PENSIONS AND LIFETIME SAVINGS ASSOCIATION

INVESTMENT CONSULTANCY SERVICES AND FIDUCIARY MANAGEMENT SERVICES – COMPETITION AND MARKETS AUTHORITY INVESTIGATION – ISSUES STATEMENT: RESPONSE BY THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

13th October 2017

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

INTRODUCTION

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

The Pensions and Lifetime Savings Association (the Association) welcomes the decision of the CMA to investigate the market for investment consultancy and fiduciary management services. Many members spoke highly of the consultancy services they received, including fiduciary management services. However scheme members (both large and small) have persistently expressed concerns about transparency and alignment of interests in this market.

This response focuses on the indicative results of a trustee survey that we ran with our members, relevant findings from our 2016 Annual Survey as well as some initial observations from conversations we have had with schemes on this topic. We intend to undertake more in-depth analysis to feed into the investigation and look forward to further engagement with the CMA on the broader questions over the coming months.

We hope the investigation will be undertaken in a proportionate and timely manner which prevents avoidable costs and uncertainty for schemes and consultants over the next 18 months.

SCOPE

The advice given by investment consultants in areas such as asset allocation, manager selection and investment strategy has a significant impact on schemes' investment returns. We agree with the decision to focus on pension schemes within the wider range of institutional investors. As pension schemes control such a significant proportion of institutional assets under management in the UK and are key clients of investment consultants, it is sensible for the investigation to concentrate on this area.

We believe the potential detrimental effects outlined in the issues statement are correct. Members have emphasised concerns about reduced innovation in the sector in recent years; that increased scrutiny on levels of scheme governance can lead to trustees – nervous about the potential compliance implications – choosing the 'safe' investment or asset allocation approach which might not always be in the best financial interests of members. Similarly, schemes have raised concerns about how bespoke the investment advice offered by consultants is in practice.

Relevant legislation and regulation

The CMA asks whether there are any legislative or regulatory provisions which have an impact on competition in this market. It is difficult to identify a single root cause. The UK has a highly fragmented pensions system, where many smaller schemes do not have the governance capacity and investment expertise necessary to deal with the many challenges facing both DB and DC schemes.

This has had an impact on the demand side part of the investment consultancy market in two ways: firstly, schemes without internal investment expertise are more likely to rely on the advice they receive from consultants.

Secondly, in an effort to improve governance standards, government and regulators have often regulated to the lowest common denominator, resulting in a highly prescriptive and micro-managerial approach to regulating the actions of trustees, scheme managers, and their advisers. We believe this has potentially led to a more risk-averse and compliance-led approach from trustees, which could result in reduced innovation in the sector as well as a reluctance to choose a relatively new or different provider of investment consultancy services.

It is also likely that wider pressures and the economic uncertainty since the financial crash will have influenced trustees to be more prudent in their fiduciary duties.

The nature of investment consultancy services

The CMA – and the previous FCA reports – identifies a wide variety of services offered by investment consultants, including advice on asset allocation, manager selection etc. However, there should be greater recognition of the fact that many investment consultants also offer operation and support services e.g. detailed reporting on assets, implementation of decisions by trustee boards, or treasury functions.

Investment consultant provision of these support (as opposed to advice) services has implications for the CMA's analysis; consultants often bundle advice and support services together and while this may reduce the governance burden and fees, it potentially also makes it more difficult for trustees to understand the costs of each constituent part. Having one investment consultant which provides both advice and other support may also discourage trustees from switching to another provider, even when there may be clear benefits to doing so for distinct elements of provision.

HYPOTHESES FOR INVESTIGATION

We think the CMA's hypotheses for investigation are sensible. We welcome the continued focus on both the demand- and the supply- side of the market.

Demand-side and information issues

On the demand-side, we agree with the CMA and FCA analysis that there is a range of investment expertise on scheme trustee boards. TPR found that 69% of large schemes felt their non-professional trustees possessed a level of knowledge and understanding that met the TPR Trustee Knowledge and Understanding (TKU) Code.

This dropped to 38% for smaller schemes[1] - however, the relationship between size and good governance is not as clear-cut as this statistics would imply; there are some schemes which are very well governed and examples of larger schemes which are poorly governed.

Our 2016 Annual Survey asked 172 respondents what skills were represented on their board of trustees. The most common was 'financial skills' (90%) followed by 'pensions' (69%) and 'investment' (68%). The most common skill for which trustee boards had training plans was 'investment' (88%) followed by 'pensions' (85%).

There is a clear role for further training of trustees in investment, actuarial and financial skills. However it is unreasonable to expect all trustees, particularly lay trustees, to become expert in investment matters, given the relative infrequency of trustee board meetings.

For further details on trustee capability, scrutiny and behaviour, please see our section on 'The Trustee Perspective' below.

We think clarity and comparability of information on fees and performance is, as with elsewhere in the institutional investment chain, an important area of focus. The CMA should also consider to what extent the gap between trustees' understanding/initial fee reports and the actual fees charged may also be affected by any changes over time in trustees' objectives and the ultimate scale of the service/advice over time.

Conflicts of interest

We believe fiduciary management can offer some benefits for schemes, including reduced governance burden, greater efficiencies and cost savings. However, some scheme members have raised persistent concerns about the potential misalignment of interests where consultants offering investment advice also have an in-house fiduciary management or master trust offering. We understand there have been instances where a scheme's investment consultant was strongly focused on recommending their own in-house offering.

