CMA investigation into investment consultancy services and fiduciary management services – Response to the Statement of Issues

12 October 2017

1. Introduction

1.1. This submission is made by Lane Clark & Peacock LLP ("LCP") in response to the Statement of Issues, published on 21 September 2017 by the CMA. The Statement of Issues sets out the initial hypotheses of harm and potential remedies to address any adverse effects on competition the CMA may find in its investigation into investment consultancy services and fiduciary management services.

1.2. We welcome the opportunity to comment on the Statement of Issues.

1.3. This document contains LCP's confidential information/business secrets, disclosure of which might significantly harm the legitimate business interests of LCP for the purpose of Section 244(3) (a), Part 9 of the Enterprise Act 2002.

1.4. In our view, the supply of advisory investment consultancy services is generally conducted in a competitive and innovative environment, although there are some areas to be addressed and we look forward to seeing the CMA's analysis and proposed remedies.

1.5. We believe that there are a number of issues with the market for fiduciary management services that will benefit from the CMA's investigation.

1.6. Although LCP does not offer fiduciary management services, our business is affected by how this market operates. We also have a number of clients invested with fiduciary managers. We are regularly asked to advise on the selection and monitoring of fiduciary managers due to our independence, lack of conflicts of interest in this area and wider knowledge of the asset management industry.

1.7. In our response, we give comments on the following key aspects of the Statement of Issues:

- Background to the investment consultancy market.
- The theories of harm – we comment on whether we believe the areas highlighted are leading to adverse effects on competition; the extent to which LCP addresses any of the issues raised; and, our view of the extent to which the market as a whole already deals with the issues.
- The potential remedies – we comment on the effectiveness and proportionality of the potential remedies.

2. Background to the investment consultancy market

2.1. The CMA has provided a high level review of the investment consultancy market in its Statement of Issues and we will not replicate that here. We do think it is worth making a few general points that may assist the CMA with its investigation.

2.2. The investment consultancy industry is characterised by innovation, sophisticated analysis and dedicated people who have a keen understanding of the issues affecting their clients, and who are effective at communicating these and delivering appropriate advice.

2.3. Pension scheme clients comprise the largest group that purchase investment consultants' services. Other client types include charities, insurance companies and endowments. Our response focuses on services offered to pension schemes, but much of the content is relevant to other clients.

2.4. Investment consultants, and the wider pensions consulting industry, are focused on the ultimate aim of securing benefits for members. The industry is characterised by all stakeholders to a scheme working collaboratively to that end.

2.5. Investment consultants offer a wide variety of services and each client will use its consultant in different ways. In Appendix A we provide some examples of real client situations, our services to them and our experiences of dealing with them, to highlight the variety and complexity of investment consulting services.

2.6. Decisions by our clients, and our advice to them, needs to balance the needs and the interactions of different stakeholders – for pension schemes, this is principally between the trustees and the sponsoring employer working together for the benefit of scheme members.

2.7. In providing investment advice to pension scheme clients, there is a wide range of factors that need to be balanced against one another; these include: the existing level of funding; potential returns; availability of cash and expected cash outflow; contingent payments, other forms of security such as guarantees, or contributions from the employer; investment risk appetite and risk capacity (of both the trustees and the sponsoring employer); and, wider operational and covenant risks. Investment consultancy is not investment management and it is unusual for the objective to be solely the maximisation of returns; it is about assessing the sometimes competing factors noted above to develop a suitable strategy for delivering an overall objective or set of objectives.

2.8. The objective or objectives will likely change over time as circumstances develop and the relative importance of the different factors change – e.g. a scheme close to buy-out (i.e. close to securing all benefits with an insurer) may no longer place great reliance on generating excess investment returns, but may instead seek to manage risk and security for members and be more focussed on holding assets which are easier to pass on to an insurer.

2.9. Investment consultancy is, in our view, often closer to a risk management function than to investment management. See Appendix A for some examples.

2.10. There are substantial differences between investment consultancy services with respect to an advisory-only relationship and a fiduciary management service. The former, is an advice-only offering while the latter is a discretionary service to manage a portfolio of investments. The issues facing these markets are, to a large extent, distinct and the potential remedies to any shortcomings in one may be of no or limited relevance to the other and could even be harmful.

2.11. The CMA's Statement of Issues refers to **"investment consultants"** in many of the potential remedies. The definition of investment consultants includes any firm offering either investment consultancy services, fiduciary management services or both. Given the different nature of these services, we have highlighted some of the key differences and indicated where the CMA may wish to consider the issues and potential remedies separately.

2.12. For clarity, we offer a summary of the services offered by investment consultants below. Only the services in italics are referred to in the FCA's Terms of Reference in its market investigation reference[1].

