APFI RESPONDS TO FCA MARKET STUDY FINAL RESPONSE

With effect: 28 June 2017.

What: This response is provided on behalf of the Association of Professional Fund Investors in response to the Financial Conduct Authority ('FCA') final response MS15/2.3 to the interim paper MS15/2.2, part of the Asset Management market study, with responses for CP17/18 due by 28 September 2017.

About: The FCA interim report MS15/2.2: On 1 November 2016 the FCA issued a 200-page interim report assessing the state of the £7trn (€8.18trn) strong asset management sector in the UK, the FCA highlighted that investors in active funds often pay higher charges than necessary due to a lack of price competition. In addition, it highlighted that fund objectives were not always clear, and performance was not always reported against an appropriate benchmark. The study focussed heavily on the experience of the defined contribution pension schemes and investment consultant market and charges and performance of active funds. On 28 June the FCA issued its response MS15/2.3 to that consultation and also outlined CP17/18 for further consultation. The APFI notes the FCA's observations set out are broadly consistent with the findings set out in the interim report. We therefore draw to the FCA's attention the APFI's previous responses:

The APFI's initial response - Press Release 23 November 2016 http://www.investmenteurope.net/regions/uk/apfi-responds-to-fca-interim-report/
The APFI's formal response dated 20 February 2017 - http://www.investmenteurope.net/regions/uk/apfi-spots-2-7trn-uk-managed-assets-jeopardy-fca-response/

The Association of Professional Fund Investors (APFI) again welcomes the FCA examining this area of great interest and providing further feedback, on behalf of fund buyers and customers. The APFI supports greater transparency relating to the costs of fund management, competition, outcomes and standards in fund investing and how they impact customer outcomes. The APFI specifically welcomes the FCA's proposal to bring investment consultants into the "regulatory perimeter" and its observations relating to fund governance, the focus on the Fund Gatekeeper and investment consultants albeit the APFI questions whether the report goes far enough in terms post-launch review and that this likely falls short of investment due diligence conducted by PFIs globally. The FCA also continues to focus more on governance structures rather than the competence of 'independents' and those involved within those structures.

We draw the FCA's attention to our earlier response to MS15/2.2 and look forward to inputting on CP17/18. As previously noted to the FCA, most funds that still exist today relate to a time when commission and marketing weighed heavily on some buyers' decisions. Meanwhile the APFI has championed the value of professional fund investing (PFI) and we believe that the variable quality of fund investing across markets has impacted the assessment of active versus passive funds. This is particularly so amongst the large aggregated studies (eg, SPIVA), which take no account of buyer segment, expertise or process. It is true that many active fund managers today underperform the market just as many outperform. As the global asset management market has grown, to $42 trillion globally according to latest estimates, it has effectively become the 'market', which is in stark contrast to pre Big Bang or ERISA in the US. The market continues to mature. Today many PFIs increasingly use index-based and specific Beta products to access targeted parts of the market. To this end the APFI must approach the issue even-handed wherever possible while reflecting the views of our members.

Our overall view of the FCA's response is therefore supportive but on FCA's conclusion have concerns that not enough professional fund investors (PFIs) submitted *sufficient* evidence to balance the conclusions from broad index studies (mostly by passive providers) in relation to active funds. The FCA's observation remains that on average, both actively managed and passively managed funds did not outperform their own benchmarks after fees. This finding applies for both retail and institutional investors. The FCA continues to note 'little evidence of persistence in outperformance' in academic literature, and where performance persistence has been identified, it is persistently poor performance. The APFI welcomes the recognition for good investment fund governance and benefits of harmonising market standards and fiduciary obligations covering; all investment consultants, gatekeepers and professional fund investors. We believe such standards should also extend to all fund rating agencies, insurance providers, distributors, workplace pensions and platforms. Therein;

