Discussion with pension scheme in house investment staff

Hosted by the Pensions & Lifetimes Savings Association, 16 May 2018

The following is a summary of points discussed between members of the CMA's market investigation case team and some in-house pension scheme investment staff. The meeting was arranged for the CMA by the Pensions & Lifetime Savings Association and took place at their office in London.

Attendees represented large pension schemes, all of which employed investment consultants, but none of which used fiduciary management.

We do not consider the views given in the discussion as typical of all schemes, but we consider that they provide some useful supporting evidence to other data we have gathered.

Summary of discussion

1. Attendees noted that ICs provide a range of different services to pension schemes, including monitoring of performance and transition management, which in some cases can be highly complex. They noted that overall investment strategy is the most important service for scheme outcome.

2. They told us that their schemes did not have a standard way of assessing the quality of investment consultants (ICs) that they used although the IC's ability to understand the needs of the scheme based on their knowledge of it was a common theme.

3. They emphasised that the IC-client relationship was key and that this was often based on the individual consultant, rather than the overall firm. The lack of a hard measure was not seen as problematic.

4. Some had a practise of reviewing their IC provider every few (eg. 8) years; some noted that a change could be initiated by a change of scheme chair. They noted that a change of IC provider did raise a risk for the scheme due to the need for a new IC provider to build up their knowledge of the scheme. It was noted that this could act as an inherent barrier to switching.

5. Attendees considered that the CMA's published emerging finding that market concentration is higher for the supply of IC to large pension schemes is not surprising. They commented that this is partly because managing a very high

value of assets requires some additional skill which smaller ICs may not have. However, they noted that this is also down to how schemes perceive firms' reputation, and that there is nothing fundamental to stop large schemes using mid-sized ICs. They also noted that larger schemes are less dependent on ICs because they are able to do more work in-house, particularly that of a more routine nature, and pick and choose different advisors for specific bits of advice.

6. In discussing potential greater disclosure of IC and other investment fees, attendees raised the risk that this could encourage pension schemes to focus on lower cost asset classes which might not be the best investments for their scheme, or might have higher risks attached. Attendees also noted however that IC fees are substantial and they supported itemised invoicing.

7. Attendees were agreed that fiduciary management (FM) could be a beneficial service for some pension schemes, although it did not absolve the scheme of carrying the risks of investment. (They also noted that ICs were not ultimately accountable for the outcome of their advice.)

8. They suggested that FM could lead to a greater concentration of pension scheme's investment strategies as they would be led by a few firms and that this could represent a systemic risk.

9. In discussing potential standards for IC performance and fees and whether these should be regulatory standards, attendees noted how other financial sectors had introduced self-regulation of standards as an alternative and that this could be useful if investors, as well as their providers, were included. They also noted that industry-standard tools, such as template 'request for proposals' were available in other financial sectors. Attendees agreed that standardisation of the tender process would be helpful in both IC and FM.

10. Attendees commented that they consider it best practice for schemes to tender when moving into fiduciary management. They also told us that the use of third party evaluators can be a good way for schemes to ensure they get a good deal. Adopting the current advisor as FM without due process was a concern.

11. Attendees commented that the expansion of the Financial Conduct Authority's (FCA) regulatory perimeter to cover all IC and FM activities could be a useful catalyst for improvements within the industry. However, they noted that it could also result in a more protracted investment process, and raise costs for firms due to the need for a compliance function and this might form a barrier to entry of new firms.

12. Discussing the potential switching costs for pension schemes in FM mandates, attendees explained a range of factors that could affect this, including whether assets were held in the scheme name (eg. as “managed accounts”). They noted that the FM provider might be aware of divestment costs but not the full costs of transition. They noted that the level of costs and the ease with which they could be transferred would be highly dependent on the type of assets held. They also noted that some FM providers make a point of assuring clients that assets were held in the scheme name and that they were transferable to another FM provider.