CAPITA

Peter Swan
Project Manager
Investment Consultancy Market Investigation
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

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Dear Mr Swan

INVESTMENT CONSULTANCY SERVICES AND FIDUCIARY MANAGEMENT SERVICES MARKET INVESTIGATION

We welcome the opportunity to respond to the Issues Statement in respect of the Investment Consultancy Services and Fiduciary Management Services Market Investigation published by the Competition and Markets Authority (CMA) on 21 September 2017.

This response is made in relation to Capita Employee Benefits comprising of Capita Employee Benefits Limited (CEBL) and Capita Employee Benefits (Consulting) Limited (CEB(C)L). These are the two companies within Capita plc that provide services within the scope of the Market Investigation. The business is managed as a whole under the trading name of Capita Employee Benefits.

Our services include the provision of investment consultancy services as defined by the market investigation. However, we do **not** provide fiduciary management services and as such we have not commented on the sections of the Issues Statement relating to fiduciary management.

The Investment Consulting Practice team currently employs around 20 individuals and is in the 2nd Tier of investment consulting teams.

Capita Employee Benefits' principal business is as a UK-based employee benefits consultancy. Formed in October 2012, the company brought together the consultancy and technology solutions of Bluefin Corporate Consulting, and the pensions administration services of Capita Hartshead.

As a combined business, we now offer a comprehensive range of employee benefits and pensions services, with expertise in administration, consultancy and technology: DB and DC trust, master trust, GPP, healthcare, risk, and flex – supported by specialists in HR consultancy, benefits administration and technology, communications consultancy and employee education.

CMA's Approach to the Investigation

Proposed focus

We agree with the proposed focus on workplace pension schemes as we would agree that they are the largest body of customers for providers of investment consultancy services.

All our current investment consultancy clients are workplace pension schemes or their sponsoring employers. As such we are unable to comment on the extent to which other institutional investors use investment consultancy services and if there are any issues.

Assessment of potential detrimental effects

We agree that the list of detrimental impacts identified in paragraph 22 of the Issues Statement are the correct impacts for the investigation to focus on. We would also point out that if the investigation confirms that the market is not working effectively for trustees and as a result they are not receiving advice to maximise their governance of pension schemes, there are wider indirect detrimental impacts that should be considered. For example, there could be reduced funding levels for DB schemes and resulting higher employer contributions or inadequate default strategies for DC schemes where the majority of members will be auto-enrolled, resulting in the risk of poor member outcomes.

Previous reviews, ongoing work and future developments

We agree there should be liaison with the Financial Conduct Authority and the Pensions Regulator to avoid unnecessary duplication. In particular, the Pensions Regulator has published extensive guidance for trustees around investment governance and management of advisers.

We agree that the current and future developments listed in paragraph 29 of the Issues Statement should be taken into account.

A further market trend that could be considered is the increasing trend of employers outsourcing the provision of their pension scheme arrangements through the use of Group Personal Pensions (GPPs) or master trusts.

It should be noted that the market for GPP consultancy advice has very little overlap with the investment consultancy market, since there is very little scope for investment advice to employers in respect of GPPs. It is a significant and much broader market in itself. To include this area of consulting would significantly broaden the investigation assuming that firms which, are not investment consultancies but provide advice in relation to GPPs, are to be included.

Market characteristics and outcomes

Key characteristics

(a) Lack of clarity and precise definition of investment consultancy services and fiduciary management services and potential overlap in the types of services offered.

We agree that there is a lack of clarity and precise definition of investment consultancy services and fiduciary management services with overlap in the types of service offered. We think it is important that a clear definition is applied so that the assessment of the market is fully representative and that the implementation of any potential remedies are applied to a level playing field. As noted above, we also believe it is important that the scope of the market is clearly defined, as the range of market participants involved in providing trustees/employers with consultancy services on pension scheme arrangements is much broader than those providing investment consultancy services.

Although there is a lack of clarity, the fiduciary management market is not restricted to investment consultants. The asset management industry also offers fiduciary management services and these services are direct competitors of investment consulting fiduciary management services.