A. The APFI continues to promote professionalism and accreditation in fund selection and the FCA is right to investigate the competency of those incumbent in senior decision-making roles, influencing roles and committees.
B. The APFI again reminds the FCA that profit margins are not evenly distributed across the industry and that asset concentration within the U.K. industry (and globally) continues to hurt competition at the detriment of smaller boutique firms. The FCA is encouraged to investigate this, assess different business models, consequences of the Annual Management Charge (AMC) model versus those employing more innovative performance-based fee structures such as a symmetrical AMC. In our opinion the FCA has not fully considered the efficacy of the AMC model, which is the dominant model used by active and passive asset managers.
C. The APFI believes that the legacy of commission, marketing and poor fund selection has ostensibly driven poor outcomes between charges and gross performance but is not necessarily representative of that relationship among funds held and selected by professional fund investors. However the APFI recognises that the onus is on APFI members and PFIs to provide that evidence.
D. The APFI asserts that activist groups and regulators continue to assess persistency of outperformance over relatively short time periods and/or fail to consider compounding and magnitude of XS gains over losses relative to benchmarks and the relative riskiness and invest-ability of the benchmarks.
E. The APFI asks the FCA to clarify its observation around net outcomes and distinguish those outcomes between high cost legacy funds versus higher cost funds currently marketed and bought. If we expect competition and skill as a necessary pre-determinant for 'alpha' in active management then we would expect more active funds to underperform, than outperform, over a prolonged period.
F. The APFI is supportive of further work around 'active' funds with very low tracking errors, being put under pressure to either; reduce fees, close or restructure. We note the risk of further asset concentration arising from consolidation of these funds.
G. The APFI notes its members are among the best examples in terms of negotiating fees with asset managers and welcomes engagement with the FCA on this matter. PFIs are often on the frontline in terms of bringing fund costs down.
H. The APFI notes that institutional investors often struggle to negotiate fees with asset managers due to a lack of expertise or understanding of capability or choices within a given sector. This may be due to an over-reliance on a) decision by committee and b) investment consultants.
I. The APFI notes the equal potential for good and bad market practices arising from a concentration within the investment consultant market. Fiduciary accountability, fairer competition for smaller consultancies and best market practises. We agree that potential conflicts of interest can arise among investment consultants that also launch fiduciary asset managers and pressure distributors to add those funds to their platforms.
J. The APFI supports better application of PFI approaches and fund governance among Direct to Consumer platforms.
K. The APFI supports improving competition, transparency and market standards in the U.K. asset management industry and in relation to professional fund investing.

L. The APFI supports the increased duties for asset managers, including value for money, which should be reflected through the value chain to include distributors, research agencies, gatekeepers and consultants. Easier share class switching should facilitate better MIFID2 integration.
M. The APFI supports greater cost transparency can help drive better outcomes. This needs to be done in context to bundled fee pricing, which can be counterproductive and costs not reflected in the NAV.
N. Independent governance structures require more than non executives and requires more immediate contact between Independent Governance Committees and fund selection and governance professionals.
O. The APFI supports fairer return of revenues and costs to fund investors, including Box profits and stock lending revenue, which is a large profit contributor for Passive fund providers.
P. The APFI asks the FCA to review asset managers retaining retrocession post end of the sunset clause, which on average may be worth 30bps to investors.
Q. The APFI notes that for PFIs, transparency and breakdowns of the all-in-fee will be necessary to facilitate meaningful cost negotiations absent of transparent clean price points and abolition of rebates.
R. The APFI supports the FCA in respect to standardised disclosure of costs, which should be distinguished between Retail and institutional investors whereby they are PFIs.
S. The APFI supports professionalism in fund investing and part of this includes investment consultants. The APFI recognises industry forces around consolidation but concentration of fund advocacy and investing may drive poor outcomes. The APFI supports the FCA's referral to the Competition Markets Authority (CMA).
T. The APFI fully endorses the FCA's proposal to the Treasury to bring investment consultants into the 'regulatory perimeter'. The APFI suggests the FCA should consider benchmarking the practices of fund ratings agencies, consultants, insurers, DFMs and multi-managers. That study might include the approach to performance data, due diligence, judgemental factors, value for money, ratings models and biases arising.
U. The APFI welcomes further focus on investment platforms in terms of fund governance, due diligence, investing and competition.
V. The APFI broadly welcomes the FCA's focus on 'Fund Gatekeepers', recognising their growing influence on manager selection (et 'guiding community').
W. The APFI agrees with the FCA's observations re fund flows and performance, this may point to poor selection practises and effect of sales and marketing.
X. The APFI urges the FCA to consider carefully any action that encourages investors to churn portfolios, thereby generating costs and crystallising losses following periods of underperformance.
Y. The APFI agrees that proliferation and expansion of the absolute return sector has resulted in deteriorating median outcome for investors. These funds are complex and beyond the capability of all bar PFIs.
Z. The APFI reiterates that competence in governance structures is fundamental to improving outcomes.

The APFI holds that identifying and selecting good managers, that are consistent and competent, is not easy. Here the value in professional fund selection, diversification and prudent switching should add value net of fees to the end investor. The APFI looks forward to engaging with the FCA further with regards to this consultation. To support we encourage APFI members and other professional fund buyers to demonstrate the value added from professional fund investing by sharing their experiences, to respond to the FCA CP17/18 consultation, share best practice, median costs and value added over benchmarks. We believe that forum should extend to all quarters of Professional Fund Investors (PFIs), not solely investment consultants. The APFI will engage members and respond to CP17/18 in due course. For and on behalf of the Association of Professional Fund Investors.

