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THE FCA'S CALL FOR A MARKET INVESTIGATION : WHAT DO I NEED TO KNOW?

INTRODUCTION

As noted in our detailed review of the Financial Conduct Authority's (the FCA) final report on its Asset Management Market Study (the Final Report), the FCA is currently minded to press ahead with a market investigation reference (an MIR) to the Competition and Markets Authority (the CMA) in relation to the provision of investment consultancy services[1]. The FCA has announced a short consultation on its provisional view that it should reject the proposals from some in the industry which sought to head off the MIR.

This briefing note provides some background on the reasons why the FCA considers an MIR to be appropriate and explains the processes and procedures that apply to market investigations, as well as highlighting the likely implications for investment consultants, investors and fund managers.

WHAT IS A MARKET INVESTIGATION AND WHY MIGHT A MARKET BE REFERRED?

A market investigation is a tool which is used to undertake an in-depth investigation of a market which is perceived not to be working in the wider interest of consumers. Importantly, an MIR is not a sign that individual companies are suspected of breaching competition law. Instead it is used where a regulator such as the FCA considers that it has reasonable grounds to suspect that any feature (or combination of features) on that market (or markets) distorts and / or has an adverse effect on competition.

There have been a number of market investigations into the financial services sector in recent years, with the retail banking and PPI investigations amongst the most high profile of these reviews.

Market investigations are conducted by a CMA inquiry group who must decide whether there are features of a given market that have an adverse effect on competition (an AEC). If an AEC is identified they are also responsible for identifying remedies.

WHY IS AN MIR PROPOSED FOR THE INVESTMENT CONSULTANCY SERVICES MARKET?

The FCA considers that it has reasonable grounds to suspect that there are a number of features of the market for the provision of investment consultancy services that may distort competition. These include:

- a weak demand side where some categories of clients have limited experience and resources, leading to a higher level of dependency on investment consultants;
- relatively high levels of concentration and relatively stable market shares among investment consultants with relatively low levels of switching;
- high barriers to entry and expansion; and
- vertically-integrated business models (i.e. where certain firms offer both advisory and fiduciary management services), which could create conflicts of interest.

WHY DID SOME IN THE INDUSTRY PROPOSE UNDERTAKINGS IN LIEU OF A REFERENCE?

Undertakings in lieu (UILs) are commitments (either structural, behavioural, or both) which can be offered by a party (or parties) in the relevant market in order to address a regulator's concerns. If they are accepted, the commitments become binding and remove the need for an MIR.

Aon Hewitt, Mercer and Willis Towers Watson, who together represent approximately 56 per cent of the investment consultancy services market (according to the FCA), have proposed a series of UILs in order to address the FCA's concerns and avoid an MIR. A number of commitments were proposed, including measures to:

- encourage regular tendering of investment services contracts;
- increase transparency around fees, costs and performance to aid comparison, including through the use of a standardised Annual Disclosure Statement to clients receiving fiduciary management services;
- address conflict of interest concerns through the adoption of a gifts, hospitality and entertainment policy and commitments to no longer recommend (but simply introduce) the investment consultant's own Master Trust to a client;
- formalise, and review periodically, complaints and redress procedures; and
- adopt and abide by an Investment Consultants' Code of Conduct.

ARE THESE UILS GOING TO BE ACCEPTED BY THE FCA?

Although the FCA welcomes the proposed UILs, in its Final Report the FCA states that its provisional view is that it would not be appropriate to accept these UILs. The FCA considers that it cannot be confident that the proposed UILs would satisfy the relevant statutory test to "achieve as comprehensive a solution as is reasonable and practicable" to any adverse effects on competition that it has identified in investment consultancy services. This is because, amongst other factors:

[1] These are widely defined in paragraphs 5.2-5.4 of the draft terms of reference that the FCA published alongside its interim report in November 2016.

- the UIL package covers less than 60 per cent of the market, which in the FCA's view leaves the possibility of competition issues for a large segment of the market remaining unaddressed; and
- given the potential conflicts of interest relating to vertically-integrated business models, the FCA cannot yet be reasonably confident that structural remedies are not necessary.

The FCA has the power to accept UILs rather than make an MIR, but it is relatively rare for UILs to be accepted. This is because, when a regulator is considering an MIR, it is usually at a stage where it has not completed a sufficiently detailed investigation of the potential competition problem(s) in order to sensibly judge whether particular UILs will provide adequate solutions. Regulators will also often be concerned about successfully negotiating UILs affecting a large number of industry participants, making UILs less likely in such circumstances.

WHEN WILL WE KNOW IF AN MIR FOR THE INVESTMENT CONSULTANCY MARKET WILL BE MADE?

The FCA is publicly consulting on its proposal to reject the UILs, before making a final decision. As such, the FCA invites all interested parties to consider its provisional views and its proposal to reject the UILs. The closing date for responses is **26 July 2017.**

Following that consultation, the FCA will carefully consider all comments received. The FCA Board will then make the final decision on whether to make an MIR (or whether it is minded to accept the UILs). If the FCA's Board is minded to accept the UILs, it will launch a further consultation on that decision and interested parties will have another opportunity to comment at this stage. If UILs are not accepted, the FCA expects to publish a final decision on the provisional MIR in September 2017.

