12th October 2017

Mr Peter Swan
Investment Consultancy Market Investigation
Competition and Markets Authority ("CMA")
Victoria House
Southampton Row
London
WC1B 4AD

Submitted via email to: investmentconsultants@cma.gsi.gov.uk

RE: BlackRock's response to the statement of issues on the market investigation into investment consultancy and fiduciary management services

Dear Mr Swan,

BlackRock Investment Management (UK) Limited ("**BIM**" and together with other subsidiaries of BlackRock Group Limited. "**BlackRock**")[1] is pleased to have the opportunity to respond to the Competition and Markets Authority's ("CMA") statement of issues (the "**Statement**") on the market investigation into investment consultancy and fiduciary management services (the "**Investigation**").

We welcome the opportunity to comment on the content of the Statement and we would be happy to continue to contribute to the thinking of the CMA on any issues that may assist in the outcome of the Investigation. In providing our response, we have focused mainly on the theories of harm and any potential unintended consequences of these.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

Capitalised terms not defined in this response shall have the meaning ascribed to them in the Terms of Reference.

Consultants play a critical role in the institutional investment industry for both Defined Contribution ("DC) and Defined Benefit ("DB") schemes, one that is mandated by UK pension regulations, in order to assist Trustees in pursuing the full funding of their schemes and the ability to pay retirement benefits to their members. It is therefore important that any advice provided to them in determining the success or failure of a pension scheme objectives is appropriately monitored and reviewed to ensure consistent regulatory standards are set. We agree with the CMA's proposal to focus on pensions schemes in the context of this investigation

BlackRock is supportive of this initiative however, we also stress the importance and significance of any findings in the context of the wider decision of the UK to leave the European Union. BlackRock recognises the important role that the UK has played in helping shape the asset management industry in Europe and while wishing to ensure that the UK industry is held to the highest standards it must remain competitive within the European framework after the UK's exit from the EU.

[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

1) Our perspective as an asset manager who provides fiduciary management services

BlackRock is a global asset manager. As at September 30, 2017, BlackRock's assets under management total US$5.98 trillion across equity, fixed income, cash management, alternative investment, real estate and advisory strategies. BlackRock also provides risk management and advisory services. BlackRock is active in the UK through BIM.

In conducting the Investigation, we consider it important that the CMA consider carefully the process by which pension scheme trustees, and many other institutional investors, acquire fiduciary management services. Fiduciary management is an important and growing area of the Institutional investment industry and of our business. In the course of providing Fiduciary management services to UK defined benefit pension schemes, we provide advice under the Pension Act 1995 ("**PA95**"). We do not provide PA95 advice to UK DB pension schemes on a standalone basis and therefore do not provide this advice unless we are appointed a fiduciary manager.

Blackrock competes with a significant number of other suppliers of Fiduciary management services. While some suppliers of Fiduciary management services are specialists and focus solely on the provision of this service, a number have started supplying these services alongside long established core businesses in the Institutional investment industry. For example, the majority of fiduciary management mandates are supplied by industry participants with a core investment consulting business[2].

We believe that all Institutional investors should have a choice of which services they use and who provides those services. They should be able to make well informed decisions when selecting their provider, be they investment consultants, master trust providers or fiduciary managers. Standardised qualitative and quantitative information should be made available by providers to Institutional investors in order to distinguish between the available options.

2) CMA's approach to the Investigation

a. *Proposed focus:*

- We agree with the CMA's proposal to focus on pensions schemes in the context of the investigation.
- The regulatory obligation on DB pension scheme trustees to seek PA95 advice when exercising their duties highlights the importance of the link between the advice given and the effectiveness of the solution for pension schemes. In our experience, it is not common for trustees to act contrary to the PA95 advice they receive from their investment consultant.

b. *Assessment of potential detrimental effects: w*e agree with the detrimental effects identified in the Statement and we suggest two additional ones:

- that the advice to acquire Fiduciary management services in the first place may not be in the best interests of the client; and
- the auto enrolment charge cap in the defined contribution ("**DC**") space could lead to employers choosing contract-based DC plans or Master Trusts in order to reduce costs and their ongoing fiduciary responsibilities to members. In doing so, they are likely to use investment consultancy services once, rather than on an ongoing basis. This could lead to poorer outcomes for end customers if there is less scrutiny applied to the investment solutions within the contract-based schemes or master trusts. It is often the case in contract-based schemes that scheme default investment options are not regularly reviewed and updated, leaving members in out-dated default funds. In contrast, trust-based schemes are likely to review their fund offerings more frequently. A tri-annual review similar to the tri-annual actuarial valuation in DB could be introduced as a requirement to ensure regular review.

c. *Previous reviews, ongoing work and future development:*

---

2 KPMG Fiduciary Management Market Survey (2016), p3, Chart 'number of mandates by type'.

- BlackRock believes that the combination of industry efforts underway and imminent regulatory change[3] will enhance transparency and disclosure of the fees for Fiduciary management services.

