ShareSoc
UK Individual Shareholders Society
Suite 34, 5 Liberty Square, Kings Hill,
West Malling, ME19 4AU
Phone: 0333-200-1595 Email: info@sharesoc.org
Web: www.sharesoc.org

UK Shareholders' Association
UKSA, 1 Bromley Lane, Chislehurst, BR7 6LH
Phone: 01689 856691
Email: officeatuksa@gmail.com
Web: www.uksa.org.uk

18 February 2019

Via email to SectorViews@fca.org.uk

Financial Conduct Authority,
12 Endeavour Square,
London E20 1JN

Re: FCA Sector Views

This is a joint response from UKSA and ShareSoc on behalf of individual investors.

UKSA and ShareSoc have 5,000 members who are representative of the 5 million people who own shares and have investment accounts with platforms in the UK. Individual investors who own 12% of the UK stock market. Individual investors own 30%, if you include their investments via funds, pensions, etc.

We have limited our comments to the Retail Investments Sector View (Chapter 6).

We agree with your comment in Chapter 6, on page 47:

- *The main concerns in this sector continue to be unsuitable products and services, high charges, and low quality products and services. These could have knock-on effects for confidence and participation.*

These points have been made before, not least in the 2016 FCA Asset Management Market Study Interim Report MS15/2.2, which noted inter alia:

- *The annual average disclosed fee for actively managed equity funds available to UK investors is 0.90% of the assets under management (AUM) and the average passive fee is 0.15%. Furthermore, transaction costs (charged when asset managers trade on investors' behalf) are normally higher for active funds (as illustrated in Figure 1.2). (p10 para 1.3)*
- *The evidence suggests there is weak price competition in a number of areas of the asset management industry. This has a material impact on the investment returns of investors through their payments for asset management services. (p11 para 1.16)*
- *Our analysis shows mainstream actively managed fund charges have stayed broadly the same for the last 10 years. Very few asset management firms told us they lower charges to attract investment, particularly for retail investors – most believe this would not win them new business. (p11, para 1.18)*
- *In contrast, we found that charges for passive funds have fallen over the last five years. This, combined with the growth of passive investing, suggests that price awareness and competitive pressure on price is building among certain groups of investors. (page 12, para 1.19)*
- *We have found considerable price clustering for active equity funds, with many funds priced at 1% and 0.75%, particularly once assets under management are greater than around £100m (see Figure 1.5). This is consistent with firms' reluctance to undercut each other by offering lower charges. We also note that as fund size increases, price does not fall,*

suggesting the economies of scale are captured by the fund manager rather than being passed onto investors in these funds. (Page 13, para 1.20)

- *Asset management firms have consistently earned substantial profits across our six year sample, with an average profit margin of 36%. These margins are even higher if the profit sharing element of staff remuneration is included. (page 14, para 1.21)*
- *Many active funds offer similar exposure to passive funds, but some charge significantly more. Figure 1.8 shows the charges (the Ongoing Charges Figure) for active equity funds compared against the 'tracking error'. The tracking error shows the variation of the difference in the returns of the fund against the underlying benchmark. A low tracking error generally indicates that the fund is closely replicating the benchmark, although it may be seeking a small outperformance against this or trying to limit underperformance. There is around £109bn in expensive funds that closely mirror the performance of the market (they have a tracking error below 1.5) and are considerably more expensive than passive funds. (Page 15, para 1.27)*
- *Retail investors do not usually negotiate directly with asset managers and our evidence suggests that fund governance bodies acting on their behalf do not typically focus on value for money. (Page 18, para 1.43)*

These were damning criticisms of the industry. Not much has changed. Yet your Sector Views tries to present a much rosier picture of the current situation. Your 2016 postion was very clear. The FCA position put forward in Sector Views is much less clear. We think the FCA is backsliding. In seeking to work closely with the industry the FCA is being much too consensual and weak-minded. Consequently, it is failing to reflect fully the needs and interests of the customers. **Quite frankly, we are appalled that Sector Views fails to give sufficient weight to these damning criticisms of the industry.**

The Sector Views report fails to highlight the differences in portfolios' sizes. **We think the analysis should have been undertaken by portfolio size, as many of the issues, remedies and actions needed are heavily dependent on it.**

We note that Platforms have approx. £500bn AUM and annual revenues of £1.3bn. The average platform account has about £100,000 of AUM, but the median figure is much less. Average revenue per customer is £260 (26bp).