(b) Difference in size and type of pension funds

We agree that the difference in size and type of pension funds is an important characteristic that needs to be carefully considered. Care needs to be taken to ensure that engagement with schemes and trustees covers the broad spectrum of schemes in place. It is important to engage with small and mid-sized schemes to obtain their input to ensure that results are not distorted. One option is to engage with independent and professional trustees that provide support to smaller and medium sized schemes. We also believe that engaging with the Association of Member Nominated Trustees would be useful.

(c) Importance of the role of trustees

We agree that pension trustees have a critical role in this investigation. As noted above we think it is important that the investigation engages with the full range of trustees to ensure their different needs, challenges and perspectives are understood, in order for them to discharge their statutory and fiduciary duties.

We also believe that the role of the employer is of importance for example the relationship between trustees and employers for workplace schemes (particularly DB schemes) and where employers are providing GPPs.

(d) Challenges in assessing pension scheme performance

We agree with the reasons noted that make the assessment of performance difficult, particularly because of the differences between scheme objectives, risk appetites, etc. We think that it is particularly important that the individual requirements and objectives of schemes are properly considered as these can vary widely. We would observe that it is relatively easy to assess the performance of an asset manager over a 3 to 5-year window. However, it is much harder to assess a pension scheme's performance, as its objectives are long term and are not always precisely defined. Objectives with time-lines of 20 years or more are not uncommon. It is also possible that restructuring may take place within scheme which might impact or influence performance.

(e) Extensive regulations and legislation surrounding pensions

We agree that the legislative and regulatory environment surrounding pensions is complex and any potential impacts from this complexity on market competition should be considered, especially the increasing regulatory burden for trustees whose governance obligations are already considerable. Consideration should be given regarding the different aspects of institutional investment advice that fall within the scope of regulation and the different regulators (e.g. the FCA, Designated Professional Bodies, etc) to ensure that there are no restrictions to the provision of additional investment consultancy services for firms working to a higher level of requirements.

Market outcomes analysis

Quality of service considerations

(a) Whether investment consultants are providing high-quality asset manager recommendations

We agree that the analysis conducted by the FCA should be examined in detail. We also think that an examination of the selection methodologies used by investment consultants would add value to any assessment of the quality of asset manager recommendations being made. However, our opinion is that there is no value in extending the quantitative analysis undertaken by the FCA to include 2016/17 data as asset manager recommendations are usually made for a minimum of 3 years.

(b) The extent to which investment consultants are driving competition between asset managers

We agree that an important aspect of the investigation is a consideration of the extent to which investment consultants are driving competition between asset managers and that this should take into account the outcomes from the FCA's wider asset management market study.

(c) Whether investment consultants are providing high-quality asset allocation advice

We do not think that there is a straightforward or effective way to undertake a quantitative assessment of the quality of asset allocation advice. Each client has a unique set of circumstances and market experience will determine the success or otherwise in terms of the impact on the scheme's funding level. Further, the timeframe over which the impact on funding is measured makes measurement difficult. As such we agree any assessment should be focussed on qualitative measures as proposed.

(d) Whether investment consultants are providing high-quality fiduciary management services

We have no comments as we do not provide fiduciary management services. However, in c) we discussed some of the difficulties in measuring asset allocation advice, including timeframes and objectives.

(e) Whether investment consultants are providing a high quality of service in other ways

Our view is that the clarity of advice given and the extent to which the advice given meets specific client requirements are key factors that should be considered.

Fees

We agree that a review of fee structures and trends within the market would be beneficial. However, our view is that margin would be a better measure of profitability for investment advisory businesses than return on capital employed.

Hypotheses for investigation (theories of harm)

A. Demand side and information issues

Customer characteristics

As noted above we agree that it is very important to understand the differences between pension schemes as their requirements vary due to a number of factors not just their size.

