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By email investmentplatformsmarketstudy@fca.org.uk

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Dear Ms Blatchford

FCA Investment Platforms Market Study

Which? welcomes the opportunity to comment on the FCA's proposed Investment Platforms Market Study, one of the proposed remedies of the FCA's Asset Management Market Study.

Which? notes the conclusions of the Asset Management Market Study with great concern, in particular, the FCA's findings that "asset management firms typically do not compete on price", and that "there is no clear relationship between charges and performance". These findings regrettably are not surprising, following many years' of studies reaching similar conclusions.

Which? therefore welcomes the FCA's proposed remedies, especially the need for consistent and standardised disclosure of costs and charges. It is nevertheless disappointing that the remedies do not go far enough to address the underlying failure of competition in this critical industry, namely the almost complete obfuscation of pricing and performance of asset management products and services. This failure has contributed to consumers having a very low understanding of vital pensions and savings products. As a result, most consumers end up paying far too much for these products, as an analysis of the FCA's data show, by around £20bn a year[1].

In particular, it is disappointing that the FCA's Final Report apparently resiles from the overwhelming evidence that passive funds are preferable to active funds [1.7], especially on price, and as default or core holdings for the vast majority of retail investors. Which? is particularly surprised at the FCA's finding that "active funds, on average, outperformed

[1] The FCA Asset Management Market Study Interim Report (MS15/2.2) states that the UK asset management industry manages over £1 trillion for UK retail investors and £3 trillion for UK pension funds and other institutional investors [1.2]. It reports that the average fee for actively managed funds is 0.90% and for passively managed funds is 0.15% [1.14], and that actively managed funds represent 74% and passively managed represent 23% of total assets [3.31]. Hence, if all investors in actively managed funds were to switch to passively managed funds, then they would save £22bn a year for the same or better risk-adjusted returns.

benchmarks before charges were deducted, but underperformed benchmarks after charges" [6.3], as this finding is at odds with established financial orthodoxy. For example, William F. Sharpe, pioneer of modern finance and Nobel Laureate:

> "If 'active' and 'passive' management styles are defined in sensible ways, it must be the case that:
> 1) before costs, the return on the average actively managed dollar will equal the return on the average passively managed dollar; and
> 2) after costs, the return on the average actively managed dollar will be less than the return on the average passively managed dollar.
>
> These assertions will hold for any time period. Moreover, they depend only on the laws of addition, subtraction, multiplication and division. Nothing else is required."[2]

Accordingly, this suggests that the FCA's finding that active funds outperform benchmarks before charges reflects a measurement error or comparison to the wrong benchmarks.

Investment platforms are an increasingly important part of the retail distribution landscape. Which? strongly agrees though that the FCA's Investment Platforms Market Study must also include the wider distribution landscape within scope of the study [3.1] – namely, including financial advisers, wealth managers, direct sales, and other distribution channels – and that this should enable the FCA to assess whether issues that apply to platform service providers also apply more broadly across other distribution.

As noted at [1.5-1.6] of the Terms of Reference, it will be necessary for the study to investigate:

- what impact platforms have on overall charges investors pay for their retail investment products;
- whether platforms use their bargaining power to negotiate good deals for investors;
- in turn, whether platforms compete on their own distribution costs; and
- whether commercial relationships between platforms, asset managers, and financial advisers have the potential to distort competition.

Accordingly, the Investment Platforms Market Study is an essential opportunity to address the major competition problems and associated consumer detriment identified in the Asset Management Market Study further, in particular, of:

- "little evidence that firms compete on the basis of price, particularly for active products" [6.2];
- "no clear link between price and performance" [6.2];
- "little evidence of persistent outperformance" [6.3];
- "some investors paying 'active' prices for products that are only partly active" [6.3];
- "asset managers appearing to be poor at controlling transaction costs" [7.2]; and

[2] Sharpe, William F., "The Arithmetic of Active Management", *The Financial Analysts' Journal* Vol. 47, No. 1, January/February 1991. pp. 7-9. Active management is not in itself necessarily worse than passive management: the problem is that consumers should not be paying any significant amount more for active management than passive management. The FCA Asset Management Market Study nevertheless shows that they are paying 500% more on average.

- “investment consultants not appearing to drive significant price competition between asset managers” [10.1].

Some of the Asset Management Market Study’s findings are specifically relevant to the Investment Platforms Market Study, for example:

- concerns about the impact of increasing vertical integration of distribution and fund management in some firms [5.1]; and
- that retail platforms can secure discounts on fund charges but this practice did not appear to be widespread [5.1].

The greatest concern with asset management is lack of effective competition. At worst, asset management appears characterised by resale price maintenance (RPM), whereby product providers set the prices that distributors charge. This is also characteristic of some other financial services products. According to the CMA, RPM is illegal and subject to substantial fines[3].

Regrettably though, previous regulatory measures, such as the Retail Distribution Review (RDR), do not appear to have addressed or solved these problems. Moreover, the RDR may have compounded some of the problems. First, the RDR ban on commission payments from product providers to distributors effectively limits retail price competition on product prices. Second, the RDR has encouraged product providers and distributors to vertically integrate in order to circumvent the commission ban. This is a potential distortion of competition. These effects are likely unintended consequences of the RDR.

A related and significant concern is the FCA’s evidence that financial advisers do not give prominence to low cost passive funds[4]. This evidence further calls into question the role of distributors in facilitating price competition and of the suitability of financial advice. As a result, the RDR must be within the scope of the Investment Platforms Market Study.

A recent Which? investigation of wealth manager St James’s Place, one of the leading vertically integrated product providers/distributors, highlights many of the problems in the asset management industry[5]. Which?’s investigation revealed almost complete lack of transparency as to the charges and services offered by St James’s Place. This appears characteristic of the wider market.

Overall, Which? does not believe that the FCA’s proposed Market Study remedies will materially reduce the extremely large level of consumer detriment in asset management in the foreseeable future, and therefore that much more direct remedies are needed.

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[3] See for example recent CMA Open Letter: “Restricting resale prices: an open letter to suppliers and resellers”, June 2017.

[4] For example, Asset Management Market Study Interim Report [4.15].

[5] See “Exclusive: wealth manager St James’s Place misleading customers on charges”, *Which? Money magazine*, August 2017

Which? welcomes the opportunity to contribute to the Market Study and to meeting with the review team at the earliest opportunity.

Yours sincerely

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