Note of CMA roundtable discussions with pension trustees

1 & 2 May 2018

The following is a summary of points raised in discussions with three groups of pension trustees in two sessions at the CMA's London office.

Attendees were invited from respondents to the CMA survey of trustees. Most were from larger pension schemes, although not all. One trustee of a DB pension scheme was unable to attend and the CIO attended in their place. Some trustees were on a number of schemes including DB, DC and hybrid schemes.

We do not consider the views given in these discussions and captured in this note as representative of all pension schemes, but we do consider that they provide useful illustration and explanation of issues we have identified from the survey and other evidence gathered.

Any indicators given of the numbers of trustees expressing any view are approximate and do not indicate that additional weight is given to those perspectives, rather they only reflect the nature of the discussion held.

Where appropriate and for clarity we have noted whether specific points were made in explicit relation to DB or DC. No DC scheme attendees purchased FM services.

Definitions

AM – Asset manager/management	DB – Defined benefit
DC – Defined contribution	IC – Investment Consultant
IC-FM – A firm that offers both IC and FM services	FM – Fiduciary manager/management
LDI – Liability Driven Investment	MNT – Member nominated trustee
TPE – Third-party evaluator	tPR – the Pensions Regulator
UILs – Undertaking in lieu [of reference]	

Capabilities, capacity, skills and experience of trustee boards

1. Attendees noted that the composition of trustee boards varied significantly, including in relation to the number of Member Nominated Trustees (MNTs), whether there were professional or independent trustees and whether there were trustees with investment experience.

2. The approaches of trustees to a range of investment issues were in part determined by the covenant in place with a scheme sponsor. One trustee characterised a strong covenant as a scheme's "greatest asset". Some schemes with a strong sponsor covenant could be under less pressure to

achieve a specific level of growth and so might spend less time on investment decisions.

3. Attendees noted that lay and member nominated trustees generally have a limited amount of time to devote to their trustee duties. A professional trustee gave examples of where lay trustees were not able to devote time to their duties, including knowing a DB member nominated trustee who was not certain if they were a member of the scheme.

4. Several trustees noted that they had struggled to recruit trustees from the scheme's membership. Several trustees expressed a view that larger schemes tended to have access to a wider pool of potential trustees and tended to have more skilled, knowledgeable and engaged trustees.

5. DC trustees queried how DC schemes which did not use an IC (shown to be common in the CMA survey) would get appropriate advice for the potential complexity of issues that their own schemes faced, even if only for a limited number of issues.

Relevant factors that affect decision making of trustees

6. DB Trustees noted that a scheme's circumstances affected its approach. Factors referenced in discussion included

    - Strength of employer covenant
    - Whether the scheme was open to new employees
    - Whether the scheme was open to contributions from existing employees
    - The profile of cashflows
    - The scale of any deficit
    - The role of any 'in-house' expertise

7. One DB trustee noted that their scheme had a large number of employers which took a significant amount of trustee time. For example, strategies to address deficits needed to be agreed with each.

8. One DB trustee noted that if a scheme has been "de-risked" they would happily take a more passive approach based on a target of gilts with a small uplift.

9. Some trustees said that a typical trustee might be expected to devote 1 day per quarter to their duties. Paying greater attention to any one aspect of a scheme would necessarily sacrifice time devoted to other matters. One DB trustee set out the different facets of trustee oversight as 'strategy, covenant, ops, funding, liabilities and investment'.

10. Trustees said that these factors combined with trustee capability could affect the pressure that could be exerted on advisers.

11. One trustee of a small DB scheme said that the strength of their covenant meant that the scheme had decided to engage a smaller, 'more niche' IC provider rather than a much larger IC-FM firm.

12. DC trustees noted that the part-time nature of trustees means that IC proactivity was important. The key role of the IC was to present new ideas and strategies and to flag emerging issues that the scheme would need to address.

The relative importance of fees

13. IC fees were of much less interest to many trustees than investment fees.

14. Some trustees recognised the importance of getting value for money of IC fees but noted that they were typically much lower than FM or AM fees and very small relative to the value of assets. Some trustees noted that a small improvement in fund performance, or reduction in AM fees could easily equate to a whole year's IC fees.

