SEI's response to the CMA's Investment Consultancy Services and Fiduciary Management Services Market Investigation Issues Statement

SEI's business

1. This submission is by SEI Investments Europe Limited ("SIEL"), which is a UK company, regulated and authorised by the Financial Conduct Authority. SIEL, part of the SEI group, is a wholly owned subsidiary of SEI Investments Corporation, a NASDAQ listed company ("SEIC"). This submission sets out SIEL's initial views on the investigation and on the CMA's Issues Statement.

2. SIEL provides a number of services to financial services firms and professional intermediaries, including the distribution of its affiliated Irish UCITS funds (the "SEI Funds"). As an FCA authorised firm, SIEL is subject to the individual capital adequacy assessment process (the "ICAAP"), a summary of which is publically available, and is subject to the Markets in Financial Investments Directive as well as other regulatory obligations.

3. SIEL offers "fiduciary management" services to pension scheme trustees. SIEL's fiduciary management services operate as a distinct business-line, in that there is a dedicated management function, business development and client servicing team within the UK and other SEI group affiliates.

4. Broadly speaking, SIEL's fiduciary management services consist of: strategic asset-allocation advice; recommendation and execution of investment products, including the SEI Funds[1]; and the management of the client's portfolio of investments, including active re-balancing and re- allocation of asset classes.

5. Whether through the SEI Funds or separately managed accounts, SEI is responsible to its clients for the performance of a number of third party managers it has appointed under a delegation arrangement. As such, SEI considers itself to be a specialist fiduciary manager, accountable to its clients for the advice on their portfolio, the implementation of that advice, and the management of underlying investments.

[1] The SEI Funds adopt a 'Manager of Managers' investment approach. This entails the SEI Fund Manager, delegating mandates to a number of third party investment managers. In doing so, the SEI Fund Manager's process entails researching, appointing and monitoring of third party investment managers.

6. As a specialist provider, SIEL does not offer a separate advisory business to pension scheme trustees that have not engaged it for fiduciary management services. SIEL does not, therefore, charge hourly advice fees to clients.

Investment consultants and fiduciary managers

7. In looking at the investment consultancy and fiduciary management services markets, there is an important distinction between:

- <u>investment consultancy as a standalone service</u>: This is the traditional model, and still very common. Investment consultants may advise pension scheme clients to use a fiduciary manager service or another asset management model. Either way, the client's decision will be guided by the investment consultant's recommendation. This area, as we understand it, is the main focus of the investigation.

- <u>fiduciary management services</u>: When a pension scheme decides to use fiduciary management services, the scheme appoints a provider which will provide strategic advice and carry out asset management. Most fiduciary management firms provide asset liability studies, strategic asset allocation advice, and investment reporting which are akin to the services provided by investment consultants. The value of fiduciary management lies in coupling these services with implementation / asset management, to achieve the outcomes intended by the client. In other words, the strategic asset allocation advice and related services cannot be separated from the total service offering that fiduciary management services constitute as a whole without considerable loss of value.

The role of fiduciary management in the market place

8. Fiduciary management providers compete directly with investment consultants to win business from pension trustees discharging their statutory duties under the Pensions Act 1995. Fiduciary management services include strategic advice of the type that trustees are required to obtain under s.36 Pensions Act 1995. Fiduciary management service providers such as SEI, remain accountable for the implementation of the advice they give, as well as the selection and oversight of third-party investment managers. This means clients are not charged for advice under the same pricing

structure as that used by firms providing investment consultancy services as a stand-alone service.

9. The existence of fiduciary management services firms represents a relatively new innovation in the pensions market. SEI's own fiduciary management offering was launched in 2007/2008, as a way to offer clients a value-added package of investment advice, governance and implementation. It was one of the first in the UK market. The development of fiduciary management services is an important and innovative development in the UK pensions market in the last decade.

10. SIEL regularly pitches to pension scheme trustees to win business as a provider of fiduciary management services. It is often the case that it is doing so in direct competition to traditional investment consultants.

11. Trustees who have employed fiduciary management services have identified the benefits to include improved governance and risk management and increased speed of asset allocation decision making and implementation. These advantages are benefits to consumers as well as to trustees[2].

12. For all these reasons, fiduciary management firms are able to offer clients real value by offering these services together, as well as offering an alternative to the traditional investment consultancy model. However, for fiduciary management firms such as SEI to succeed, the services on offer need to be offered as a group and separation of these services would lead to an end to fiduciary management and both its competitive market benefits and real benefits to trustees and members.

The nature of the market

13. In its Issues Paper, the CMA has correctly identified, at paragraphs 31 to 34, some of the key characteristics of the market for the provision of services to pension trustees.

14. The CMA is correct that, as discussed above, there is an overlap in the services offered by investment consultants and fiduciary managers. However, the CMA should be cautious to characterise this overlap, and the lack of a clear definitional boundary between the two, as a symptom of a lack of competition. Fiduciary management is a market innovation in response to the incumbency of investment consultants.

[2] Please refer to Appendix A of SEI's response to Questions 18-21 of the CMA's Market Information request

However, in order to compete, fiduciary managers have to offer trustees a sufficient breath of services to ensure that the trustees are properly discharging their role and statutory responsibilities.

15. The CMA is also correct to identify early the wide range of sizes and types of pension funds. This variety must lead to a diversity of solutions and room to innovate and develop products which are tailored to the needs of particular funds. An outcome which reduced the scope and incentives to innovate would not be a pro-competitive outcome.