2.12.1. ***Investment consultancy services*** – advice to decision makers of an institution on investing its assets. This is an advisory-only service and the client may choose to accept or reject that advice. These services generally involve providing education, analysis and recommendations to allow the client to make an informed decision on what is believed to be the best option for the scheme given its circumstances. To highlight specifically the advisory nature of this service, and to avoid confusion with the CMA's definition of "investment consultants" as referred to above, we sometimes refer to this as advisory investment consultancy services in this document. These services may include advice on:

2.12.1.1. **High-level risk-management** – the governance structure of the client's decision making bodies; setting high-level risk constraints and return objectives; setting measures and objectives for mark-to-market risks (e.g. pension scheme funding level); planning "flightpath" changes to risk and return objectives (e.g. if a scheme's funding level improves by more than expected under the funding plan, lock in the unexpected "good news"); securing members' benefits through a buy-out or buy-in with an insurance company; *managing risk*; drafting the Statement of Investment Principles; collating information for financial accounts; assessing the *suitability, implementation and monitoring of a fiduciary manager.*

[1] FCA, Asset Management Market Study Final Decision: Market Investigation Reference (MIR) on investment consultancy services and fiduciary management services

2.12.1.2. **Implementation** – *strategic asset allocation*; *strategy selection* (e.g. how to allocate the agreed allocations to asset manager mandates); *different types of investments* (e.g. use of pooled vehicle or segregated account); tactical asset allocation; *manager selection*; fee and contract negotiations with a manager; custodian selection and fee negotiations; transition of assets between mandates; manager monitoring; operational monitoring; and cost control.

2.12.2. ***Fiduciary management services*** – discretionary management services for the management of a portfolio of assets. These services fall, broadly, into two versions: full-fiduciary and partial-fiduciary. **Full-fiduciary** is a discretionary mandate to implement some or all of the services under "Implementation" above for all of a scheme's assets. **Partial-fiduciary** is a discretionary mandate to implement these services for only part of the assets, for example, a single asset class. In our view, there is little distinction between a partial-fiduciary service and an asset manager offering a fund-of-fund (or manager-of-managers) product.[2]

2.13. Note that some investors, and pension schemes in particular, are not able to delegate responsibility for the services under "high-level" risk-management. How scheme assets should be invested at a strategic level should be decided by the trustees[3]. For example, trustees are able to delegate the management of all assets to a single fiduciary manager; but the return objectives and risk constraints that this fiduciary mandate contains must be decided by the trustees.

2.14. Trustees need to budget their time according to the potential impact of a decision on member outcomes. Different decisions made about client assets, regardless of whether these are made by trustees, fiduciary managers or asset managers, have different levels of impact on the outcomes.[4] In particular, the evidence suggests that overall, the biggest impact relates to asset allocation decisions, with manager selection decisions having a modest impact on the outcome for most pension schemes[5]. We help our clients focus time on the factors that we believe will make the most difference to their financial outcomes. Clients generally have limited governance budgets and so trustees are generally well-advised to spend less time thinking about which managers to appoint, and more time on strategic asset allocation and related issues – e.g. being prepared to take advantage of de-risking opportunities as and when these arise.

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[2] A fund-of-funds is an investment fund that itself invests in other funds. In many cases the fund-of-funds' manager will select underlying third-party funds. A manager-of-managers product is a similar concept implemented through segregated accounts rather than pooled funds.

[3] Page 9. Investment guidance for defined benefit pension schemes, The Pensions Regulator, March 2017.

[4] Page 11. Investment guidance for defined benefit pension schemes, The Pensions Regulator, March 2017.

[5] See for example the important paper by Brinson, Hood, Beebower, Determinants of Portfolio Performance (1986)

2.15. Asset management products can be seen, to some extent, as a way to implement particular desired asset-level exposures. In most cases, whether the manager outperforms the benchmark / objective for that asset class has materially less impact on the overall performance than asset allocation – i.e., it is far more important to consider what assets the scheme overall is invested in, taking account of factors such as those outlined in 2.12.1.1 above. We advise on manager selection with regard to ensuring that assets are managed professionally, in accordance with the relevant objectives, and in a risk-controlled way. Selecting a manager that will outperform its peers or a benchmark is certainly part of the aim, but we recognise there are constraints to achieving that.

3. Theories of harm

3.1. The CMA has set out three main areas it wishes to investigate under its theories of harm.

Customers cannot effectively assess, compare or switch consultants

3.2. We think the issues raised under this theory of harm are generally very different for advisory investment consulting services and fiduciary management services. Accordingly, we think the CMA should analyse them separately. Generalising remedies across these different types of business may not lead to the optimal outcome in either case.

3.3. We welcome any initiative to improve the advisory investment consultancy services and the fiduciary management markets as a whole for all clients and ultimately the benefit security for pension scheme members. We recognise that improvements can be made by the industry in the information supplied to clients to help them make better informed decisions.

3.4. In general, we find that most clients are able to make a well informed decision when acquiring investment consultancy services. We generally receive detailed and insightful questions on our approach, capability, fees and performance from prospective clients, in writing and in person, during a tendering exercise.

Fees

3.5. We always aim to provide transparency to our clients on fees for investment consultancy services. We either agree with our clients a fixed fee for specific projects in advance, or charge on a time-cost basis. In many cases, our clients prefer fixed fees so they have greater transparency, certainty and control over costs. Our charge-out rates are provided to clients and prospective clients and regularly compared with peers, for example by obtaining feedback in tender processes. We also provide regular (typically monthly) updates for our clients summarising the work undertaken and associated fees so it is clear how they have spent their advisory budget.

3.6. We see many pressures from clients to reduce our fees. In advisory investment consultancy services the fees are not usually based on a percentage of assets and the fee is invoiced directly – rather than taken from assets (which is often the case for fiduciary mandates and the asset management industry generally). Both of these factors mean clients are very aware of the fees charged and experience tells us they are sensitive to their level. In comparison to other service providers to institutional investors such as asset managers, and particularly relative to the potential impact on long-term financial outcomes, investment consultants' fees are low. This is reflected in the relatively small industry-wide fee revenue of £242m[6]. This compares to approximately £7.6bn in fee revenue that asset managers generate from the £1.6tn of assets that investment consultants provide advice on[7].