15. In relation to FM, a trustee said that fees were important but not the main focus when selecting an FM provider.

16. One DB trustee noted that their scheme's FM fees was in the order of 8 times greater than their IC fee. Another trustee said that their IC fee was in the order 0.03% of the value of assets.

Provision and granularity of fees

IC

17. Trustees felt that they were able to ask advisers for fee information in a range of formats. Several trustees said that IC firms would provide information in any format, but trustees had to a) ask for it but b) know what they wanted to receive.

18. Trustees had a range of experiences in relation to how trustees or sponsors received fee information. Approaches included:

- Trustees being sent invoices but immediately forwarded to the sponsor for payment
- Trustee or Chair approval of invoices for company payment
- Invoices sent direct to company for payment so that trustees had no sight of fees despite taking decisions over IC selection.

19. Even where DB sponsors (not trustees) received and paid IC invoices directly, trustees did not believe that sponsors had significant influence on which IC firm was selected. However, in such circumstances trustees might have less visibility of fees.

20. For some trustees, the majority of work conducted by the IC was project based and ad hoc with fees agreed in advance. Fee structures varied for both DC and DB schemes, with some charged a relatively low retainer.

21. Some trustees received details of asset manager fees and charges direct from their asset managers while others received some form of analysis from their IC. Performance-based fees could be complex.

22. Regulatory developments were expected to improve the transparency, granularity and clarity of AM fees. One trustee said that this was a positive step but would be of greatest use for AMs to better understand their own fee structures. The trustee said that there was a limit to the level of detailed information that trustees could interpret but these developments might force AMs to reconsider their fees.

23. For IC in particular, some trustees felt that assessing value for money was only possible after the event, when the scheme's performance could be assessed. One trustee said that even with transparency it still didn't answer the question of "is this high?" – a 1% growth in assets would dwarf the IC fee.

24. One DC trustee was frustrated that ICs often instead appeared to suggest work that was revenue-generating for them rather than adding value to scheme performance – the trustee had received multiple suggestions of additional, chargeable work. Another trustee had noted that after expressing concerns to the IC over an AM's performance the IC's reaction had been to offer to review their performance, for a fee.

25. One DC trustee said they had experienced a form of drip pricing from their IC. For example, they had agreed a fee with an IC only to find that tasks that they assumed would be included in the exercise were priced and charged after agreeing the initial engagement. This had led to costs being 2-3 times greater than the initial cost of work. Although each additional charge would not justify a tender process the overall cost did. While the trustee was not dissatisfied with the overall price, they felt the IC could have reasonably expected that those services (such as shortlisting AMs) would be expected to be included. DC trustees were of the view that customers would benefit from a standard list of services that ICs should include in tenders, and particularly in bundled services.

26. One DC trustee noted that, when running a tender process for a bundle of services, the bids received were with one exception very similar. However, on further interrogation there was variability in what was included in the scope of what was proposed on each aspect of the bundle, which required an additional exercise with bidders to make their tenders comparable in scope. It was not clear to the trustee that a less experienced trustee board would be able to identify and address this risk.

27. DC trustees were concerned that while most charges were paid by the employer, any charges deducted from the scheme assets would receive less scrutiny.

FM

28. Some DB trustees were not worried about seeing regular asset management fees; their main focus was on net performance and whether this was meeting the scheme's target. One trustee noted that they did not have time to undertake detailed regular reviews of fees. They were also told about AM charges when they first moved into FM and so knew whether they were competitive.

29. However, some trustees thought that greater granularity was necessary, including of AM fees. This would help to keep track of the overall fee paid to the FM provider (including those invoiced and those deducted directly from assets). One trustee suggested an annual in-depth review of fees would be helpful.

30. Some trustees noted that bundled (all-in) fees are common for small schemes using FM. Some thought that this might cause the provider to use cheaper passive AM products and that any negotiated discounts might not be passed on to the client.

31. Several trustees said that they had had to challenge their FM provider to get FM fees presented in a way that was helpful for them; therefore they would support measures to mandate the provision of certain fee information and that this should include all fees charged.

32. Trustees who had bought FM services agreed that good fee information was particularly important at the point of FM selection and trustees supported standardisation of fee information at tendering. They would like to know the total fee that would be paid. Many trustees also thought that this information should be provided on a regular basis and that this would particularly help schemes whose trustees did not have the expertise needed to demand this information.