Trustee/employer engagement

As noted above, we agree that a survey of pension scheme trustees should be undertaken and that these need to take into account all different types of pension scheme trustee and their role in relation to the scheme.

We agree that the role of employers is important and needs to be appropriately considered. However, as noted above, the market for consultancy services regarding the implementation and design of pension schemes is considerably broader than that for pure investment consultancy advice. As such if there is any further investigation into this as an area it needs to ensure it takes into account all relevant areas of advice and market participants.

Clarity and comparability of information on investment consultants' fees and performance

We agree that fees for investment consultancy services need to be clear and transparent to the customer. We also agree that information provided about performance needs to be clear and informative. As such we agree with the proposed approach to analysis in this area.

Barriers to switching and tendering

We would observe that one reason for low switching rates could be that pension schemes are satisfied with the service they are receiving from their investment consultants rather than there being barriers to switching. We would also observe that it is relatively easy for schemes, particularly the larger ones, to change their investment consultant compared to other services such as administration.

Trustee/employer capabilities and incentives

The range of different trustees and their varying capabilities is a noted issue and there have been moves in the pension industry to make pension trusteeship more professional. The work of the Pensions Regulator in this area should be taken into consideration, as they have issued substantial guidance on how trustees should manage their scheme advisers. However, it's clear that poor governance and decision making by some trustee boards impacts the demand side.

Complexity

Our view is that the investment advice provided has to be appropriate for the needs of the client and must be able to be explained. A number of factors need to be considered to assess whether or not advice is inappropriately complex but think some assessment is required to determine whether or not the fees being charged are providing value for money. The focus should be on whether the level of complexity meets the needs of the customer and value can be demonstrated. The Pensions Regulator has noted recently that smaller schemes should not ignore more complex products if they could add value to the scheme.'…. simplification should not be used as a substitute for training and you should document your reasons for simplifying. You should also be aware that a certain level of complexity may be necessary to adequately address your scheme's particular circumstances, in which case simplification would not be an appropriate option' – Pensions Regulator March 2017

Impact of demand-side issues on market outcomes

We agree that analysing whether customers are paying higher prices or receiving a lower quality of service may prove to be challenging, particularly regarding quality of advice and we are not aware of a feasible way of effectively analysing this.

B. Conflicts of interest

Moving clients into in-house products (eg fiduciary management/master trusts)

We do not provide fiduciary management services so cannot comment on that aspect.

We note that the sale of master trusts was not highlighted as a potential area of concern by the FCA and as such further analysis should only be undertaken if the wider responses to the Issues Statement indicate that there are causes for concern from clients.

Our view is that the sale of other in-house products, such as an accredited master trust, to a client can be appropriate where it can be shown that the in-house product meets the needs of the client and that the other options available in the wider market have been appropriately considered and explained to the client. The key issue is about transparency.

On the subject of scheme aggregation, we note that a combination of master trusts and pooled investment vehicles will offer the opportunity for smaller schemes to benefit from lower investment costs and/or wider pension services.

Outside business relationships

We agree that an assessment of the analysis undertaken by the FCA is the best initial approach in this area. We would note that where the market participants are FCA regulated they are required to have internal controls in place to identify and mitigate any potential conflicts of interest.

Gifts and hospitality

Again, we agree that an assessment of the analysis undertaken by the FCA is the best initial approach in this area.

C. Barriers to entry and expansion

Our view is that this is a key area for the market investigation and agree with the approach to be taken.

Remedies

The CMA's approach to remedies

We note the CMA's approach to remedies and its list of potential remedies at this early stage of the investigation. As the investigation is at an early stage we have provided some initial thoughts and comments against each of the potential remedies, where appropriate. We would welcome the opportunity to provide more detailed consideration once the investigation has been completed and the potential remedies can be considered in light of the investigation's detailed findings.

Potential remedies on which views are sought

A. Demand side and informational remedies

Insufficient information is available to trustees and employers to compare investment consultants' fees and quality

Require investment consultants to provide clear, consistent information to trustees in relation to all fees

We support this proposal in principal subject to seeing the final conclusions of the market investigation.