3.7. From our work advising on fiduciary mandates, there are some improvements we would like to see in fiduciary managers' fee transparency. In some fee models, the client pays a fixed ad-valorem percentage of assets to the fiduciary manager, who pays the underlying managers from this revenue. There is, therefore, the potential for fiduciary managers to improve their income and profitability by selecting "cheaper" managers; this is a potential conflict of interest. We would like to see a requirement that fiduciary managers disclose their own net fee each year ex-post.

3.8. There is a similar issue with Master Trusts[8] where transparency of the fees paid to underlying service providers is generally poor.

Measures of performance

3.9. All of our advice is highly bespoke to the client, and is purely advisory – typically the outcome agreed (i.e. the client's decision informed by our advice) is the result of collaboration / discussion between us, the trustees and the employer. On occasion, some clients choose not to accept our advice (or change the objectives), or at least not all of it or there may be more than one suitable solution. Our advice frequently has to take account of complex, changing circumstances. As with, for example, legal advice, our advisory services do not lend themselves well to purely quantitative measurement of the quality of advice, being highly contextual and subjective to the specific client and its circumstances.

3.10. All our advice balances risk and outcomes – so helping a client avoid an unfavourable outcome can be just as important to one investor, as achieving a given level of investment return is to another.

[6] FCA, Asset Management Market Study Final Decision: Market Investigation Reference (MIR) on investment consultancy services and fiduciary management services. Based on 12 of the largest consultancies, relating to investment consultant advice.

[7] LCP calculation based on the FCA Asset Management Market Study Interim Report finding that the average fee on institutional investors is 0.63% for active products and 0.15% for passive, with 68% of assets managed actively.

[8] A Master Trust is a form of multi-employer occupational trust-based pension scheme established under trust and intended for use by employers that are typically not connected with one another. Master Trusts involve a single provider managing a pension arrangement for multiple employers under a single trust arrangement.

3.11. We believe clients understand the difficulties of measuring performance for investment consultancy services. We are only rarely asked about a quantitative measure of the performance of our advice.

3.12. In both advisory investment consultancy services and fiduciary management services, there are some areas that could be measured quantitatively and we comment on each of these in the potential remedies in section 4 below.

Barriers to switching and tendering

3.13. We do not see particularly high barriers to clients switching and tendering for investment consultancy services – in fact, of all the pensions advisory services (e.g. administration, actuarial, corporate etc.) that firms such as ourselves provide, investment consultancy services are seen as the easiest to transfer elsewhere. We see a fairly regular stream of opportunities for new clients and have been successful at persuading clients to replace their existing investment consultant.

3.14. We have seen very few clients switch providers of a full-fiduciary product. Switching full fiduciary providers is potentially complex and costly. Some portfolios include illiquid assets that could take many months to liquidate. In switching, a client could potentially incur substantial transactions costs and spend time not invested in the markets as the transition was processed.

3.15. We do see some benefits in clients having a long-term relationship with an investment adviser (of both types). The adviser having detailed knowledge of the background to a scheme is valuable to clients. There are also benefits to a scheme taking a long-term perspective on its portfolio and receiving consistent advice over time.

Trustee/employer capabilities and incentives

3.16. In our view, clients generally have sufficient experience and knowledge to judge the abilities of their investment consultant. Increasingly, trustees have appointed a professional trustee to their board to add experience and expertise, especially where the trustee board lacks certain expertise. We are frequently challenged by clients on our advice. It is rare that a client will accept advice that he / she does not fully understand. One of the challenges we face is explaining technical details in terms that a non-expert will understand, so that clients can appreciate the advice and any recommended course of action. In our view, advice that is overly-technical such that the client is unable to understand or challenge it, is likely to lead to an unhappy client and would not be good for our business (given that clients can easily switch provider).

Conflicts of interest

3.17. We have developed our business and aligned our incentives to reduce conflicts of interest and to provide clear and objective advice as far as possible. We have taken an active decision not to offer fiduciary management services, Master Trust services or services to asset managers (in their capacity as asset managers).

3.18. From time to time, we have debated internally whether we should offer a fiduciary management service, but each time we have concluded that our clients are best served with our provision of independent advice.

3.19. In the sections above on performance measurement and in Section 4, we note that we believe that measuring the performance of advisory investment consultancy services via a purely quantitative approach is not the most appropriate method. Given this, the consequences of providing advice that may be conflicted cannot easily be measured or detected. It therefore becomes even more important to remove conflicts of interest as far as possible to give clients confidence that they are receiving unbiased advice.

3.20. We consider that there are conflicts of interest in providing both investment consulting services and full or partial-fiduciary management services. A few perceived key areas of conflict are:

3.20.1. An investment consultant may advise a client to convert from an advisory relationship to an affiliated full-fiduciary management relationship without proposing that the client take independent advice on first, whether using a fiduciary manager is suitable for them, and second, whether the affiliated fiduciary manager is the best choice for them. The 2016 KPMG UK Fiduciary Management Survey[9] indicated that only 33% of new fiduciary manager appointments were advised on by an independent third party. This suggests that the majority of clients moving from advisory to fiduciary management are not taking independent advice on the appropriateness of the move, nor on the choice of fiduciary manager.

