Response to the CMA investment consultants market consultation

1. Introduction

B&CE is the provider of The People's Pension. The People's Pension is a master trust serving 3 million mostly low and medium income savers in the auto-enrolment market.

The People's Pension is an efficient, not-for-profit alternative to the government-funded state intervention of NEST. It is not reliant on state subsidy of any kind. We are run under a trust in the interest of our members. As part of B&CE Holdings, we have been providing welfare and employee financial benefits for the construction sector since 1942 (B&CE also provided a stakeholder pension for the construction industry, which served a further 476,000 members and who are currently in the process of transferring to The People's Pension).

2. Summary

In our view the market for the supply of investment consultant and fiduciary management services to small pension schemes does not work as well as it might do, likely leading to higher prices to employers and employees and lower returns to employees. The largest schemes by and large have the buying power and internal capability to require cost-effective service in the scheme's interest and are able to monitor effective delivery of that service.

The structure of the consulting market means that any size of pension scheme is exposed to potential conflicts that can be exploited by large consulting groups that operate both advisory and fiduciary businesses (including DB or DC master trusts). We firmly believe that a critical aspect of pensions practice is trustee/employer clients treating their consultant as a "trusted adviser" – and they consequently (and rightly) expect such advisers to always be seeking the best available solution in the market. The aforementioned conflicts get in the way of this happening. The classic example of this is an investment consultant advising a trustee board setting in train a sequence of strategic recommendations that lead the client to the consultant's own fiduciary solution. This solution may well not be the most appropriate solution available.

There is also the issue of evaluating smaller scale DC schemes. In these structures, often the administrative costs are met directly by the employer (possibly on consultant recommendation) and therefore do not flow through the trust itself – and thus do not currently form part of value for members assessment.

We think that market failure could be remedied by three rules in particular. We believe these rules would prevent the issues giving rise to poorer outcomes for smaller schemes and sub optimal outcomes for larger schemes.

These remedies are:

- Rule 1: A prohibition on the same company being both adviser and supplier of fiduciary management/funds/master trust to a scheme. Companies could potentially operate in all market segments but would have to choose between them if they sought to offer a service to a pension scheme; and

- Rule 2: A duty on trustees of pension schemes to consider value for money at a minimum for (i) employees, <u>and</u> (ii) employers. We would suggest that amongst the smallest schemes that where there are excessive rents being taken by consultants that they are often being met by employers and not through the trust itself. This can mean costs being passed on to employers without employers realising that these costs might be unnecessary if a bundled solution was used. We would also suggest in the members' and employers' interest that the value for money test includes, as it does in Australia, a duty on trustees to consider whether they have the scale to deliver as good a degree of value for money compared to the best schemes on the market and where this is not the case to consolidate. Reporting on the fulfilment of these duties ought to be required in the Chair's statement.

- Rule 3: a requirement for mandatory tendering where vertically integrated providers have supplied investment consulting and fiduciary management/master trusts.

3. Comments on the specific remedies being considered by the CMA

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

This is likely to be more of an issue with respect to fiduciary management than advisory consulting on investments. Charging structures for the former can be opaque or multi-faceted (potentially including performance fees that could be spuriously pegged to certain funding or performance outcomes). Rule 2 is likely to make trustees more demanding.

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

Our view is Rule 2 would lead to all trustees requiring such reporting. However, an explicit requirement for a consistent approach may assist trustees in smaller schemes.

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

This would likely assist the trustees of smaller schemes, albeit there are challenges in meaningfully comparing advisory fees given the impact that the experience and skills of the consultant leading the advice will have on quality and value for money. Some broad categorisation of typical fee bands for senior consultants, consultants and support staff involved in an account could be helpful.

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

We think fee problems tend to be more prevalent in fiduciary management than advisory consultancy. However, action in this area may assist smaller schemes.

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

Pension fund trustees already receive considerable, granular detail on performance against benchmarks and objectives. We do not believe it is feasible for consultants to report on the impact their own advice has had on those returns, given the process trustees go through to react to advice can be protracted and is highly unlikely to happen in a way that means the efficacy of a decision can be tracked quantitatively.

Results will also be significantly affected by timing. There can be long lags between trustees receiving advice and trustee boards implementing a decision; results may not really be a consequence of the advice. Indeed, advice may be ignored or watered down. Much consulting advisory time is spent on generic asset decisions, not manager selection, and asset decisions may well be more about risk mitigation than return delivery.

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

Our experience is that this should be but often is not a focus of investment consultants and requires direction from trustees. This may be less forthcoming from trustees in smaller schemes. Transaction costs as well as fees can be an issue and smaller schemes may face similar difficulties in processing and dealing with disclosure.

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

As above, standardised performance metrics may not be very accurate or meaningful – and could result in unintended outcomes (i.e. slavish attention from trustees that could be better served looking at longer term asset strategy issues).

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

We are not convinced this will provide much value. If market failure arises because trustees on smaller schemes lack the capacity to make informed judgements, this will also bias such reviews. Indeed, in many cases, it may be the consultant which writes the commentary.

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

Where provision of these services is vertically integrated, this will be key to unwinding inappropriate selections if combined with our suggested Rule 1.

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

This may well assist trustees of smaller schemes.

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

In our view, this is critical to improving outcomes, hence our suggested Rule 2. We believe that Rule 2 would drive some positive trustee behaviours that will naturally solve the widespread challenges of sub scale schemes.

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

This is an integral element of our suggested Rule 2.

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

This is a sensible suggestion – albeit this assumes that it is a properly expert independent trustee, aware of the technical issues and capable of devoting the necessary time. There is a supply side issue here of sufficient such trustees, which points to the importance of consolidation instead.

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

Our suggested Rule 1 would eliminate this as an issue.

Require mandatory tendering of fiduciary management/master trust services

Where provision of these services is vertically integrated, this (Rule 3) will be key to unwinding inappropriate selections if combined with our suggested Rule 1.

Prohibit investment consultants from providing fiduciary management/master trust services

In our view, this is a key provision and forms our Rule 1.

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

This would seem sensible.

Require full disclosure of business interests to trustees

This would seem sensible, although the issue is really dealt with by our Rule 1.

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

If our proposed Rule 1 were adopted, this would be achieved.

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

Excessive hospitality is only economically rationale where our suggested Rules 1 and 2 do not apply. We would suggest it is better to tackle the cause rather than a symptom.

Impose limits on the type of hospitality eg legitimate business meetings and conferences only
Require full disclosure of hospitality received to trustees
As above

Impose an outright ban on hospitality

As above

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

Where provision of these services is vertically integrated, this (Rule 3) will be key to unwinding inappropriate selections if combined with our suggested Rule 1.

Require divestiture of investment consultancy services from asset managers

If our suggested Rules 1 and 2 were adopted then we do not think this is necessary. It would potentially raise cost to the industry as a whole as within the consultancy/fiduciary firms, both services benefit from common research and data.

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