Require consistent reporting of fees charged compared to those quoted or estimated

We support this proposal in principal subject to seeing the final conclusions of the market investigation.

Require investment consultants to report all fees to an independent benchmarking service to allow pension schemes and employers to compare their fees to the market

Our view is that a number of factors would need to be considered due to the differences in type of service and consulting models that can be offered in order to identify a consistent defined benchmark. Any benchmark would need to be very clearly defined and we would be concerned that it might not be truly representative of the scope of different types of services that could be provided. An unintended consequence could be a move to a standardised service that fails to meet the needs of a very varied customer base. Our view is that measures to encourage a more effective tender process would be a better option if issues are identified.

Require investment consultants, when providing advice, to be clearer on the impact of a particular course of action on their own fees

We support this proposal in principal subject to seeing the final conclusions of the market investigation.

Ban certain investment consultant pricing practices

Our view is that the key issue is ensuring transparency and client understanding. A ban on certain practices could have unintended consequences and reduce the availability of investment consultancy services to some categories of customer.

Require investment consultants to report on pension fund returns against agreed benchmarks

For the reasons outlined in our response above, we are of the view that it would be very difficult to do this effectively. In addition to the issues highlighted earlier, any requirement would also need to consider the scope of schemes to report on (so as not to increase costs on small schemes, for example), the current disclosure requirements for schemes to report on investment performance in accounts, and the relationship between the investment consultant and the client (as investment consultant is not a reserved role for a scheme, as opposed to Scheme Actuary, you can have more than one consultant advising a scheme, or a consultant advising on a very small aspect of the scheme and not the overall asset allocation.)

Require investment consultants to report the fees of asset managers selected and give details on the extent to which they have reduced fees for the trustees

We support this proposal in principal subject to seeing the final conclusions of the market investigation.

Require investment consultants to report the performance of their manager recommendations based on standardised performance metrics

Our view is that it would be very difficult to develop standardised performance metrics on a scheme specific basis. However, it could be possible to measure investment manager performance across investment consultancies, on a generic basis, based on when they alter their recommendation. However, this covers the smaller part of the role of investment consultants as it is recognised that asset allocation is the much more important decision. Also with more schemes adopting passive, as opposed to active investment strategies, the importance of this area will reduce.

Require pension schemes and employers to provide reviews of investment consultants, with aggregate results shared/available on websites

Our view is that such reviews may not be consistently completed, may not be on a like for like basis and are subjective. As such it is not clear that they would add the value intended.

There is insufficient and/or ineffective tendering and market testing

Introduce mandatory tendering for consulting, fiduciary management services and/or master trusts

We would support this proposal if the market investigation identifies that there is currently insufficient or ineffective tendering in the market.

Establish rules to improve the tendering process

Any rules would need to have sufficient flexibility to be relevant to the full range of pension scheme clients, particularly the smaller schemes, to avoid unintentionally creating a barrier to smaller schemes seeking investment consultancy services due to increased costs. Trustees can easily approach a number of investment consultancies, when they want to replace or benchmark their existing consultant.

Produce standardised off-the-shelf tender documents that smaller pension schemes and employers could (but would not be obliged to) use to make tendering cheaper, easier and more effective

Providing a standard template for trustees to use when requesting proposals would help if it clearly laid out the scope of services, which trustees could easily amend. This will aid the process and could lead to more trustees carrying out reviews if they are able to see the relevant elements of the process. However, it is a relatively cheap process for trustees currently so would not necessary lead to cheaper tendering.

Recommend some form of aggregation/consolidation of pension trusts to benefit from economies of scale

Our view is that this is a matter for the Department for Work and Pensions as further aggregation and consolidation of pension trusts will require legislation.

Trustees are not incentivised to achieve value for money from investment consultants and/or have insufficient experience to discharge their duties

Ensure that trustees have responsibilities for obtaining value-for-money from investment consultants/scrutinising consultants' advice

The issue here would be how to define value-for-money. As an alternative, we think it would be more effective to increase the capabilities of pension trustees so they can challenge and scrutinise their advisors. We would support working with the Pensions Regulator to enhance their guidance and training in this area.