3.20.2. An investment consultant may advise a client to use an affiliated manager under a partial-fiduciary mandate, to invest part of its assets. The client may not take independent advice on the use of the fiduciary manager or the affiliated adviser may not design the most competitive selection process which may increase the chance its affiliated fiduciary manager is selected.

3.20.3. An investment consultant, having advised a client to use an affiliated manager under a partial-fiduciary mandate to invest part of its assets, may find it difficult to advise that client to move its fiduciary mandate should the affiliated manager perform poorly.

3.20.4. An investment consultant that provides both investment consultancy services and full or partial-fiduciary management services to a scheme may be conflicted in proposing that the trustees consider securing some or all of the

[9] 2016 KPMG UK Fiduciary Management Survey.

members' benefits via an insurance policy, since this would reduce the asset base on which remuneration is received.

3.20.5. An investment consultant that provides both strategic asset allocation advice and partial-fiduciary management services to a scheme may be conflicted. The strategic asset allocation will affect the amount of assets managed by, and fee paid to, the fiduciary manager.

3.20.6. An investment consultant that provides strategy selection advice and offers fiduciary management services has, potentially, the incentive to advise the creation of a complex portfolio. If, due to the complexity, the governance burden on the trustees of monitoring the portfolio becomes too high, then appointing a fiduciary manager to take on much of the responsibility becomes more attractive.

Moving clients into in-house products

3.21. We have been approached by clients asking for an independent review of advice provided by their current investment consultant proposing a move of assets to that consultant's in-house fiduciary manager. We welcome The Pension Regulator's recent guidance that clients should have an independent review and monitoring of a fiduciary manager[10].

3.22. At some firms, a fiduciary management service has developed out of an investment consultancy services business. We have some sympathy for the argument that the fiduciary manager is merely implementing the advice given to clients, and doing so in an efficient manner. We think fiduciary management is suitable for some clients and, for them, can improve decision-making, reduce costs and improve outcomes.

3.23. We do, however, consider fiduciary management as an asset management service and directly compare full and partial-fiduciary management services offered by consultancy businesses to those offered by asset managers; including fund-of-funds products, where applicable.

3.24. We think managing the conflicts of interest in offering both investment consultancy services and a full-fiduciary management service to the same client is very difficult and in our view, some separation of these services may enhance competition and benefit the end user.

3.25. We believe the conflicts of interest in offering both advisory investment consultancy services and a partial-fiduciary management service are, generally, even more difficult to manage. Given likely remuneration structures, we would anticipate that an in-house investment consultancy service could have the incentive not only to

[10] Page 15. Investment guidance for defined benefit pension schemes, The Pensions Regulator, March 2017.

recommend the in-house product, rather than a competitor, but also to allocate more to that asset class when recommending a strategic asset allocation.

Outside business relationships

3.26. We do not offer services to asset managers in their capacity as an asset manager – we do have asset manager clients to whom we provide advice on their pension scheme or other areas not directly related to the products offered to pension scheme clients[11]. We do not take payment from managers attending conferences organised by us.

3.27. We do work closely with asset managers to help develop products that will be of value to our clients and the pensions industry more generally. By bringing our understanding of clients' circumstances together with managers' investment and sourcing skills we can improve the likelihood that products are developed quickly which meet a clear client need. We find that managers are open to engagement with us on such matters in part because of our independence. We consider this to be part of our service to clients and receive no remuneration from the asset managers for this.

Gifts and hospitality

3.28. We recognise that gifts and hospitality have been a part of the investment consultancy industry. We believe the scale and frequency has reduced over time, but recognise that more can be done to remove any impression of conflicts arising from accepting hospitality.

3.29. As noted in 3.27 above, we often work with asset managers to develop approaches and products that benefit clients. It is, therefore, beneficial to clients that we have a good working relationship with asset managers. We often find that informal meetings are a good way to do this. Without the specific time constraints of formal meetings and without a particular agenda to address, investment discussions are often broader and more forward looking. We do recognise though that this does not require hospitality to be provided.

3.30. We have a gifts and entertainments policy. We regularly review any gifts and hospitality received and monitor that no single manager or consultant is providing / receiving gifts / hospitality at an inappropriate level.

Barriers to entry

3.31. We do not see significant barriers to entry or expansion for advisory investment consultancy services. As noted in 3.13 above, clients can easily switch between providers of investment consultancy. We, and others, have been able to grow our

[11] We provide services to asset managers unrelated to their investment funds / services. For example, we may advise; the trustees of a pension scheme, where the sponsoring employer is an asset manager; the asset management company on its pension scheme; and, an insurance company that has an asset management subsidiary.

businesses over recent years. We have had many successes in persuading clients to appoint us, including replacing one of the “big-three” consultancies, driven to some degree by the launch of the big three’s fiduciary management services and the associated concerns regarding conflicts.

3.32. We believe that for some potential clients at least, the desire to appoint an investment consultant who has a clearly stated position on independence has helped us to grow our business in recent years.

3.33. Most of our clients use only one investment consultant (although it is fairly common for the sponsoring company of a scheme and the trustees of the scheme to each appoint a different investment adviser, especially among the larger pension schemes.) We have seen only a limited numbers of clients appoint different investment consultants to take on specialist projects.