WHAT HAPPENS NEXT IF AN MIR IS MADE TO THE CMA?

The FCA will publish the terms of reference describing the features of the investment consultancy market which it suspects are giving rise to an AEC. The CMA will then establish an Inquiry Group to conduct the investigation and will typically begin by sending a number of detailed questionnaires to key industry participants.

HOW LONG WILL THE MARKET INVESTIGATION TAKE AND WHAT ARE THE KEY MILESTONES?

Market investigations should normally be completed within 18 months from the date that the MIR is made. In exceptional circumstances this deadline can be extended by 6 months.

The CMA will normally publish an Issues Statement in month 3 setting out the areas of concern, with Provisional Findings and possible remedies following in month 12 and a Provisional Decision on Remedies in month 16 before the Final Report is published in month 18.

WILL THE CMA ONLY TAKE EVIDENCE FROM INVESTMENT CONSULTANTS?

No. The CMA will send questionnaires to key market participants. This will not only include investment consultants themselves, but may also include their clients (e.g. pension trustees and other institutional investors) and suppliers (e.g. fund managers).

In addition to targeted questionnaires, the CMA will publish a number of other working papers and calls for evidence which will allow interested third parties to respond with their views. The CMA will also hold hearings with key stakeholders at various key stages of the process which will provide further opportunities for parties to make their views known.

The CMA has a number of statutory information gathering powers that it can rely on to assist with its evidence gathering. In particular, the CMA has the power to require:

- the attendance of parties to give evidence;
- the production of specified documents (or categories of documents); and / or
- any person carrying on a business to supply specified forecasts, estimates, returns or other information in a specified form and manner.

It is also worth noting that the CMA has now concluded its consultations on proposals to change the way that it conducts market investigations. Many of the proposed changes are intended to streamline the investigation process and amongst other things encourage earlier and more flexible engagement with stakeholders (e.g. by holding formal hearings sooner in the process).

WILL MY RESPONSES TO THE CMA BE MADE PUBLIC?

The CMA will typically publish responses to formal consultations on Issues Statements and Remedies Proposals, etc. on its website as well as summaries of any hearings. It is normal for respondents to be given an opportunity to highlight commercially sensitive aspects of such responses and for those points to be redacted before publication.

Responses to detailed questionnaires that contain commercially sensitive information or request copies of individual customer contracts or other sensitive documents and analysis will not typically be made publicly available. However, this information will form a basis for the CMA's findings and decisions are therefore likely to include high-level generic summaries of the evidence they received in the reports.

WHAT TYPES OF REMEDIES CAN THE CMA IMPOSE?

If the CMA finds that there is an AEC, it has wide-ranging powers to change the behaviour of firms and the wider market, but as individual companies are not being investigated for breaches of competition law (e.g. anti-competitive agreement(s) or abusing a dominant position), a market investigation cannot lead to the imposition of fines.

Nonetheless, potential market investigation remedies can have far-reaching consequences and may include:

- prohibiting or restricting certain market practices (such as "pay to play");
- measures to encourage or increase switching through competitive tendering;
- compulsory provision of information to aid comparison and increase transparency around fees / costs; and / or
- imposing structural remedies which can require companies to ring-fence parts of their business to avoid conflicts of interest and even sell parts of their business in order to foster and improve competition.

In deciding which remedies may be appropriate to resolve an AEC in a given market, the CMA will typically have regard to a broad range of factors (which would include considerations such as effectiveness, reasonableness, proportionality, and the likely consumer benefits and / or detriments).

WILL THE INDUSTRY REMAIN UNDER COMPETITION LAW SCRUTINY?

If the market investigation were to uncover any indications of wider anti-competitive behaviour (e.g. illegal information exchanges, price-fixing, market sharing, etc.), this could lead to a separate investigation into the conduct of the relevant parties under wider competition law principles. If such investigations were to lead to an infringement decision, it could ultimately result in significant fines, potentially up to 10 per cent of world-wide group turnover.

It is also relevant to note that in its Final Report, the FCA commented on a possible lack of awareness of competition law in some areas of the asset management sector (particularly in relation to how the law applies to commercial relationships and interactions). In this regard, the Final Report reminds firms of the importance of ensuring that their business activities are undertaken in compliance with competition law.

It is clear that the FCA will be keeping the sector under review and it is worth recalling that in April this year the FCA launched its first competition law dawn raid - a timely reminder to everyone that it is willing to use the full range of its concurrent competition law powers where appropriate.

OUR COMPETITION PRACTICE CAN PROVIDE FURTHER INFORMATION:

We advise on all aspects of UK and EU competition law and have extensive experience dealing with competition issues in the financial services sector. We have had frequent involvement assisting clients in the sector since the FCA acquired its concurrent competition enforcement powers, as well as wide-ranging experience of previous market studies and MIRs. If we can be of any assistance, please feel free to contact any of the team members on the details set out below, or your usual Macfarlanes contact.

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