Require the inclusion of at least one professional trustee for each pension scheme/enhance training for trustees

We agree with any steps that increase the capabilities of trustee boards.

Our view is that any steps to enhance training of trustees should be encouraged and should be done in conjunction with the work being undertaken by the Pensions Regulator.

B. Potential remedies to address conflicts of interest

Investment consultants encourage clients to use their fiduciary management services and/or master trust services even if it is not in the clients' best interests

Require investment consultants to give greater clarity to trustees that they are moving into a different arrangement, and that they could seek this service from other firms

We are supportive of proposals that clarify the blurred lines between different services and ensure there is a clear and consistent regulatory perimeter within which to operate.

Require mandatory tendering of fiduciary management/master trust services

We would support this proposal if the market investigation identifies that there is currently insufficient or ineffective tendering in the market.

Prohibit investment consultants from providing fiduciary management/master trust services

We consider fiduciary management and master trust to be very different propositions with very different charging structures, fee levels and conflicts of interest. This needs to be taken into account when deciding whether it is appropriate for firms to offer these alongside consulting services. With regard to investment consulting and fiduciary management, the FCA Market Study indicated there were potential concerns that need to be resolved and we will be interested to see if the current investigation confirms that to be the case before commenting further.

Measures to control prices in relation to master trust services

The existing value for money obligation on master trust trustees should control pricing, especially with the new regulatory oversight regime from the Pensions Regulator. As such our view is that the effectiveness of these existing measures should be considered before further measures to control prices are considered.

Bringing the supply of investment consultancy services and fiduciary management services within the FCA's regulatory perimeter

We are supportive of proposals that ensure there is a clear and consistent regulatory perimeter within which to operate.

<u>*Investment consultants' recommendations are influenced by their business relationships with asset managers*</u>

Require full disclosure of business interests to trustees

We support this proposal in principal subject to seeing the final conclusions of the market investigation.

Impose measures to ensure there is stronger separation of different business areas within investment consultants

We do not provide fiduciary management services so cannot comment on that aspect.

<u>*Investment consultants' recommendations are influenced by hospitality*</u>

Impose limits on the value of hospitality that investment consultants are allowed to receive from asset managers

We support this proposal in principal subject to seeing the final conclusions of the market investigation.

Impose limits on the type of hospitality eg legitimate business meetings and conferences only

We support this proposal in principal subject to seeing the final conclusions of the market investigation. It will be important to ensure definitions are clear and to consider the objective of specific items of hospitality.

Require full disclosure of hospitality received to trustees

We are not convinced of the value to trustees of full disclosure of all hospitality and believe that clear definitions and limitations would be more effective.

Impose an outright ban on hospitality

Our view is that an enhancement of controls to ensure any hospitality is reasonable and has a legitimate business purpose would be more effective. An outright ban may have unintended consequences and reduce the opportunity for investment consultants to engage with asset managers and positively influence them for the benefit of their underlying customers e.g. through fee negotiations, discussions regarding product developments, etc.

C. Potential remedies to address barriers to entry and expansion

Introduce mandatory tendering for investment consultancy services and/or fiduciary management services

We would support this proposal, in principal, if the market investigation identifies that there is currently insufficient or ineffective tendering in the market. However, the type of client and the specific service being purchased would need careful consideration to ensure a proportionate approach is taken.

Require divestiture of investment consultancy services

This is a significant proposal that would require careful consideration and clear evidence to support it.

Basic FCA accreditation scheme to provide certification of smaller consultants

Our view is that any accreditation scheme should be applicable to all consultants regardless of size to ensure a consistent approach.

We look forward to working with the Competition and Markets Authority as its investigation progresses and the opportunity to provide further comments once the initial investigation is complete.

Yours sincerely

Tim Green
Risk & Compliance Director