3.34. Market concentration is primarily due to historic mergers of firms. This concentration is slowly reducing. Our main competitors other than the big-three are well resourced firms with experienced individuals. The industry employs highly talented people and this extends into the smaller firms. We see few inherent barriers to expansion in the investment consultancy services industry.

3.35. One of the biggest barriers to entry is the scale of the research function needed to research and monitor asset management products for clients. This barrier has reduced somewhat over recent years as providers of data and improved use of technology has meant delivering an effective research function is easier and less capital intensive.

3.36. We see barriers to clients switching Master Trusts. The administration and investment management services are generally bundled making it more difficult for a client to change provider of its scheme. Even if the client does decide to change provider, it may only be able to direct future contributions to the new provider and may not have the power to move existing assets. Without being able to offer a transfer of the existing assets, the client has no bargaining power with any new Master Trust provider.

4. Detailed responses to potential remedies

In this section, we comment on the anticipated effectiveness and proportionality of each potential remedy. Our responses here, to some extent, assume that in the course of its investigations the CMA has found an adverse effect on competition and is proposing the remedy to address it. This assumption may be at odds with our view expressed in section 3, and, in any event, we note that the potential remedies considered in the CMA’s Statement of Issues are purely hypothetical at this stage.

Potential remedy	Our comments on the potential remedy
Information and demand side issues	
Require investment consultants to provide clear, consistent information to trustees in relation to all fees	**Investment consultancy services** – we have no objections to this remedy. We would caution against requiring a standardised or overly restrictive charging structure in light of the highly bespoke and client-specific nature of the services in question where a more flexible approach may benefit the client. **Fiduciary managers** – we think it may be helpful for fiduciary managers to disclose their net fee each year ex-post; and disclose revenue for any related business involved in the delivery of the fiduciary service, such as a fund platform. Similarly, it may be helpful for providers of Master Trust services to be more transparent on the fees paid to service providers and those retained by the company running the Master Trust. There is a potential agency problem, with the employer selecting a Master Trust service provider, but with the member of the DC scheme (typically) paying the fees. Greater transparency would help this issue.
Require consistent reporting of fees charged compared to those quoted or estimated	We are not averse to this proposal in principle as long as it does not constrain the client's ability to be flexible in how they engage with their advisers and pay for services. Certain projects we undertake cannot be scoped out in full, in advance. We typically use a time-cost approach for such work to share the risk with our client that the project is more complicated than originally envisaged. If this remedy were to make it more attractive for us to quote only fixed fees for projects, it is likely that we would tend to quote a higher fee to be compensated for taking on the risk of the project taking more time than first thought.
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	**Investment consultancy services** – we think this proposal is inappropriate. There is no standard service package for clients and hence the fees vary widely depending on the services required and the complexity of the particular piece of work. **Fiduciary management services** – we think the proposal would be effective. The definition of the service being delivered by fiduciary managers, whether it is full-fiduciary or partial-fiduciary, can be defined in a reasonably straight-forward way. A published database of fees for these services may therefore be more appropriate. However, it may reduce profitability and breadth of suppliers of independent reviews of fiduciary managers, who would otherwise be able to provide this fee monitoring service to clients for a fee.

Require investment consultants, when providing advice, to be clearer on the impact of a particular course of action on their own fees	We have no concerns with this potential remedy. We consider it part of our role to highlight immediate and likely foreseeable future costs (including our own fees) of following any course of action.
Ban certain investment consultant pricing practices	**Investment consultancy services** – we are not aware of any pricing practice that we believe should be banned. As long as it is clear who is paying, how much each party is receiving, and the potential conflicts are managed so as not to create perverse incentives or restrict certain managers from participating, we see no problem with innovative pricing models. **Fiduciary management services / bundling** – offering both investment consultancy services and fiduciary management services under a bundled fee: if the client is given good information on transparency of fees, we do not see the need to ban this practice. (But please note our response to a potential remedy on whether a bundled service should be permitted at all in the Conflicts of Interest section.)
Require investment consultants to report on pension fund returns against agreed benchmarks	**Investment consultancy services** – we do not think that this remedy would be effective at improving clients' ability to select an investment consultant. We cannot envisage a standardised quantitative measure that would create a comprehensive metric to judge the quality of advice between different consultants and across different clients. The measurement of performance, as with all bespoke consultancy services, is a difficult problem. Like legal or management consultancy services, all of our advice is highly tailored to the client, and is purely advisory – clients may choose not to accept at least some of it – and often needs to find a balance between different parties, such as the needs of trustees and constraints on, and support from, sponsoring employers. Any measure of performance in terms of an investment return is likely to be the average from a very wide distribution and it may be inappropriate to draw any conclusions from it. We firmly believe the "added value" in the asset allocation advice is not simply the excess financial return from this advice. Asset allocation advice to DB pension scheme trustees should take into account many elements, including the timing of liability payments, the scheme's financial position versus one or more metrics, the attitude of the trustees to risk and/or complexity, the strength of the sponsor's covenant, regulations, the scheme rules and available practical ways to implement the selected investment portfolio. The relative importance of each of these factors varies considerably between pension schemes. The Pensions Regulator sets out many of the factors that trustees should consider in investing assets in its recent guidance for DB schemes. Similarly, for DC schemes, the strategic advice on asset allocation of a default option is impacted by various factors, including: the nature of the workforce, contribution levels, scheme size, and sponsor views.

