

A Bird's Eye View Sparrows Newsletter

August 2017

The FCA Asset Management Market Study Final Report

Did the FCA take their eyes off the ball?

"We find that as with our preliminary analysis, consultants' highly rated products aggregated together did not outperform non-highly rated products"¹.

"We expect to make a final decision on whether to make a market investigation [recommendation in relation to the investment consulting industry] to the CMA in September 2017"².

"We are recommending that the Treasury considers bringing investment consultancy services into the regulatory perimeter. We do not currently regulate the asset allocation advice provided by investment consultants and employee benefit consultants. This means we are not able to set performance standards or assessment criteria for this advice."³

The investment consulting industry certainly bore the brunt of the FCA Final Report, which was published at the end of June 2017. Many of the key messages from the interim report were watered down in the final document; as a result the focus of attention has swung towards the consultants, who would have probably preferred to stay out of this probe altogether.

Did the FCA take their eyes off the ball? Did they not find sufficient evidence or reason to pursue the asset management industry directly, and so decide to take a stab at the consultancy space? Or perhaps, as some have suggested, this is a political battlefield where the FCA is attempting to expand its political power by casting its regulatory net over the consultants?

My own inclination is to give the FCA more credit than others, who evidently have been disappointed by the weak note on which the final report concluded. I believe that the FCA has taken a rational decision on the back of facts and evidence not generally known to the public.

Allow me to explain why I believe the FCA has done anything but miss its target:

On March 5th 2015 Judge Business School (University of Cambridge) announced the 2015 winner of the Commonfund research prize for original academic research relevant to endowment and foundation asset management. The prize was won by Tim Jenkinson (Oxford) and his colleagues for their paper *Picking Winners? Investment Consultants' Recommendations of Fund Managers*⁴.

The Jenkinson paper examines survey data from investment consultants with a combined share of 90 per cent of the US consulting market, and focuses on consultant recommendations over actively managed US equity funds. The research found no evidence that funds recommended by investment

consultants to institutional investors subsequently outperformed the market. Equally importantly, the research noted that despite their poor ability to identify and differentiate good fund managers from bad, investment consultants nevertheless exercise significant influence over asset movements.

The research concludes: *“We find that consultants’ recommendations of funds are driven largely by soft factors, rather than the funds’ past performance, and that their recommendations have a very significant effect on fund flows, but we find no evidence that these recommendations add value to plan sponsors”*.

In the U.K. three companies, namely Aon Hewitt, Mercer and Willis Towers Watson, collectively command at least 56% of consulting revenues. These three firms wield significant influence over their investor clients, and effectively determine how these institutions invest their capital. As a result, these consultants have sufficient influence to determine which asset managers will survive and which will perish.

With great power comes great responsibility, but alas, it appears the consultants are failing us all. Their recommendations have delivered, in the FCA’s words, poor value for money. No surprise, then, that the FCA recommends bringing this activity under regulatory control, and subjecting it to the same standards and scrutiny to which other market participants are subjected.

Not surprisingly, investment consultants already plan to fight the UK competition referral⁵. We hope that the FCA hold firm on their position, as we that HM Treasury agree with the recommendation that investment consultants should be regulated.

Yariv Haim
Founder and CEO



For more information on our philosophy, process or if you just want to challenge these observations, please get in touch.

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¹ Source: <https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf> (p. 62)

² Source: <https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf> (p. 14, clause 2.35)

³ Source: <https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf> (p. 14, clause 2.36)

⁴ Source: <http://www.umass.edu/preferen/You%20Must%20Read%20This/PickingWinners.pdf>

⁵ Source: <https://www.ft.com/content/236010a6-5d84-11e7-9bc8-8055f264aa8b>

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