Exit fees

33. Some trustees noted that they had little or no idea what the cost of exiting their current investment approach under fiduciary management was. One trustee noted that this has not been an issue as investment performance had been strong but recognised that if performance did change this was important information that would need to be understood. In discussion those trustees expressed a view that greater clarity of exit fees would be beneficial.

34. Some trustees were concerned about the costs of being locked into FM funds, rather than the cost of switching FM provider. A number of trustees however strongly indicated that FM switching costs were high because the portfolio would almost always change when switching provider. In some cases providers insist that certain aspects of the portfolio are changed – e.g. one trustee stated that some providers insist that their own LDI product is used. It might take many years of out-performance to recoup the switching costs involved. One trustee said that switching FM provider could lead to charges worth 1% of assets under management.

35. Some trustees whose schemes had FM were not clear on the level of exit charges if they were to change. Several trustees strongly felt that any change in FM provider would in practice trigger significant switching costs in the form of transaction fees, as previous investments would be exited and new investments initiated. They were clear that the ability to switch, and cost of switching FM provider would be very dependent on the type of funds within the FM mandate (how liquid, how bespoke to that firm).

36. Some trustees were concerned that information on transition costs and exit charges was poorly disclosed at tendering.

37. Switching costs for IC were perceived to be lower than the costs of switching scheme administrator. DC trustees said their schemes had tendered for various services which included different combinations of bundled administration, platform and IC services. Where services were bundled, it was the transfer of member data between platforms and consultants that increased the cost, complexity and risk of switching.

38. DC trustees noted that in buying bundled services there were additional add-ons only available from certain providers that might make switching more difficult.

Assessing performance

39. Trustees valued the quality of advice from their consultants in both FM and IC. Trust in, and credibility of, their main adviser were important themes across trustees for both DC and DB schemes. Often this trust was linked to a specific individual, not to the firm overall.

IC

40. Trustees expected ICs to flag poor investment performance to them. However it was recognised that in some cases, such as where a change in investment strategy might lead to significant additional costs, it would not always be appropriate for an IC to advise to switch AM if the costs would exceed the underperformance.

41. Assessment of investment performance was difficult in a number of respects, including whether trustees agreed to pursue any suggested strategy. One trustee noted that a recommended AM might perform well but if it being recommended attracted sufficient investors then it would no longer be available.

42. Trustees supported some measure for comparative performance of ICs but were not clear how any metric would be constructed, particularly factoring in whether or not trustees adopted advice, or how it would be governed independently. It was felt that a performance standard might be useful, but would not be a decision-making driver in IC selection.

43. Trustees considered IC service quality to be important. Advice needed to be pitched at the right level. The ability of a consultant to understand scheme needs and its investment beliefs was seen to be key.

44. Some trustees said that they had needed to ask their advisers to stop trying to sell them extra services both in relation to IC and FM.

45. One member-nominated trustee said that facing pushback or a “brick wall” when challenging an IC was an indicator that greater scrutiny was needed.

46. One DC trustee noted that their scheme had experienced very different performance (with a difference in growth of 15 percentage points) from different funds/products within the same asset class which were recommended by their IC. In that example while the assets may have performed well in aggregate it wasn’t clear what to take from the scale of inconsistency of performance and if in fact the class of asset was inappropriate.

47. DC trustees thought that IC performance could be measured but only retrospectively – the simple question would be: has the fund done better than if no changes had been made. That was an assessment that trustees could feasibly make as they would know what the IC had or hadn’t recommended changing but would potentially be difficult to compile depending on the complexity of investment advice.

48. DC trustees thought that providing outcome analysis for individual scheme members was useful, but was often very confusing, particularly for those who were relatively young and whose outcomes were subject to a range of assumptions and projections forward by potentially several decades. One DC trustee noted that poor outcomes information could lead to unpleasant surprises at retirement if members did not understand what they could expect when they retired. Similarly for many DC members, understanding what was necessary in advance of retirement (such as gradual de-risking) was a fundamental issue. The issue was further complicated, particularly in DC by the potentially large number of different funds that members had historically paid into.