	Measurement of the "value added" by the advice, ideally, needs to take into account all relevant factors. An overly simple, standardised way to measure asset allocation advice, which focuses only on the financial return, could encourage consultants to recommend portfolios with inappropriate levels of risk in order to maximise returns, which may not be in the best interests of the clients or members of the pension scheme. In addition, advice from investment consultants is usually based on very long-term investing – our advice is often based on achieving an investment objective over 15 year periods or longer. The advice is not attempting to create a portfolio that will outperform an alternate portfolio over shorter (and somewhat arbitrary) measurement periods. Risk-adjusted returns may be more appropriate, but these metrics usually measure the volatility of portfolios, which is unlikely be a good proxy for the key risk a pension scheme runs: an unacceptable outcome at a future date, possibly decades away. An alternative to providing a quantitative measure of returns as the performance of investment consultancy services could be a best-practice score of the percentage of clients that can demonstrate they have considered each of the relevant factors in investing their assets in each year. This could reference particular points in, for example, The Pensions Regulator investment guidance for DB[12] and DC[13] schemes and its framework for Integrated Risk Management[14]; and the Myners principles[15]. This approach is consistent with our view that investment consultancy services are more like risk management than asset management in nature. The danger is that any single quantitative measure could be used inappropriately as a means of judging the overall level of performance of a provider of investment consultancy services. There is a risk that clients or potential clients could make poor decisions on selecting an investment consultant based on this measure because it is one of the few quantitative measures available. As with any professional service, choosing an investment consultant is unlikely to be best achieved by focusing on one aggregate measure. **Fiduciary management services** – the potential remedy is more appropriate here. Many of the key decisions on, for example, the level of risk that can be tolerated and the return objective, are made by the trustees. These are then given to a fiduciary manager as an investment objective, which it can be measured against. Performance of partial-fiduciary management can and should be measured in a similar way to asset management, i.e. relative to a benchmark for the asset class – accepting the associated shortcomings of this. However, full-fiduciary mandates should, arguably, be longer-term than many other asset management objectives; any measure of performance may be too short-term to be meaningful.

[12] Investment guidance for defined benefit pension schemes, The Pensions Regulator, March 2017.

[13] Code of practice no: 13, Governance and administration of occupational trust-based schemes providing money purchase benefits. The Pensions Regulator, July 2016.

[14] Regulatory guidance. Integrated Risk Management, The Pensions Regulator. Dec 2015.

[15] Updating the Myners Principles: a response to consultation, HM Treasury, DWP, The Pensions Regulator. Oct 2008.

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	**Investment consultancy services** – we do not think this proposal is practical nor provides meaningful information and could even lead to increased asset management fees. It is not obvious what the benchmark fee could be. The headline fee quoted by managers may not reflect an expectation of the manager, but rather an initial negotiating position, so may not be appropriate. Using this measure as the "benchmark" creates an incentive for both the asset manager and the investment consultant to increase the headline fee, to demonstrate larger discounts – this could lead to higher actual fees for some clients. In practice currently, for every mandate, we do assist clients in negotiating fees at the time they appoint a new manager. As part of ongoing monitoring, we review asset manager fees for most clients. Where we expect that multiple clients will invest in the same fund, in a relatively short period, we will try to negotiate a reduction based on the expected size of assets in aggregate, so for example, if assets reach certain levels then fee discounts will be given to all clients. In some cases, when our clients have, in aggregate, a meaningful amount invested, we will subsequently put pressure on managers to reduce fees for all clients. Ultimately, we are not a party to the client / manager contract and can only go so far in negotiating the fees for our clients. We believe that fees are important, particularly within DC arrangements in which, unlike DB, the fees taken by the manager have a direct impact of the members' ultimate level of benefits. On a regular basis, we therefore survey fee levels in the investment management industry and provide this publication to both our clients and the wider pension industry. **Fiduciary management –** the same issues apply to fiduciary management as investment consultancy services. Here, of course, the fiduciary manager is responsible for the manager selection and fee negotiation. Disclosing the fee paid to each manager in a fiduciary portfolio would be useful information for trustees and their providers of investment consultancy services.
Require investment consultants to report the performance of their manager recommendations based on standardised performance metrics	**Investment consultancy services** – We are not strongly against this potential remedy. Providing manager recommendations for each asset class is an important part of our role. Typically, though, over the longer term, manager selection does not have a significant impact on the performance of a client's portfolio[16] and this measure may be used inappropriately as an overall measure of the performance of an investment consultant. Increasingly, some of the asset classes used by DB pension schemes do not have explicit benchmarks or have flaws in the benchmarks that would make this type of comparison inappropriate. DB pension schemes invest much of their portfolios into liability driven investments, real estate and other private assets that do not have well defined benchmarks or have significant

[16] As stated in section 2.14 investment outcomes are predominantly impacted by asset allocation, rather than the choice of one manager over another.