16. We agree with the view that trustees' background, experience and skills vary. We include (at Appendix A to this submission) a research study undertaken by SEI in partnership with Dr. Iain Clacher *(Associate Professor in Accounting and Finance, Deputy Director of the Centre for Advanced Studies in Finance at Leeds University Business School and co-chair of the UK Actuarial Profession's cross-practice working party on behavioural economics for actuaries)* entitled 'Governance and Groupthink in UK Defined Benefit Pension Schemes' published in January 2016 which identified a link between the make–up of UK Trustee Boards and evidence of Group Think and its potential impact on pension scheme decision making.

17. We emphasise that the regulatory environment in which pension scheme trustees operate has evolved significantly in the last decade. Trustees' duties are increasing as a result of changes in regulation e.g. trustees are required to undertake a certain level of training. This evolution should result in trustees becoming more knowledgeable and informed than ever. As a result, the issues in paragraph 16 relating to Group Think could go some way to being addressed.

The position of the three largest investment consultants and conflicts of interest

18. The current structure of the investment advice market means that there is little space for firms other than the three largest investment consultants to win business – a feature identified by the FCA in its Asset Management Market Study. SIEL often finds that these consultants are the incumbent providers to many clients, and retain that position without any competitive tendering. Trustees rely on the advice received from their appointed investment consultancy firm, which is naturally incentivised to refer any follow up work to itself where it also offers fiduciary management services.

19. This incumbency advantage is something that SIEL has had to work very hard to overcome. The incumbency advantage is something that is reinforced by the natural

conservative nature of trustees, who are investing the money of others against a backdrop of legislative obligations. It is also based on long term relationships. In particular, the involvement of incumbent advisers in all aspects of the trustees' work in an inhibitor to innovation and a barrier to entry.

20. On the other hand, SIEL's success in building up its business may indicate that practical barriers to switching are lower than cultural ones.

21. Investment consultancy firms are responding to market pressures by moving into the fiduciary management space, whilst leveraging their position as incumbent advisors to pension scheme trustees. For instance, SIEL is seeing an emerging trend that firms offering investment consultancy as a stand-alone service are both recommending and providing master trust services to DC pension schemes.

Client reporting and accountability

22. A fiduciary management firm is accountable to its client for the advice on the client's portfolio and the implementation of that advice. It is the AUM fee model present in a fiduciary management service that makes the relationship accountable. [3]

23. Fiduciary management provides clients with the ability to clearly track the path of the funding level against the customised objectives set by the pension scheme. This means that the challenges associated with transparency of performance in an investment consulting model are overcome.

24. Clients are able to benchmark a fiduciary management firm's performance against the customised investment objectives set by the client. However, as investment objectives are tailored to the client, there is a challenge in being able to benchmark and compare the performance of different fiduciary management firms against the requirement of different clients. SIEL recognises that clients may wish to have some measure of comparability and has contributed to a study aiming to compare fiduciary management firms[4]. However, care should be taken to ensure that fiduciary management firms are not reduced in their ability to tailor services to clients or

[3] SIEL has developed a detailed breakdown of all its charges in a typical fiduciary management relationship. SEI intends to submit this breakdown as a response to Question 25 of the CMA's Market Information request.

[4] http://www.ic-select.co.uk/services/ic-select-fiduciary-management-reporting-a-new-industry-standard.html

required to provide 'standardised' services, as this would limit fiduciary management firms' ability to compete in the market, as well as stifling innovation in this market.

25. There is also a significant degree of regulatory change expected – such as the implementation of Markets in Financial Instruments Directive II – which will increase the obligations on fiduciary management firms (unlike investment consultants, who do not fall within the ambit of these types of regulation) to disclose information to clients, including information on fees and performance. We consider that the CMA's review should account for this changing regulatory backdrop.

Remedies

26. SIEL understands that the CMA's power to impose remedies is closely tied to its finding on the operation of competition in the market. It is therefore very cautious in making submissions about proposals to construct remedies to an as yet undefined problem. The following comments should be taken in that context.

27. As a general proposition, SIEL would welcome remedies which would give it a greater chance to compete fairly for business. These might include some requirements for regular and open tendering, the use of a standardised, principles based approach to tendering and an increase in expertise amongst trustees.

28. Whilst SIEL might also welcome carefully crafted remedies intended to address the inherent conflict of interest that arises when the providers of "impartial" advice are also providers of financial products, SIEL considers that considerable care is needed in this area. As explained above, the emergence of fiduciary managers in the last decade is an important pro-competitive innovation in the market, offering trustees an alternative model to the benefit of consumers. However, the statutory duties of trustees mean that there is an overlap between the services provided by consultants and those provided by fiduciary managers. This overlap is further complicated by the fact that, sometimes, trustees use investment consultants to provide advice on the benefits and selection of fiduciary managers.

29. Any remedy which provided for a blanket separation of advice and implementation would have a profoundly damaging impact on the business model of fiduciary managers; and thus on competition and consumer welfare.

30. Instead, if the CMA concludes that remedies are needed to address the conflict of interests of advisers, it should first consider steps such as declarations of interest or third party benchmarking of “own brand” products.

Conclusion

31. The market for fiduciary management services is one that is continuously changing – particularly as a result of changes in regulation. We urge the CMA to look carefully at anticipated changes in regulation to consider if any of these address the issues it has identified, or indeed, create additional issues.

32. Fiduciary management firms are wrestling with the power of incumbent investment consultants and we encourage the CMA to not take any steps which would reduce the ability of fiduciary management firms to innovate and challenge the position of investment consultants.

33. SIEL remains available to assist the CMA as required in further considering the fiduciary management market.