financial impacts of climate change and resource utilisation
- Distribution and promotion of such products and linked research plays a key part in educating owners and society

[1] For more information about UKSIF, please visit www.uksif.org.
[2] Except where the context demands we use "owners" to cover both institutional and retail asset owners

Delivery in these roles is on an even larger scale when the contributions of what the AMMS terms "ancillary" services such as investment consultants and ratings/data providers are included.

The asset management sector is of the first importance in driving SRI in UK financial services and in turn helping the UK meet its varying obligations under domestic and intentional law. To cite the example of climate change, it will to a significant degree be investments funded by savers and intermediated by asset managers which finance the commitments the UK has made under the Climate Change Act and the Paris Agreement.

These investments will be made to mitigate financial risk and to make returns for the benefit of savers. These two elements reflect the first and third of your operational objectives. The risk/return considerations will mean better products and performance and thus contribute towards an "appropriate" degree of protection for savers, and the increased robustness in the investment approaches of regulated firms will "enhance the integrity of the UK financial system". The potential risks to one portion of the financial system, insurance, were highlighted in the speech by the Governor of the Bank of England on the insurance sector in September 2015.[3]

For these reasons UKSIF urges the FCA to make only careful and proportionate interventions in the asset management sector which, as the next section outlines, faces some significant issues.

<u>A rapidly evolving market, at risk from inappropriate intervention</u>

The UK market for SRI is evolving rapidly driven by inter-connected regulatory, intellectual and societal/end-saver pressures. We will not seek to explain the interplay of cause and effect but note the following as key examples:

- The Law Commission clarified that trustees "should" consider financially material factors, a view now echoed in advice from the pensions regulator ("TPR"). This will increasingly drive change in products and services demanded by institutional investors.
- The impending IORPs II directive requires much greater disclosure on pension fund provider approaches to SRI and this will probably place a greater reporting burden on fund managers.
- Net sales of funds defined as "ethical" by the Investment Association were £807m in 2016 compared with total net retail sales in all classes of less than £5bn. This strength follows several years of growth and should mean retail product ranges will evolve.
- UKSIF opinion polling showed that 63% of the public would welcome a "label" for sustainable financial products. We interpret this as meaning there is a growing pressure for changes in product ranges[4]

Of these developments those stemming from the work of the Law Commission are significant in two ways. First the need to consider financial materiality will boost consideration of new issues linked to environmental, social and governance issues ("ESG"); second, despite originating in work focused on DB pensions, the Law Commission "thinking" (as a simple term) has spread. It has been applied by the Government to the new Local Government Pension Scheme investment pools even though they

[3] http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech844.pdf
[4] http://goodmoneyweek.com/media/press-releases/new-good-money-weekyougov-poll-results-announced

are not subject to "conventional" fiduciary duty, and the thinking is referenced in a recent QC's opinion on the responsibilities of charity trustees[5]- again not the immediate area of Law Commission attention. We think the Law Commission thinking is becoming the norm. This will have implications for other FCA areas beyond this study; we cover this briefly in the last section of this letter.

The sharply increased importance of SRI will re-define what adequate looks like in asset management. Many of the current approaches are likely to be seen as insufficient to meet the growing demands placed on asset managers. Among other issues asset managers will need to:

- Broaden their expertise to cover areas such as the environment, human rights and other social issues
- Become expert in corporate governance and voting[6]
- Recruit specialists in these areas and buy or originate the data to serve them
- Employ staff and use services to manage against a much-wider range of benchmarks- simple capitalisation weighted benchmarks may well decline in popularity
- Widen their geographic coverage
- Broaden their suite of report topics and techniques

We believe that these already evident developments in asset management mean that the service required will evolve and will become more expensive to provide. This change will occur at the same time as changes affecting the provision and use of research services stemming from MIFID II come into effect.

In the light of the changes already occurring we would urge caution in how the FCA interprets past data on fees and margins. We suspect the terms of trade are already turning against the asset management industry, and perhaps especially active managers. Whilst we would argue that the asset management market is moving too slowly for UKSIF's purposes it *is* moving and this movement might be disrupted by some of the interventions you suggest in your paper.

Anecdotal evidence from UKSIF members at all points in the value chain is that competition is intense with fee levels under pressure. We are not in a position to challenge the data in your report in detail but they do not mirror what we are told.

As we say, we think the market is moving and will move further in terms of products and services. We wish this movement was more rapid. We do feel the process of adoption of new approaches which reflect the findings of the Law Commission for instance is too slow. But we do not feel a lack of competition between fund managers is to blame for this. Rather there is a culture of caution in DB pension management and trustees face what they may see as more immediate issues such as funding.

One way the FCA could stimulate competition would be by stressing the evolving responsibilities of fiduciaries in line with the Law Commission's views. This would stimulate mandate and service reviews by owners, and innovation by asset managers.

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[5] http://www.bwbllp.com/file/summary-and-opinion-pdf

[6] Guidance from TPR suggests that owners ask asset managers to say when they voted contrary to advice from any proxy voting agency used. We believe this reflects a view that some managers are not actively considering their voting. They clearly should.

The FCA could say that rapid movement to an asset management market where products and services reflected the Law Commission thinking would be viewed as evidence- only partial of course- of an efficiently working market. The intervention could include a reference to the possibility of introducing legislation along the lines of paragraph 10.14.

Our comments on your proposed remedies

We do not comment on the precise detail of many of the proposed remedies. Instead we give our thoughts at a higher level.

