

Key Takeaways from the UK Financial Conduct Authority's Review into the Asset Management Market

IN SHORT

The Situation: On 28 June 2017, the UK Financial Conduct Authority published the final findings of its review into the UK mainstream asset management market and announced a package of reform proposals to address the concerns identified.

The Result: The FCA's final report highlights investor protection, competitive pressure and regulating intermediaries as areas of concern. The proposed new rules and guidance to address these concerns are subject to a relatively rapid consultation timetable.

Looking Ahead: Despite the stated focus of the report, it is expected that the FCA's findings and proposals will, to some extent, inform practice across the market, including for private equity and other alternative fund managers, who need to pay close attention to the future consultations.

On 28 June 2017, the UK Financial Conduct Authority ("FCA") published its final report in relation to its review of the UK asset management market. The report sets out a package of reform proposals designed to address certain concerns identified in the report.

Background

The UK's asset management industry is the second largest in the world, managing approximately £6.9 trillion of assets. The FCA launched its market study in November 2015 to investigate how well the market works generally and whether the investment products consumers invest in offer value for money. The review was intended to focus on mainstream asset managers (i.e., not alternative asset managers), pooled investment funds, insurance-based investment products and segregated mandates.

Findings and Reform Proposals

The FCA's final report identifies three key areas of concern: (i) a lack of investor protection, (ii) a lack of competitive pressure and (iii) regulation of intermediaries.

Investor Protection. The FCA proposes to strengthen the duty on asset managers to act in the best interests of investors and to use the Senior Managers regime to bring individual focus and accountability. The proposals (which are subject to further consultation) include a requirement that asset managers appoint at least two independent directors to their boards, changes to make it simpler for managers to switch investors into cheaper share classes where applicable, a requirement for better disclosure of box management practices and a return of risk-free box profits to investors. The FCA will also chair a working group to focus on how to make fund objectives more useful, and it will consult on how benchmarks are used and performance reported.



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Competitive Pressure. The FCA identified a lack of pricing competition among asset managers. To increase competitive pressure, the FCA proposes to introduce a requirement that managers disclose a single, all-in fee (including asset management fees and an estimate of transaction costs and any intermediary fees) to investors. In addition, the FCA supports calls for consistent and standardised disclosure of costs and charges to institutional investors and recommends that both industry and investor representatives agree on a standardised template of costs and charges. The FCA proposes to ask an independent person to convene a stakeholder group to develop these proposals further, for both mainstream and alternative asset classes.

Regulating Intermediaries. The FCA will seek views from interested parties on whether to ask the UK competition authority to investigate investment consultancy services. Subject to such a referral, the regulator recommends that the UK Treasury consider bringing investment consultants into the regulatory perimeter.

Private Equity and Alternative Funds

Whilst alternative asset managers were excluded from the focus of the FCA's review, there will be a question over whether the FCA's revised approach might be brought to bear on managers of private equity, hedge and other alternative asset funds in the future. Given that the FCA is a principles-based regulator, it is likely that the current proposals reflect the FCA's perception of best practice toward investors in any asset class.

Indeed, the FCA's director of competition is reported as having stated that: "The focus of the study has been on the mainstream asset management community. Broadly, do we think some of the same principles apply to hedge funds? Yes". The FCA has specifically indicated that it will include private equity and hedge fund managers in its transparency drive despite them not being a focus of the study. Although it is also reported that the FCA has no immediate plans to look at these firms, we would not rule out future action or impact.

Additionally, investors may seek to apply any changes in approach or policy that they adopt as a consequence of the FCA's findings and recommendations in relation to their mainstream investments to their alternative investments, particularly in respect of transparency issues, which could bring pressure on alternative asset managers to conform with any changes in practice.

Next Steps

Any new rules and guidance will be subject to a cost-benefit analysis and formal consultation. The FCA has published a consultation paper setting out its proposals in relation to fund governance, risk-free box profits and share-class switching. The closing date for responses is 28 September 2017.

The FCA expects to publish further consultation papers on most of the remaining reform proposals before December 2017.

Given the relative speed at which the FCA is acting, we will continue to monitor the proposals closely and continue to provide updates on the rapidly evolving regulatory landscape.

THREE KEY TAKEAWAYS

1. The manner in which asset management firms are governed and communicate their objectives and charges to investors is likely to change in the near future.
2. The FCA's findings and proposals are likely to affect private equity and other alternative funds as a matter of expected best practice and future regulatory action.
3. All asset management firms should keep close track of the regulatory developments as the FCA looks set to move quickly.

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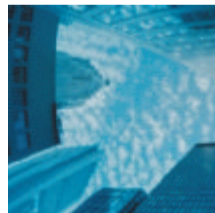
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