The FCA MS17/1: Investment platforms market study report notes the 47 players in the platform market. However, the report fails to recognise that they do not all compete head to head. There are various different business strategies and many players focus on particular niche(s). This is obvious when one looks at the following heat map of platform charges by size of portfolio, such as shown on the Daily Mail's ThisIsMoney website

https://www.thisismoney.co.uk/money/diyinvesting/article-2564059/How-Sipp-platform-costing-you.html.

UKSA-ShareSoc say the FCA report, Investment platforms market study, should have focussed more on the Gorilla in the midst of this competitive battle. Hargreaves Lansdown has 30% of this market by income (2017 income £386 million versus market size of £1.3billion) and 16% by AUM (£79 bn out of £500 bn.) Its revenue per customer is £405, versus the industry average of £260, HL average AUM of £83k v £100k and charges of 49bp versus average of 26bp.

The issue is whether Hargreaves Lansdown (or others) is/are adopting anti-competitive behaviour.

We also worry about:

- fund charges and discounts. The lack of easily available, clear, transparent data on platform charges is a concern.
- The difficulties and delays in transferring from one platform to another.

The ability of beneficial shareholders who hold their shares in nominee accounts being able to vote their shares easily and at no additional cost is a critical aspect of shareholder rights and shareholder democracy. **It is surprising that this issue did not feature in the FCA consultation on market platforms nor in your Sector Views.**

Currently only 6% of retail shareholder vote at AGMs. This is because of the difficulties, for those holding shares via nominees, that platforms have created. The platforms are not facilitating shareholders exercising their voting and other rights.

In addition, the shareholder register does not require the name on register of the beneficial owner of shares held via nominees. Currently, HM Government has no plans to change this, despite it being a clear objective of the EU Shareholder Rights Directive. The Law Commission review of Intermediated Securities must be given a much higher priority. The FCA support in this issue would be most welcome. Being able to communicate with shareholders would allow the registrars to offer an alternative service to platforms.

In our response to the Platforms Consultation, UKSA-ShareSoc called upon the FCA also to examine these issues:

1. **A new "name on register" electronic system** needs to be provided if "dematerialisation" is to fully happen so that investors can buy and sell shares through any broker and not be locked into one broker as happens at present.
2. The protection of holdings in nominee accounts by alleged "ring-fencing" of client holding and cash which is totally undermined by the rules in the Special Administration Regime.
3. The relatively low protection provided by the Financial Services Compensation Scheme in relation to the amounts likely to be invested in platforms, e.g. in pension SIPPs and ISAs.
4. The basic poor legal protection offered by nominee accounts and the failure of almost all stockbrokers to offer personal crest accounts (i.e. where your name is on the share register of the company and your holdings therefore clearly legally your own and not the platform operators).
5. Similarly, the requirement to use nominee accounts for ISAs and SIPPs is deeply uncompetitive because it locks clients into one platform from which they have difficulty withdrawing.

These issues do not seem to be covered by the FCA Sector Views Report but are major contributors to the current uncompetitive environment for retail investors in respect of platform operators.

Closet Trackers

Another area of concern for us is closet trackers, where funds charge exorbitant fees for a service which is closer to a tracker frund. We note however the recent FT report on the 5 Feb 2019 FCA publication https://www.fca.org.uk/publication/policy/ps19-04.pdf by Owen Walker, Asset Management Correspondent FEBRUARY 4, 2019: FCA orders more fund disclosure from asset managers Watchdog targets 'closet trackers' charging high fees for active management. https://www.ft.com/content/693fd46c-2867-11e9-a5ab-ff8ef2b976c7

Nevertheless, we think these closet tracker issues should have been included in the Sector Views.

Consumer Education

Many of the issues you raise about possible consumer harm are linked to the very poor standards of consumer education in the UK. People leave school with totally inadequate financial education. The syllabus is too narrow and unchallenging. For example from an early age, pupils should be challenged in their maths classes to work out percentages and interest rates.

We recommend you look at the adverts on the TV for loans, betting and mortgage switching. The depth of these adverts (or to be precise the lack of depth) is a refelction of the advertisers expectation of its target audience, and of their inability to be able to make straightforward financial judgements about the content of the advertisements. The advertisers clearly believe that people will be taken in by these adverts. We think this is horrid.

The FCA should be making noises about the need for better financial education, as well as protecting consumers from harm. This is a complex problem and both approaches need to be addressed in parallel.

Yours faithfully,

Cliff Weight, Director, ShareSoc

Peter Parry, Policy Director, UKSA