FM

49. Several trustees said that their FM provider reported their performance net of fees on an ongoing basis.

50. One trustee said that, at the point of buying FM, each provider presented performance information that made their performance appear favourable. Therefore, the trustee had not attempted to identify the top performer, and had focused on fees instead.

51. To assess the performance of the current provider, a number of trustees noted that the baseline information is how the scheme is performing against its journey plan. There was also broad support for some independent

benchmarks (such as LIBOR + x%). One trustee supported comparing performance vs peer groups on an ongoing basis.

52. A number of trustees stated that the performance of the growth and LDI parts of the scheme should be reported separately.

53. There was support amongst many trustees for standardised performance information at tendering. Many trustees agreed that the composites would have to be very similar to their own scheme. One trustee argued that standardising performance information is extremely complex and providers will always find a way to 'game' the system.

54. Many trustees strongly supported the idea of a standardised appendix in tender documents that would show fee and performance information in a completely consistent way. This should also include information on compliance, risk, personnel and conflict of interest policy. Several trustees also thought that this information should then be provided on a regular basis after that.

Factors in choosing an advisor

55. Price was one relevant factor but trustees found it hard to understand whether proposed fees were like-for-like. One trustee had held a tender for combined IC-FM that gave rise to proposed fees that ranged from £1million to £4million. It was not clear to the trustee what extra they would receive for a much larger fee.

56. Several trustees noted the difficulty of selecting an FM provider and some had found using a TPE helpful in this process. Many trustees strongly supported guidance being provided on how to select an FM or IC provider, as well as an up to date record of who provides these services and TPE services.

57. Several trustees described their final selection of adviser as being based on "whether [they] would trust them with [their] own money." The personal relationship with the adviser was seen to be key.

58. One trustee noted that they had been dissatisfied with the quality of service from their IC provider and perceived that the scheme was deteriorating. After testing the IC with a series of pieces of project work, the scheme had switched.

59. Several trustees said that they did not believe there was any perceived price difference between large and small firms but large firms did not appear interested in supplying smaller schemes, particularly if trustees sought a

bespoke approach. DC trustees also noted that smaller firms were not necessarily cheaper but also that large firms would not accept small ad hoc projects (in the order of £10,000) unless the scheme was an existing client.

60. One trustee said that they didn't think that IC firms were able to offer meaningful suggestions to fully open DB schemes and how to "re-risk" schemes.

61. Trustees had mixed experiences of the ability of ICs to drive down AM fees. However, it was noted that where discounts were achieved they could be sizeable in both absolute terms and relative to the IC fee.

62. DC trustees noted that typically strategies didn't change very often but that the underlying AMs would potentially change every 1-3 years.

Encouraging trustee engagement

63. Some trustees were wary of mandatory switching or tendering though others felt it was a way of ensuring trustees tested the market (although as noted below there was general support for mandatory tendering when first moving into FM, among trustees currently buying FM). Concerns included any requirement becoming a tick-box exercise. DC trustees were concerned that mandatory periodic tendering for IC was simply pushing a problem with IC behaviour onto trustees.

64. A relatively strong requirement to test the market periodically was supported in relation to IC schemes. Trustees said that a comply or explain regime could be an effective and proportionate way to achieve this. Schemes which had not conducted a tender could explain why not, and how they had sought to test the market.

65. Trustees noted that there were few incentives to switch IC/FM provider if they were achieving their goals, even if there was a sense that there might be better services elsewhere. Trustees said that the relationship with an individual adviser was important and if there was dissatisfaction with them, the risk of switching might be significant, which gave rise to the value added from a tender.

Reporting

66. There was generally thought to be a low level of engagement in pension schemes by members with little or no reaction to published statements, etc.

67. One Chair said the lack of member engagement meant that they had been developing an approach of producing a letter along with other materials setting out at a very high-level what key messages members needed to be aware of.

68. Trustees considered that reporting to members was less likely to have an impact than inclusion of information in returns to tPR. Reporting to tPR was more likely to be effective for schemes with other potential risk indicators which might attract greater tPR scrutiny.

69. One trustee was concerned that tPR should not have any role in approving a decision on whether/how a scheme sought to test the market as this could add time to the process.