- Moreover, the trend towards consolidation of pension schemes such as Local Government Pension Schemes ("**LGPS**") and Master Trusts in DC means that an increasingly smaller number of consultants and decision makers will be responsible for larger pools of pension assets. It is therefore critical that the market operates effectively in order to best serve the needs of the underlying end clients.

- As part of your forward-thinking considerations, we suggest that the CMA maintains its focus on the defined benefit ("**DB**") pension sector. To illustrate this:

  - While corporate DB pension schemes are typically closed to new participants and increasingly to future accruals, there are still significant assets in the sector (£1.5 trillion scheme assets)[4];and
  - Extremely large public sector schemes such as the LGPS remain open to new members and future accrual.

3) Market characteristics and outcomes

a. *Key characteristics*

i. *Difference in size and type of pension funds*:

- The ability of trustees to adequately assess the value proposition of various consultants and subsequently the advice they receive will be impacted by the trustees' respective: (i) governance model, (ii) technical expertise and knowledge; (iii) resources available to assist them in making informed decisions; and (iv) qualitative and quantitative methods to assess them.
- Typically, smaller schemes are less well off in the context of the characteristics above, but not uniformly.

ii. *Challenges in assessing pension scheme performance*:

- While we recognise the challenges outlined in the Statement, use could be made of qualitative and quantitative criteria to assess the impact of investment consultants and fiduciary managers on pension fund outcomes. For example, the qualitative criteria may include assessing the clarity of the advice provided and whether such advice is adequately contextualized each client's situation. The robustness and repeatability of the investment process, underpinned by proper risk management tools. Quantitative criteria could include (but are not limited to) performance of recommended managers, improvement in the funding level and adherence to risk budgets,

b. *Market outcomes*

i. *Whether investment consultants are providing high-quality asset allocation and manager recommendations*:

Measurement of advice

- There is no agreed practice or standard for evaluating how investment consultants are performing for their clients. Their strategic asset allocation advice, as well as their Manager selection advice, could be better assessed if they were evaluated objectively, regularly, and thoroughly.

- There can be differences in the level of due diligence applied to traditional asset management services, relative to the standards applied to investment consulting and fiduciary management services, and it would make sense to remove these differences such that trustees receive the same level of due diligence for both investment management, and advice.

[3] We note the standards on cost disclosure under MiFID II and the FCA's Better Workplace Pensions initiative which will be effective from January 2018 combine to form an effective benchmark for cost disclosure across the wider industry.
[4] Financial Conduct Authority - Asset Management Market Study Final Decision: Market Investigation Reference (MIR) on investment consultancy services and fiduciary management services, September 2017, paragraph 4.6

Manager ratings process

- The requirement for pension schemes to seek PA95 advice prior to making investment decisions typically means only products which have been approved by the investment consultant's manager research process are likely to be used. This process can result in the slow adoption of innovative or market responsive products. A good example of this has been the halting acceptance of newer diversifying investments, such as alternative investments.

- There does not appear to be a consistent method to determine whether Institutional investors are receiving the desired outcome in the context of manager ratings and there appears to be scope to improve transparency in this regard. Manager ratings exist to determine the best managers in each asset class and those most likely to deliver their stated objectives. It isn't clear that trustees are uniformly provided with sufficient transparency to determine that the manager rating, selection and implementation services provided to them have added value for their pension schemes.

Glidepath design

- In the DC space, we believe it is also worthwhile investigating the glidepath design capabilities and performance of investment consultants. Adoption of asset-manager glidepaths (via target date funds) has been very slow in the UK relative to the United States where target date funds are widely used as default investment solutions for DC. Investment consultancy firms have now begun to launch their own target date ranges within their fiduciary and master trust offerings. However wider adoption in the advised space is yet to be seen and investment consultants continue to own glidepath design on behalf of trust-based DC schemes.

ii. *The extent to which investment consultants are driving competition between asset managers*:

