

IMPACT OF THE FCA'S ASSET MANAGEMENT MARKET STUDY FOR MANAGERS OF PRIVATE EQUITY AND ALTERNATIVE FUNDS

The FCA published its Final Report setting out the findings of its Asset Management Market Study (AMMS) on 27 June 2017. The FCA has concluded that there are areas of weak price competition in a number of areas of the asset management industry and has proposed a range of remedies to seek to address these perceived weaknesses. These remedies will have far-reaching effects. While many of the remedies are only relevant to the managers of funds authorised for retail distribution, managers of private equity and alternative funds should be cognisant of those remedies which will have an impact on the way in which they operate, in particular the remedies relating to transparency of fees and charges.

We published a briefing note summarising the main proposals of the Final Report which is available [here](#).

The FCA's package of remedies cover the following three broad areas:

1. TO HELP PROVIDE PROTECTION FOR INVESTORS WHO ARE NOT WELL PLACED TO FIND BETTER VALUE FOR MONEY, THE FCA PROPOSES TO:

- ◆ strengthen the duty on fund managers to act in the best interests of investors, with a greater emphasis on considering value for money. The FCA will use the Senior Managers Regime to bring individual focus and accountability to this;
- ◆ require fund managers to appoint a minimum of two independent directors to their boards; and
- ◆ introduce technical changes to improve fairness around the management of share classes and the way in which fund managers profit from investors buying and selling their funds. Any box profits will have to be returned to funds.

2. TO DRIVE COMPETITIVE PRESSURE ON ASSET MANAGERS, THE FCA WILL:

- ◆ support the disclosure of a single, all-in-fee to investors to include an estimate of transaction charges;
- ◆ support the consistent and standardised disclosure of costs and charges to institutional investors;
- ◆ recommend that the Department for Work and Pensions remove barriers to pension scheme consolidation and pooling; and
- ◆ chair a working group to focus on how to make fund objectives more useful and consult on how benchmarks are used and performance is reported.

3. TO HELP IMPROVE THE EFFECTIVENESS OF INTERMEDIARIES, THE FCA WILL:

- ◆ launch a market study into investment platforms;
- ◆ seek views on rejecting the undertakings in lieu of a market investigation reference regarding the institutional advice market to the Competition and Markets Authority (CMA) offered by Aon Hewitt, Mercer and Willis Towers Watson. The FCA expects to make a final decision on whether to make a market investigation reference to the CMA in September 2017; and
- ◆ recommend that HM Treasury considers bringing investment consultants into the FCA's regulatory perimeter.

These proposals will be implemented in stages and are intended to complement other regulatory changes at domestic and European level, including MiFID II, PRIIPs and the extension of the Senior Managers & Certification Regime to most other investment firms.

IS THE AMMS RELEVANT TO MANAGERS OF ALTERNATIVE FUNDS?

The vast majority of the remedies summarised above will not apply to managers of private equity and alternative funds, including the requirement to appoint two independent directors to the boards of fund managers. Of relevance to the managers of private equity and institutional alternative funds are the proposals relating to standardised disclosure of costs and charges to institutional investors. The FCA is supportive of the changes to be brought in by MiFID II, with effect from 3 January 2018, which will require information on costs and charges to be provided to clients in good time before a client enters into a contract and provision of an account of actual costs on at least an annual basis.

The FCA considers that: *"the information required by MiFID II will give institutional investors a clear understanding of the costs and charges that they are incurring"* and that a well-designed template for this information will be likely to foster increased competition amongst asset managers. To this end, the FCA proposes to ask an independent person to convene a stakeholder group to develop a standardised template. Following this, the FCA will work with stakeholders to ensure that institutional investors get the information they need to make effective decisions. As part of that work, we understand that it may be possible that the FCA will seek to revisit the issue of disclosures to investors in alternative funds outside of the context of the AMMS. Therefore, in our view, fund managers and their advisers would be well advised to keep a watching brief for further developments from the regulator in the investor disclosure arena.

This support for the development of a standardised costs and charges disclosure appears to be contrary to the [FCA's proposals](#) made in CP16/29 relating to the implementation of MiFID II's conduct of business requirements. In CP16/29 the FCA indicated it did not consider it appropriate to develop a standardised format for disclosure of costs and charges to retail clients (although the FCA did acknowledge that it may revisit this in the future). We currently await the FCA's Policy Statement on CP16/29 (expected imminently) which may contain additional detail in relation to the thinking around the proposal for a standardised format of disclosure.

Which firms will the standardised costs and charges disclosures apply to?

The requirement to provide costs and charges disclosures will apply to entities which are authorised under MiFID II. The requirement will also apply to alternative investment fund managers (AIFMs) when they are carrying on MiFID business, i.e. where they manage segregated mandates or funds managed under delegation from other investment managers). In CP16/29 the FCA did not propose to apply the costs and charges disclosure requirements to AIFMs managing alternative investment funds and therefore, such firms do not need to comply with the MiFID II requirements on costs and charges disclosure or the standardised disclosure format once it has been developed.

INVESTMENT CONSULTANTS

The Final Report also covers the FCA's findings in relation to the role of investment consultants in the institutional investor market. In particular, the FCA is consulting the industry on the FCA's provisional view to reject undertakings in lieu of a reference offered by Aon Hewitt, Mercer and Willis Towers Watson and to proceed to make a market investigation reference to the CMA in relation to investment consultancy services. The FCA also recommends that HM Treasury considers whether to bring investment consultancy services within the regulatory perimeter.

During its work on the AMMS, the FCA looked at the role of investment consultants and found that:

- ◆ the consultancy market is relatively concentrated and switching rates appear low;
- ◆ on average, consultants are unable to identify managers that offer better returns;
- ◆ consultants do not drive significant price competition between asset managers; and
- ◆ no standardised framework for assessing the advice provided by consultants.

The package of undertakings that were offered included measures to encourage regular tendering of investment consultancy contracts and to increase and standardise the information provided to clients. The FCA however considers that it cannot be confident that the undertakings would satisfy the relevant legal test of "achieving as comprehensive a solution as is reasonable and practicable" for a number of reasons, including the fact that the undertakings would not cover the entire market and do not resolve concerns about conflicts of interest.

These measures relating to investment consultants will be highly relevant to those alternative fund managers who attract investment through the investment consultants. Managers who are impacted by investment consultants may wish to engage with the FCA (and potentially the CMA in the event of a market investigation reference) and HM Treasury in relation to these proposals.

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