Independent / third party involvement

70. Some trustees noted that there was a tension in various developments in the pensions sector in relation to diversity of thought, increased use of professional trustees and increased MNT involvement.

71. Several trustees described their scheme's use of an independent adviser:

- Several trustees had used a TPE or other independent adviser to assist in reviewing their current IC or FM provider, including in relation to performance fees

- One trustee said that their scheme had engaged an auditor to assess their adviser's performance. While this had cost in the order of £25,000 it provided assurance that the scheme (in the order of £500m of assets) was achieving its investment goals.

- Several trustees who had bought FM had used independent advice to support their choice of FM provider and to monitor their FM provider on an ongoing basis.

- One trustee who used a TPE to select their FM provider said the TPE had been essential in enabling the trustees properly to understand and compare the fees in the proposals received.

72. Several trustees referred to the ability of professional trustees and independent third parties to offer an objective assessment of an IC/FM provider's performance relative to that in other schemes.

73. The use of a third party might not however be cost effective for smaller schemes.

IC-FM firms' conduct

74. Some trustees had direct experience of being subject to repeated approaches from their incumbent IC-FM encouraging them to adopt an FM approach. For example, one trustee said the trustee board had communicated a clear decision against FM in one board meeting, yet had been presented with a partial FM product by their IC at the next meeting.

75. Some trustees perceived the intensity of these approaches had recently increased and that there was a presumption from IC-FM firms that schemes would adopt FM as a matter of course.

76. Trustees believed that there were large financial incentives for firms to convert IC clients into FM clients in terms of greater firm profitability or individuals getting bonuses.

77. Some trustees said that there was a risk that IC firms might deliberately avoid recommending FM if they did not offer the service.

78. Trustees were not confident that FCA regulation which requires authorised firms to act in their clients' best interests would be of any use if they were being steered towards products or services which were more clearly in the provider's interests than their own.

79. One trustee said it was not clear how other firms could compete fairly against an incumbent IC-FM firm who had developed knowledge of a scheme's objectives and approach and a personal relationship with trustees.

80. Several trustees expressed concerns about partial FM; their experience was that trustee boards sometimes purchased delegated products, not appreciating that these were FM solutions. This can cause trustees to 'slip' into using FM services. One trustee was part of a trustee board that had not realised that it was using a partial FM solution, until this was pointed out by a TPE.

81. Trustees considered that FM was a good service and that it could reduce burdens on trustees. There were 'economies of scale' around the collation and reporting of AM fees. However, for less well- resourced schemes, there could be an excessive focus on choosing the approach that would make a trustee's job easiest as was described by one trustee as "the easy way out".

82. Adoption of FM was not a simple decision and could require significant trustee time.

83. Those who did not purchase FM were not clear whether FM was a reversible decision in practice.

84. One professional trustee said they were not comfortable purchasing FM without an independent IC. Several trustees that had bought FM had made use of an independent IC or a TPE. They felt this had been helpful in supporting trustee decision making.

85. Trustees were unclear whether there were benefits of having IC and FM services provided by the same provider.

86. One trustee said that if the regulatory framework were drawn up today, IC firms would not be allowed to offer FM. However, several trustees said they would be reluctant to ban IC firms from offering IC and FM services; one trustee expressed concern that this could reduce the choice of providers in the market.

87. Amongst trustees of schemes that had bought FM, there was general support for the idea of mandatory tendering when first purchasing FM. In addition, several said that using an independent adviser was advisable to provide balance.

88. Several trustees felt that something should also be done in relation to partial FM, but that mandatory tendering may be less practical for partial FM than for full FM. One trustee said that some sort of de minimis threshold could apply. Several trustees said that more transparency/disclosure around the move to partial FM would help.

89. Using an independent advisor could also help, although there were some concerns that FM providers would be reluctant to disclose commercial information on their FM products to potential competitors. The option of 'comply or explain' was discussed as an alternative to mandating that trustees test the market (for example through tendering) before buying a service. One trustee said that the Chair's Statement had had some positive effect in DC, in terms of causing chairs to give more careful thought to the matters captured in the Statement. However, most trustees felt that 'comply or explain measures' would have a limited effect in driving changes in behaviour.