A strengthened duty on asset managers to act in the best interests of investors

Whilst we would welcome the action outlined in 10.14 if the hypothetical legislation imposed the Law Commission view of the law, we accept that at this stage it may not be proportionate and that the sector should first be given a chance to reform organically. However, you should make clear that the “best interests” of customers must include appropriate consideration of all financially material factors and you could give examples such as climate change and workers’ rights.

We think that text in MIFID II and UCITS IV develops the duties placed on asset managers in substantially the way you envisage. We think that guidance on how these duties are met in respect of the substance of paragraph 10.10 might be a proportionate way of addressing this issue. However, we are cautious on the approach to fees in some of the bullets in 10.10. As outlined above we anticipate considerable new cost pressures and our members report intense fee competition.

In terms of governance we would suggest option A at the top of page 185, strengthening the existing structures. Purely subjectively we have heard and seen examples of very weak authorised fund managers. If you have similar concerns using option B might be appropriate as well.

Introducing an all-in fee

We believe fee options B and to a lesser degree C meet the objectives of increasing information at a realistic cost.

The practical experience of UKSIF staff in active fund management makes us oppose option D. If that was adopted it is almost certain that at some point the conflict between portfolio management needs and commercial drivers would lead to conflict and give rise to a wide range of negative outcomes.

We think the plan adopted should apply to all clients.

Measures to help retail investors identify which fund is right for them

We are generally supportive of increased transparency and clarity in setting fund objectives and in reporting against them as outlined in the first three bullets of 10.23. We welcome the thinking in 10.24.

We think that measures which move the industry's focus from the short-term to the longer-term are to be encouraged and we think this would be the outcome of the thinking in 10.26. We think it may be difficult to set uniform timeframes for performance assessment across varying fund types but would support you investigating the issue further. Institutional mandates usually have a set period for performance assessment so it can be done, but it will require thought.

The risk in 10.27 seems unlikely to materialise and should not prevent the use of more explicit objectives.

Proper drafting of the rules on these matters should drive matters towards a positon where the second and third bullets of 10.28 are outcomes.

The most important element of this area is not discussed in the text but is implicit in the last bullet on the box on page 190. As we have made clear above we feel the number and scale of ESG risks in investable assets is only now being appreciated. Under the influence of the Law Commission approach these issues will become central to how institutional investors manage their assets; consideration should be given to how those risks are presented to retail investors. This is a complex and evolving area and we will not attempt to outline the varying opinions here.

Paragraphs 10.29 to 10.44

These paragraphs discuss matters on which we have little insight. Addressing the issue at a very high level we note the concern you have that retail customers may not know what they are paying and/or may not move from poor funds. This is a valid concern, but there is another perhaps more important one: people are not saving enough. We hold no brief for asset managers that overcharge or underperform and we would like to see greater transparency, but if that transparency comes with greater complexity and discourages saving it will be a retrograde step.

We recognise that you are looking into this complex area and considering new communication approaches. That is extremely important work and we encourage you in it.

Requiring increased transparency and standardisation of costs and charges information for institutional investors

We think institutional investors would benefit from increased disclosure on fees and charges and that there is benefit in them sharing that information as in 10.49. We welcome the possibility that the standardisation required might be the result of co-operation as envisaged in 10.47.

Paragraph 10.50 refers to a possible risk stemming from increased transparency. We think it is unlikely to materialise- price comparison will no doubt be a growth industry and downward pressure is likely. But in any case what matters is net investment return over an appropriate period. If funds (of all types) are managed with appropriate monitoring of ESG risks and opportunities driven by the "best interests" change, if they have better defined objectives as in 10.26, and if they state a period over which performance is monitored (ditto), asset management outcomes should tend to improve. In that context the significance of fees in decision making may reduce.

Measures to improve the usefulness and comparability of performance information used by trustees

We have heard anecdotal evidence that this problem exists. Confusion over this issue may be part of why competitive forces are muted.

We support the thinking of 10.53, but it may be that there are issues of liability and compliance involved here. In that case you are probably the entity which needs to cut through those and make clear that the use of plain English to complement complex data should be essential. You could perhaps consider mandating phrases which may be used in various circumstances. Some imagination may be necessary.

With respect to IGCs we think their remit should be expanded to explicitly require them to consider fund performance over the long-term, as well as how ESG and stewardship are taken into account by the provider.

Exploring the benefits of greater pooling of pension scheme assets

This is a complex subject and we cannot comment.

Requiring greater and clearer disclosure of fiduciary management fees and performance

Chapter 8 of the report appears to show significant problems. We are not expert in the area but just as trustees must be given adequate information in more traditional management structures it is essential they get it in fiduciary management.

Further FCA work on distribution in the retail market

Paragraph 10.67 refers to issues identified beyond the study's immediate scope. One important instance of that is the question of how the Law Commission's view that fiduciary duty requires consideration of all financially material factors is to be reflected in regulation for retail clients and in DC pensions. We have pointed out that institutional regulation and guidance, especially from TPR, is already doing this. The FCA should begin that process in the retail and DC areas.

Our view is that the Law Commission work shows that financial advisers already have a fiduciary duty to consider all financially material factors and that this needs to be made clear to them by the regulator.

In DC pensions we think Independent Governance Committees are well-placed to assume responsibility for this area and we will be discussing that when the anticipated consultation on the role of IGCs takes place.

If we are to avoid a two tier system of the management of assets, with a better system applying to institutions and a less good to retail, this work is pressing. It is clearly linked to consideration of competition in the asset management market.

We trust the above information is clear, but if you require clarification on any of the points raised please do not hesitate to contact us. Equally, we would be delighted to meet you to discuss our thoughts in more detail.

Yours sincerely,

Simon Howard

Chief Executive UK Sustainable Investment and Finance Association (UKSIF)