- In our experience, investment consultants do drive competition between asset managers, both in terms of product development and in pricing levels. In relation to price, we have seen significant compression across a range of investment offerings such as liquid alternatives, Liability Driven Investments ("LDI"), and index investments. There remain numerous examples of where investment consultancies have driven product development to satisfy Institutional investors' needs, for example, 'buy and maintain' credit and diversified growth strategies.

iii. *Whether investment consultants are providing high-quality Fiduciary management services*:

- Trustees need clear information on the performance of fiduciary mandates. This should include explanations of how mandates have performed and meaningful attribution to the components that contributed or detracted from performance. There should be explicit and clear attribution of the performance of the fiduciary mandate relative to the objective that is set for the fiduciary manager, which is often linked to the pension scheme funding level. Given the different degrees of delegation across fiduciary mandates, we believe that trustees should be clear on which parties are accountable for the key decisions that contribute to the overall performance of the mandate.

- BlackRock recognises that each fiduciary client has different risk and return requirements which can make it challenging to provide the necessary information for effective comparison. However, more could be done to facilitate trustees assessment of their outcome relative to their objectives. It is possible to create standardised, anonymised, and consistent calculated performance metrics through the creation of client grouping with similar objectives. It is important that there is sufficient rigour applied to the methodology, calculation and review of performance metrics to ensure that trustees can reliably and confidently utilise the information. BlackRock and a number of other industry participants are currently working to develop and implement these standards.

- We would suggest that the CMA include in its definition of fiduciary management the combined provision of PA95 advice and asset management (including single asset class delegation and partial portfolio delegation) to a single client.

4) Hypotheses for investigation (theories of harm)

a. *Demand side and information issues*

- We agree that there is scope to improve the ability of customers to effectively assess, compare and switch investment consultants and fiduciary managers.

- *Complexity analysis*: We recognise that it is challenging to assess whether clients have been recommended to adopt investment strategies which are unnecessarily complex. However, manager proliferation, over diversification and the unnecessary use of derivatives where physical securities would achieve a similar outcome, can all indicate unnecessary complexity.

- *Impact of demand side issues on market outcomes:*

  - We believe that it is feasible to undertake this additional analysis, and that it is essential. We further believe that it is essential to review whether the investment consultants are providing the right advice, in addition to examining price or quality of service. There is evidence[5] to suggest that it is no coincidence that larger schemes that are better resourced, have more experienced trustees and greater governance resource, exhibit on average better funding levels than smaller schemes without these characteristics.

  - In the case of DC schemes, we see similar trends. The larger schemes with in-house investment expertise and experienced trustees are much better positioned to challenge investment consultants. For smaller schemes this is more difficult.

- *Tender*: We support the practice of an open tender process when procuring an investment consultant, Fiduciary management service and/or master trust for the first time. Similar to other industry practices (e.g. audit), we also believe there is merit in a formal periodic retendering process thereafter.

b. *Conflicts of interest:*

- It is important to note that trustees are obligated to seek PA95 advice and that they typically appoint investment consultants to provide that advice.

- BlackRock believes that Institutional investors would benefit from harmonised standards for conflicts of interest disclosure and management by bringing all parties subject to appropriate levels of regulatory oversight. Any transparency enabled by the introduction of such standards would enable trustees to evaluate the extent to which there is any conflict between the provision of PA95 advice and a consultant's commercial interests. A regulatory duty to act in the client's best interest would also assist in ensuring that efforts are focused on client's obtaining the right outcomes.

c. *Barriers to entry and expansion:*

- There are limited barriers to entry to providing Investment consultancy services. Given the demand side issues referenced above, however, there is limited switching from established players to new market entrants.
- For Fiduciary management services, the limited adoption of an open tender process when choosing a provider creates a barrier to new entrants. From our experience, we have seen a number of instances where fiduciary management solutions are not tendered.

[5] In a recent discussion paper response issued by The Pensions Regulator, the 'poor-good' governance gap in terms of governance is stated to be worth at least 1-2% of additional return per annum based on past research: 21st Century Trusteeship and Governance, Discussion paper response (December 2016), page 11 (available at http://www.thepensionsregulator.gov.uk/docs/21st-century-trusteeship-governance-discussion-response-2016.pdf).

BLACKROCK

5) Remedies

In our view, it is too early to consider and comment upon specific remedies. We would welcome the opportunity to comment at a later stage in the process. In BlackRock's view, a key aspect of any remedy package is the need to consider whether it may give rise to potential unintended consequences and to avoid unreasonable cost-benefit trade-offs.

Yours Sincerely,

Alexandra Haggard
Head of Consultant Relations

Drapers Gardens
12 Throhmorton Avenue
London
EC2N 2DL