	flaws in the standard benchmarks. There is also increasing use of bespoke fixed income portfolios designed around matching the specific benefit cashflows of the particular pension scheme client. Thus in the context of DB pension schemes, this comparison, of recommended fund returns versus appropriate benchmarks, can only be done on a shrinking portion of the assets. For DC pension schemes and other investors, listed equity and standard fixed income mandates are more common and the comparison with benchmarks here is more appropriate. There are many considerations in selecting managers that do not relate directly to an ability to outperform either their peers or benchmarks. In some cases, there is a complex interaction between asset allocation and manager selection. The selection of a manager is often influenced by considerations of other elements in the portfolio. The decision making process is not always as straightforward as simply setting the asset allocation and then selecting managers to fill these weights. Adjusting the asset allocations may depend on the style of manager; or, conversely, selecting a manager with a style that is complementary to the other managers held. There are also considerations as part of the due diligence process to only select managers and funds that have reached minimum standards for operational due diligence and governance. We consider that these operational reviews have reduced risk for our clients, and driven changes in the industry. This filtering process does, however, reduce the pool of managers that we consider suitable and our chance of selecting an outperforming manager. Another investment consultant that ignored these operational risks may be able to pick a manager with better returns, but these would be subject to an unmeasured risk. **Fiduciary management services** – this remedy is arguably more relevant for fiduciary management. When reviewing any asset manager that creates portfolios using its own underlying research, we would look for evidence that the output from the research is providing above average returns.
Require pension schemes and employers to provide reviews of investment consultants, with aggregate results shared/available on websites	**Investment consultancy services** – we would be happy to participate in the reviews for this potential remedy.

Introduce mandatory tendering for consulting, fiduciary management services and/or Master Trusts	**Investment consultancy services and fiduciary manager services** – we do not believe this is a proportionate remedy and may have adverse side effects. As a company outside of the top-three, this could potentially benefit us, but we do not see a great deal of benefit for clients. The direct costs of changing investment consultant to the client are fairly low. However, there are multiple extra costs for us (and therefore any other consultant) in going through a mandatory tendering process and we are likely to have to pass some of these costs on to clients. Additionally, a new adviser could well recommend changes in the portfolio that will incur significant transaction costs. Although this advice may be given in good faith that these costs will be offset by the benefits of the changes, multiple changes of consultant over time could well be net negative. If the CMA's other potential remedies solve any shortcomings in the market, then this particular remedy should not be necessary.
Establish rules to improve the tendering process	**Investment consultancy services** – it is difficult for us to consider this potential remedy without a specific set of rules that tenders would have to follow. Given the bespoke nature of the services we provide, any rules would need to be fairly generic.
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	We are, in principle, happy to participate in producing these. We have been seeing a greater use of procurement agencies by potential clients, but this has not, as yet, led to more standardisation of questions.
Recommend some form of aggregation/consolidation of pension trusts to benefit from economies of scale	It is not really clear what the proposal is in relation to consultants. A merger of pension schemes is primarily a legal and actuarial issue and outside the remit of investment consultancy. We have developed ways for DB schemes to have some benefits of pooling assets through platforms. Manager fees are generally lower (and normally more than offset the platform fee). Where it makes governance, financial and investment sense to do this, we have been raising this with clients. We have been frustrated that the platforms have not made greater use of this pooling to take advantage of their bulk buying power and negotiate significantly lower fees with asset managers.

Ensure that trustees have responsibilities for obtaining value-for-money from investment consultants/scrutinising consultants' advice	We note that best practice as per The Pensions Regulator guidance for DB schemes and the Myners Principles[17] propose that trustees carry out a review of the advice received and the costs of their investment advisers. As noted above, if clients are dissatisfied with their investment consultant then it is not difficult to switch.
Require the inclusion of at least one professional trustee for each pension scheme/enhance training for trustees	**Investment consultancy services** – we do not think this is appropriate for all schemes. We have no significant objection to this being encouraged more, but some schemes with very simple arrangements may incur an extra cost for little additional benefit and in some cases it may hinder the relationship (perceived or otherwise) between the employer and trustees In many cases, this is an increasing and welcome feature of pension fund trustee boards. The professional trustee generally adds knowledge and experience to a board.
Conflicts of interest	Many of the potential remedies in this section are aimed at resolving conflicts in offering both investment consultancy services and fiduciary management services. We offer only investment consultancy services; we do not offer fiduciary management nor Master Trust services.
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 have no objections to this proposal.
Require mandatory tendering of fiduciary management/Master Trust services	We believe this remedy is disproportionate. We do not see a requirement for mandatory tendering for any asset management product, where the client has the necessary expertise or has sought independent advice in reviewing and monitoring the appointment.

[17] Updating the Myners Principles: a response to consultation, HM Treasury, DWP, The Pensions Regulator. Oct 2008.

Prohibit investment consultants from providing fiduciary management/Master Trust services [to the same client]	We think this is an effective and proportionate way to manage many of the potential conflicts in offering both investment consultancy and fiduciary management services. Where an investment consultant provides a full-fiduciary management service, we would recommend that a client seeks an independent review and monitoring of the arrangement from a different provider. The Pensions Regulator guidance for DB schemes has suggested this approach as a best practice. Where an investment consultant provides a partial-fiduciary management service, we would also recommend that this appointment is monitored and reviewed by an independent adviser. Combinations of specialist services may not have the same direct conflict as the situations above, but may still raise possible conflict issues. For example, an investment consultant providing strategic asset allocation advice and partial-fiduciary management services for a particular asset class, could still have a conflicted incentive to advise on a particular asset allocation. An additional benefit of this potential remedy is that it could create opportunities for smaller, specialist firms to offer *high-level risk management services* only. See our comments on barriers to entry below, but one major barrier is the cost of building a research resource. A specialist provider of this type would not necessarily have the ability to meet this cost.
Measures to control prices in relation to Master Trust services	The default option for the Master Trust's product is already subject to the DC fee-cap. We do not believe there is a requirement for further price control.
Bringing the supply of investment consultancy services and fiduciary management services within the FCA's regulatory perimeter	**Investment consultancy services** – we are unclear on how effective this remedy would be. We have no significant objection to being regulated directly by the FCA for investment consultancy services. We are currently regulated by the Institute and Faculty of Actuaries (IFoA) through the Designated Professional Body system to give any advice that is regulated. Currently, regulated advice is a fairly limited amount of the work we do. We believe the current system offers clients good protection and a proportionate level of regulation for our business but keep the position under review. Many of the services we currently provide – e.g. asset allocation – are not regulated under the FSMA. We understand this proposal to mean that the FCA would develop a definition of investment services that it proposes to classify as regulated. Depending on the scope of this definition, this could prove a barrier to entry, particularly for smaller, specialist consultancies. Some actuarial advice can directly or indirectly influence asset allocation and could potentially be captured by this remedy. It would be disproportionate, in our view, for actuarial services to be regulated by the FCA. It is also likely to mean extra costs for investment consultants, which, at least in part, are likely be passed on to clients. **Fiduciary management** – we are not aware of a way of delivering fiduciary management services outside of FCA regulation.