Our members have indicated that over recent years there has been improvement in terms of the culture of corporate hospitality and do not believe this has a significant impact on consultants' recommendations.

THE TRUSTEE PERSPECTIVE: OUR SURVEY

To help inform the CMA's initial thinking and in response to the request for further information on trustee experiences and behaviour, we conducted a survey of trustee members between the 4th and 10th of October 2017. Given the relatively short

[1] *Trustee Landscape Qualitative Research,* A report of the 2015 Trustee Landscape, TPR, 2015.

timescales involved, the rate of response is small[2]. However, preliminary evidence may be useful to shaping the investigation at this initial stage. We will continue to run this and similar surveys with the Association's member groups including employers and investment consultants and would be willing to share relevant findings and analysis with the CMA throughout the course of the investigation.

Respondents included trustee board chairs, professional trustees as well as member-nominated and employer-nominated trustees. Schemes represented range from those with £49m or less in assets under management (AUM) to those with over £5bn in AUM, and from DC, DB and hybrid schemes.

In-house investment advice

The vast majority of respondents (82%) did not use in-house investment advice. Of those which did, popular reasons for doing so included a tailored approach to investment issues, reduced likelihood of conflict of interest and greater accessibility (than external consultants). Respondents with an in-house team were overwhelmingly satisfied with the quality of advice offered. Most reviewed their in-house advisers annually and were confident that they had the appropriate skills to scrutinise cost and performance.

External investment advice

Of those respondents who did not outsource their investment decision-making[3], 100% used an external investment consultant. The most popular reasons for doing so – respondents could choose up to three options – include greater expertise in investment issues (78%), greater expertise in a specific area (70%) and the independence of advice (81%).

63% of trustees were 'very satisfied'[4] with their external consultants, with 37% 'fairly satisfied'. Comments provided about the quality of investment advice included "they bring a disinterested and objective view", "good quality, well presented advice, achieving investment principles" and "Terrific expertise. Detailed appreciation of the scheme's needs". However others noted that "[the advice was] expensive and leads to overly complex structures" and "you don't know if the advice is 100% objective".

Fiduciary management

[2] We received 28 completed responses at the time of writing. The survey remains open and we will feed in further results over the course of the investigation.
[3] Only one respondent outsourced responsibility for their investment decision-making.
[4] Survey participants were asked to give a response on a four-point scale ranging from 'very' to 'not at all' concerned.

48% of respondents had consultants which also provided fiduciary management services. 15% did not, while 37% did not know whether this was a service their consultant provided.

Of those schemes which had consultants which provided fiduciary management, 21% used these services while 79% did not. This is broadly in line with the results of our 2016 Annual Survey where 17% of respondents reported that their scheme used fiduciary management[5] (a small increase from the 11% who reported doing so in 2015).

All those trustee survey respondents which did use their consultant's fiduciary management services were either 'very' or 'fairly' satisfied with the service offered.

Trustee scrutiny and tendering

30% of respondents re-tendered their external investment consultancy services contract every 4-5 years, with 30% re-tendering every 2-3 years and 26% having never re-tendered their contract[6].

In terms of those factors which were important to a trustee board when assessing an external consultant's bid, the overwhelming majority of respondents (63%) said that quality of service was the most important. This was followed by 15% who said it was value for money and 15% citing the relationship with the consultant, while only 4% said that it was cost.

89% of respondents review the cost of their consultants annually. This differs from the findings of our 2016 Survey where 20% of respondents said they received their consultants more often than every two years (58% of respondents review their external consultants once every 2-5 years).

97% of respondents were very or fairly confident that they had the appropriate expertise to scrutinise their consultant's costs, with 89% either very or fairly confident that they had the expertise to scrutinise their consultant on their performance[7].

Regarding how often trustee boards challenge their consultant's investment recommendations, 37% said 'often', 48% 'sometimes' and 15% 'seldom'. No respondents said they 'never' challenged their consultant.

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[5] PLSA Annual Survey 2016. Base: 172 respondents.

[6] Please note we do not have information on how long these contracts had been held for.

[7] We note that this differs from the TPR's findings on TKU mentioned earlier; this could be due to the small sample of respondents.

Experience of misalignment of interests

78% of respondents have not received unnecessarily complex advice from their consultants. Of the few who said they had, specific examples included "often offers range of possibilities without steer, to lead to further work…delays decision-making" and "extension into asset classes that added little in performance or diversity, but did add cost".

Only 19% of respondents were 'fairly concerned' about whether their consultants' recommendations are affected by other business relationships with asset managers with 82% saying they were 'not very' or 'not at all' concerned in this respect. No respondents said they were 'very concerned'. On gifts and hospitality, 92% were 'not very' or 'not at all' concerned that this affected the recommendations of their external consultants. 70% of respondents thought their consultants had provided them with a complete and balanced overview of the alternative external investment advice options.

REMEDIES

Although we understand the rationale behind outlining some potential remedies at this stage in the investigation and we are happy to feed in some broad initial views informally, we look forward to the opportunity to comment further should any adverse effects on competition (AECs) be found.

In general terms, we would recommend caution when it comes to the mandating of specific behaviour as this can often have unintended consequences. As with the FCA's *Smarter Consumer Communications* agenda, we also think the CMA should be mindful that further disclosure for its own sake is not always helpful to trustees. The emphasis should be on clear, standardised disclosure presented in a meaningful way.

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