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Management Advisory Briefing Note

Transparency in Asset Management

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MONTIETH & COMPANY

BRIEFING NOTE

U.K. Makes a Move Towards Greater Transparency for Asset Managers

"Transparency" is a buzzword that crops up at almost every financial industry conference. But for all the promising talk, the U.K.'s Financial Conduct Authority (FCA) believes improvements in the asset management industry's governance and fee structures have yet to be realized. Since 2015, it has been consulting with almost 200 stakeholders from a variety of organizations through a series of roundtables and one-to-one meetings to assess "how asset managers compete to deliver value for both retail and institutional investors." Last November, the outcome of the interim report from its Asset Management Market Study concluded that there was weak price competition, causing asset managers' fees to be inflated.

On June 28, 2017, the FCA published its final findings from the Asset Management Market Study. Andrew Bailey, chief executive of the FCA, said: "We have put together a comprehensive package of reforms that will make competition work better and help both retail and institutional investors to make their money work well for them."

According to the *Financial Times*, the reforms "would make the UK one of the toughest regimes in the world for asset managers as London considers its post-Brexit future."

Crucially, the report includes support for transparent, single-fee structures, as well as independent directors on fund boards. It also announced plans for further studies on investment platforms. According to the *Financial Times*, the reforms "would make the UK one of the toughest regimes in the world for asset managers as London considers its post-Brexit future."

A collective sigh of relief - for now

For the most part, the industry sentiment was "it-could-have-been-worse." Daniel Godfrey, founder of The People's Trust, a customer-owned investment fund due to launch in September this year, stated: "Investment managers will be relieved today. The FCA has delivered a report which spares them the harshest potential remedies flagged in their interim report last November."

From its interim report published in November, many asset managers were concerned that the FCA would make a market investigation reference to the Competition and Markets Authority for an in-depth investigation into the institutional investment advice market. While such an investigation is not yet off the table, the decision has been postponed until September 2017.

The FCA has also taken steps to reduce the cost of regulatory burdens, easing concern among asset managers that complying with new regulation would eat into their returns, likely forcing an increase in fees. In a highly competitive, post-Brexit environment, higher fees would reduce the U.K.'s competitiveness in attracting foreign investments.

However, while asset managers' nerves are quelled for now, the FCA report also hints at further changes to come. Private equity firms, in particular, might fall under the microscope next. Although they were not included in the scope of its report, the FCA noted that they are "a particularly opaque part of the asset management sector," and expressed intentions to consider applying the reforms to that area of the fund management industry.

Passive funds put pressure on active management fees

Demand for lower fees is already being driven by the rise of passive investments, such as algorithmic hedge funds and ETFs. The FCA report recognizes this, stating: “We have concerns about how asset managers communicate their objectives to clients, in particular how useful they are for retail investors. We find that many active funds offer similar exposure to passive funds, but some charge significantly more for this. We estimate that there is around £109bn in ‘active’ funds that closely mirror the market which are significantly more expensive than passive funds.”

Regardless of regulatory change, many investors seek justification for the Return On Investment (ROI) they are getting from active investments, given the higher risks and fees compared to passive investment fund. According to The Boston Consulting Group, while global AUM of asset managers grew 7% to almost $70 trillion in 2016, fund fees dropped for the first time since the 2008 financial crisis.

“There’s now a better appreciation on the part of most investors that we’re in a lower return world. Fees take a disproportionately larger part of the gross return. Private investments have continued to go up in terms of commitments. Managing that is difficult,” said Lawrence Kochard, chief investment officer of University of Virginia Investment Management Company, an $8 billion dollar endowment, in an interview in February. As a result, asset managers face a squeeze on revenues as investors demand lower costs and greater transparency.

What does this mean for U.S. asset managers?

Across the pond, the Trump Administration seeks to repeal Dodd-Frank. It has already overturned regulation requiring disclosures for the payments energy companies make to foreign governments in February. Furthermore, on June 8, the Financial CHOICE Act was passed by Congress. It still has to go through the Senate, but if passed, it will loosen many of the Dodd-Frank reforms. In some quarters, a repeal of the Dodd-Frank regulations will be meet with applause. However, regardless of any regulatory change, asset managers still face increasing scrutiny by retail and institutional investors over fund fees in a low-yield environment.

Greater transparency

While the FCA report is a regulatory landmark in the U.K., the winds were already blowing in that direction. Low returns and competition from passive investment funds have fuelled questions among institutional and retail investors as to whether active management still offers value-for-money. As a result, asset managers are under greater pressure to be transparent in their fee structures and governance.

For many asset managers, the publication of the FCA report does little to change their outlook on transparency. “I have stated several times that I am in favor of all-in fees including all costs as the industry has an obligation to deliver what the customer wants,” said Martin Gilbert, chief executive of Aberdeen Asset Management. “Incorporating dealing charges for equity funds should be straightforward particularly for those managers, like ourselves, who have low portfolio turnover. It is more challenging to calculate all-in-fees for bond funds, but I'm encouraged the industry is already looking at ways of doing this. We need to embrace the concept and commit to finding a solution for the best interests of clients."

In this new world, asset managers have to prove their value in providing long-term investment strategy advice to investors. Greater transparency around fees is no bad thing, but if left unchecked, it can clog up the airwaves. We think asset managers must cut through the noise by using what we call "Expert Source Positioning." Through targeted media placements in key publications which emphasize the role asset managers have to play as long-term fiduciaries, investors understand the valuable insights asset managers can give in inching up their benchmarked returns. This measured, strategic approach is a powerful communication tool in counteracting investors' concerns over asset managers' true value. Ultimately, the transparent world is here to stay, and asset managers need to adapt to this new reality.

Zarna Patel, Media Director, Montieth & Company

Zarna Patel is a media director at Montieth & Company in its London office. Zarna has worked on media initiatives for numerous financial services firms and has developed relationships with key financial publications across all asset classes and sectors in the U.S., Canada, and U.K. She began her career as a financial technology reporter with a focus on asset management and banking.

For more information on our cross-border work with asset management firms, contact Zarna Patel at zpatel@montiethco.com.

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