Require full disclosure of business interests to trustees	**Investment consultancy services** – we have no objection to this proposal as long as it is proportionate and confidentiality issues can be adequately addressed.
Impose measures to ensure there is stronger separation of different business areas within investment consultants	We believe that clients will take greater comfort if investment consultant services are managed at arm's length from fiduciary management services. In combination with the remedies above for which we have indicated support, this would go a long way towards dealing with the conflicts of interest without removing the benefits some clients will see in having a single provider of both investment consultancy services and fiduciary management services. We also believe that services offered to asset managers, in their capacity as asset managers, should be separated from services offered to other clients – who may be potential buyers of the asset managers' services. For clarity, where advice is given to trustees of a pension scheme whose sponsoring employer is an asset manager, we do not think this business requires separating from advice to other trustees.
Impose limits on the value of hospitality that investment consultants are allowed to receive from asset managers	We cannot see any significant issues with any of the potential remedies concerning hospitality. We would like to point out that we often work with asset managers to develop approaches and products that benefit clients. It is, therefore, beneficial to clients that we have a good working relationship, and more informal meetings are often a good way to do this. Without the specific time constraints of formal meetings and without a particular agenda to address, investment discussions are often broader and more forward looking. We suggest a reasonable, limited level of hospitality be permitted, which would, for example, allow meetings in a café or over a sandwich lunch.
Impose limits on the type of hospitality eg legitimate business meetings and conferences only	See above.
Require full disclosure of hospitality received to trustees	See above.
Impose an outright ban on hospitality	See above.

Potential remedies to address barriers to entry and expansion	
Introduce mandatory tendering for investment consultancy services and/or fiduciary management services	See our response to mandatory tendering above.
Require divestiture of investment consultancy services	We believe this is a disproportionate response to the conflict of interest issue and is not required to address any barriers to entry issues. Even if this is phased in over a period of time, it is potentially highly disruptive to clients.
Basic FCA accreditation scheme to provide certification of smaller consultants	**Investment consultancy services** – please see the response to the FCA regulation remedy above. This remedy may work if the scope of services that require full regulation and those that require only basic accreditation can be defined. We would not want to see a difference in the level of regulation based purely on the size of the investment consultant.

Appendix A – experiences with clients

1. Introduction

1.1. In this Appendix we have set out some examples of the clients we have worked with recently in order to demonstrate the range of circumstances faced by our clients and how the service we provide may differ as a result.

1.2. The first example illustrates what we would describe as a "core" investment consulting service to trustee clients, although in practice the scope of services varies hugely. The remainder of the examples are specific client instances.

2. Example – core services

2.1. Generally, our core services would include providing DB UK pension scheme trustees with the following advice.

High-level risk management advice

2.1.1. When setting investment strategy, there is a wide range of factors that needs to be balanced against one another; these include: the existing level of funding; potential returns; availability of cash and expected cash outflow; contingent payments, other forms of security such as guarantees, or contributions from the employer; investment risk appetite and risk capacity (of both the trustees and the sponsoring employer); and wider operational and covenant risks. This work will often include detailed modelling of the assets and liabilities as well as scenario analysis.

2.1.2. Where clients are looking to secure benefits with an insurer, we will advise on the types of assets that meet this objective and hence the types of assets likely to prove attractive to insurers.

2.1.3. Given the mature nature of many pension funds, our strategic investment advice will often focus on de-risking towards an agreed objective – typically a particular funding target. If this is the case, we will include advice on suitable "journey plans", which will typically include time-based de-risking asset switches as well as market / funding-based trigger mechanisms for accelerating the de-risking process, if this is appropriate.

Implementation advice:

2.1.4. Having identified suitable asset classes for the scheme we will help trustees select and monitor appropriate investment managers to manage the chosen allocations on a day-to-day basis. We will also generally review investment manager documentation from an investment perspective.

2.1.5. We often provide clients with advice on how best to implement any changes to investment strategy or structure, for example by advising on how to complete transfers of assets cost effectively.

2.1.6. We will usually provide ongoing monitoring of the scheme's strategy to ensure that it remains fit for purpose and to highlight any important developments to the trustees. This will include advice on how various developments – eg market, regulatory – are likely to impact the scheme.

3. [•]

4. [•]

5. [•]

6. [•]