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www.profundinvestors.com

Association of professional fund investors

Useful links, we list the following links for FCA's consideration;

www.profundinvestors.com
http://investmentquorum.com/taking-p-sending-price-fund-selection/
http://www.investmenteurope.net/regions/uk/apfi-responds-to-fca-interim-report/
https://knect365.com/fundforum/article/85e4a7af-1782-4ea6-bc45-738409bb9a18/fiduciary-fly-trap-is-the-uk-caught-between-a-hard-brexit-and-a-soft-trump
https://www2.bc.edu/jonathan-reuter/research/active_201208.pdf
https://www.ft.com/content/d93100ca-acf4-11e6-9cb3-bb8207902122
https://www.ft.com/content/fddca86c-7ab7-11e6-ae24-f193b105145e
https://sharingalpha.com
http://www.sciencedirect.com/science/article/pii/S0304393209000609
https://www.dropbox.com/s/7kia2eg7jy56x53/Rating%20the%20Raters.pdf?dl=0
https://www.dropbox.com/s/62o251id0gxxtqc/Fintech%20Fund%20Ratings.pdf?dl=0
http://www.morningstar.co.uk/uk/news/150039/why-active-funds-have-recently-outperformed-passive.aspx
https://www.trustnet.com/News/644022/will-active-uk-funds-outperform-once-again-in-2016
http://www.iii.co.uk/articles/344221/20-active-funds-outperform
https://www.fundstrategy.co.uk/active-fund-really-passive-disguise/
https://www.trustnet.com/News/709620/the-three-flexible-unfettered-funds-outperforming-their-fettered-rivals/
http://www.morningstar.in/posts/39251/active-fund-management.aspx
http://www.marketwatch.com/story/heresy-these-7-actively-managed-funds-are-winners-2017-01-07
http://www.etf.com/publications/etfr/mutual-funds-can-be-better-etfs-times
http://www.morningstar.co.uk/uk/news/155606/emerging-markets-investing-the-case-for-passive-funds.aspx
http://www.cnbc.com/2017/01/19/peak-passive-money-is-gushing-out-of-actively-managed-funds.html
https://www.ftadviser.com/opinion/2017/01/25/justify-your-existence/
https://www.fundstrategy.co.uk/james-budden-heres-active-management-works/
http://finance.yahoo.com/news/active-management-isn-t-dead-165137758.html
http://seekingalpha.com/article/4037220-active-management-dead-sleeping

The APFI thanks the FCA for the opportunity to respond to this consultation. Queries can be addressed to: support@profundinvestors.com or JB.Beckett@profundinvestors.com.

apfi
Association of professional fund investors

About the APFI:

Founded in 2011, the Association of Professional Fund Investors was created by and for its membership. It enables professional fund investors to share ideas, ensure best practices and network with their peers.

Our Aim

APFI is dedicated to the advancement of the interests of professional fund investors and voicing the collective perspective of its members concerning key topics and trends within the global asset management industry.

Our Focus

At its core, APFI serves as a forum for its members to drive the development and the exchange of global best practices in the areas of research, analysis, due diligence and selection of asset management products. APFI seeks to build strong collegiate relationships among its members through a global networking framework. APFI advances the voice and perspective of the professional investor to industry dialogues on product development, regulatory and distribution topics concerning the global asset management industry.

APFI strives to enhance the competitiveness and overall quality of asset management products in the marketplace through its members continuously demanding exceptional quality from asset managers. Further, APFI seeks to ensure first class client servicing, reporting and transparency from asset managers.

APFI believes that the inclusion of the investors' viewpoint is crucial to the sustainable growth of the asset management industry. APFI acts to ensure the continued recognition of the importance of professional fund investors and advance their role within the asset management industry.

APFI is independent of commercial interests and is owned and controlled entirely by its members.

Our Philosophy

There are some simple truths that APFI members see as central. Certainly there are others and we invite new members to add ideas but here are the basics:

Funds are bought by professional fund investors, not sold to them.

Hot concepts are the basis for short-lived bubbles; APFI members seek to isolate funds and their managers that have sustainable investment merit.

A strong competitive environment for funds is crucial, of which open architecture is a key component.

A well thought out, sophisticated approach to fund research is forward looking and past performance is only a limited aspect of the selection process.

There is no 'right way' to analyse and select funds – APFI members utilise a broad range of techniques and methodologies.

Professional investors work most effectively in an environment of independence and objectivity.

Ends.