90. Trustees were not in favour of mandatory switching, with switching costs being cited as a downside to this type of measure.

91. Trustees were not convinced that Chinese Walls between IC and FM activities within a firm would be an effective way of managing any conflict.

92. Trustees were generally comfortable with the idea of buying FM from an AM firm, as it was reasonable to expect that the scheme would be investing into funds operated by the AM and trustees could make any decision in this knowledge.

Trustee tendering toolkit

93. Trustees noted the potential value of the toolkit, which could be provided as part of TPR's guidance. There was uncertainty amongst trustees as to whether all trustees use the existing toolkit. Some trustees noted that usage of any toolkit was likely to be restricted to more engaged trustees.

94. Any changes to the toolkit such as new modules should be short and accessible. Trustees thought that periodic, time-relevant update modules would be one way of keeping important issues at the front of mind. Trustees considered that there could be a need to require a periodic 'refresh'.

95. Trustees noted that their duties only ever increased and this should be borne in mind.

Other potential remedies

96. Trustees generally expressed support for greater clarity of advice and marketing materials.

97. A number of trustees had attended various events hosted or sponsored by firms. They were aware that these were a form of marketing. In contrast, the line between advice and marketing was more blurred in relation to the materials and advice provided by the firms. One trustee had received training from an IC as part of developing the capacity of the trustee board.

98. Trustees supported the use of a regulatory disclaimer ahead of any advised move into FM.

99. Some trustees thought that a centralised survey of trustees could be a useful way of indicating trustees' experience of particular ICs.

Other potential conflicts

100. Trustees said that ICs could act as a gatekeeper to trustees in relation to asset managers. Trustees felt that an unsolicited approach to them by an AM would be unlikely to succeed if the AM was not on an IC's "buy-list".

101. Several trustees strongly felt that hospitality such as paid-for sporting trips for investment consultants should not be permitted. On the other hand, it was felt that low level items such as tea and coffee should be allowed. Several trustees noted that ICs are already subject to rules and regulations in relation to G&H. Another said that their experience was that larger ICs were already not accepting lavish hospitality.

102. Trustees noted that some ICs had charged significant amounts to AMs to attend conferences. One IC had since stopped running such conferences whereas another was thought to have continued.

103. One trustee had concerns about ICs recommending products from which they stood to benefit financially; for example, asset management products or funds which the IC provided administration services to. One trustee felt that disclosure of conflicts would be sufficient in these scenarios. Another trustee felt that disclosure would not be sufficient, and that a ban on firms producing product comparisons involving their own products would be more effective.

104. DC trustees observed a tendency for ICs to attempt to convert ad-hoc project work into recurring reviews and assessment.

Appendix

List of schemes represented

Arcadia Group Senior Executives Pension Scheme
Arri (GB) Limited Pension and Assurance Scheme
Ashridge Pension Scheme
Associated Independent Stores Limited Pension and Life Assurance Scheme
Bank of America UK pension plan
British & Foreign Bible Society (1972) Staff Pension Scheme
Caledonian Publishing Pension Scheme.
Drax Power Group of the Electricity Supply Pension Scheme
DZ BANK AG London Branch Pension Plan
EPSL Group of the Electricity Supply Pension Scheme
Henderson Group Pension Scheme
Hertz (UK) 1972 Pension Plan
Inchcape Motors Pension Scheme
James Fisher & Sons Public Limited Company Pension Fund for Shore Staff
John Lewis Partnership Trust for Pensions
Lazard Directors & Staff Pension Schemes
Mid-Counties Co-operative Pension Scheme
New England Windows Pension Scheme
Northrop Grumman UK Pension Scheme
Oxford University Press Group Pension Scheme
RNLI 1983 Contributory Pension Scheme
Robert Bosch Limited Money Purchase Plan
Russell-Hurst Pension Scheme
Scottish & Grampian Television Retirement Benefits Scheme
T R P UK Retirement Plan
The Bank of New York Pension Plan
The Colt Car Co Ltd Retirement Benefits Scheme
The Littlewoods Pensions Scheme
The Shipowners Protection Limited Retirement Benefits Scheme
The SSVC Pension Scheme
The UK Power Networks Pension Scheme
UBM Pension Scheme