CMA Statement of issues and potential remedies

October 2017

Hymans Robertson's response

1 Introduction:

Our aim is always to ensure that any action taken is in the interests of our clients as the users of our services. We fully support the spirit of the CMA's review and particularly its objectives. It is encouraging that the CMA is keen to consult with industry on whether it has characterised the investment consulting market properly and if its proposed remedies are effective and proportionate. To help the CMA meet its objectives we have offered our candid views both on its characterisation of the market and its proposed remedies. We have also made suggestions on how to approach the review more broadly and proposed additional remedies that may not have been considered. Finally, we have highlighted the areas where we believe further investigation would reveal nothing new or of note.

We note some key observations and concerns:

- Securing better outcomes for clients is our primary objective in all that we do as a firm. We fully support any course of action that leads to improvements in the ability of customers to assess the performance and value add of investment consultants and fiduciary managers. We also support measures that lead to improved service quality, greater choice and more innovation in the market.
- At a high level, the quality of advice a client receives is based on the quality of the people providing it. As such the quality of advice is predicated on attracting and incentivising highly qualified people to work in commercial and profitable organisations. To significantly attack the attractiveness of these businesses (e.g. reduce the ability to attract and retain high quality, well qualified staff; or make these businesses too much of a challenge to run commercially and profitably) will ultimately lead to a deterioration of quality and clients will suffer.
- We also highlight the need to bear in mind the potential consequences of any measurement is to influence the approach taken to what is being measured – in this case, the advice of investment consultants. If measurement focuses on quantitative elements, it will by definition result in a focus on the shorter-term rather than those more influential factors in terms of delivering better long-term outcomes for clients. This will in turn encourage consultants to focus their advice more on these shorter-term factors in order to remain or get appointed, at the expense of longer-term factors.
- Related, the simpler a universal peer group comparator or measurement is, the more it will influence a move away from innovation and towards a more simplistic approach, and potentially less focus on value add solutions. This runs the risk of driving down the quality of service and lead to less optimal outcomes for clients, and ultimately the individuals who receive the benefits.
- As the industry is already heavily regulated, increases in regulation are likely to lead to higher costs of doing business, increased barriers to entry and less competition, not more. Given the advisory part of the industry receives a modest share of the total fees charged to clients, there is a real risk these costs will need to be passed on to the client.

If demand is a concern of the FCA then this review needs to focus on measures to ensure trustees are well equipped to assess quality of investment advice more readily without simplifying everything to a lowest common denominator that trustees can compare. We should avoid tackling a demand-based concern with a supply-based solution. Doing so will only dumb down the supply and lead to poorer outcomes.

On the supply side, greater competition is in commercial interests as well as in the interests of clients. But in pursuit of this the CMA's needs to ensure its objectives are met and that the risk of unintended consequences is mitigated.

We hope that the CMA will take a holistic view when assessing the market, rather than focussing on sub components. Doing so will increase the likelihood of it meeting its objectives.

2 The CMA's approach:

Here we offer a view on guiding principles for approaching the review to help the CMA meet its objectives:

I. Provide a clear definition of a 'well-functioning market' – a long-term focus is crucial

Having a clear definition of a 'well-functioning market' would be helpful to all. In our view, a 'long-term focus' (from the CMA, the FCA, and all market participants) should be the cornerstone of that definition. Any measures that encourage short-term behaviours will lead to market dysfunction. The Myners' review pushed for longer-term appointments of investment managers as short-term measurement can drive inappropriate behaviours. The same must apply to consultants.

Pension schemes are long-term providers of benefits and therefore trustees of pension schemes must have a long-term perspective. There is an end goal in the case of many closed DB schemes, but this is typically still long-term. Investment solutions and associated consulting advice need to be aligned to this, while managing short-term risk.

The role of investment consultants is to help trustees make better decisions – not to take the decisions for them. Turnover of trustees (as individuals) and rapid turnover of consultants will mean the loss of scheme knowledge and continuity of strategy, both of which are vital.

II. Look at the markets holistically, and not micro-manage individual components

To ensure the CMA can fulfil its objectives effectively, we would strongly recommend that it looks at these markets holistically and not micro-manage the individual components. Concentrating on sub-elements rather than looking at the bigger picture has a high risk of failure: namely less competition, clients (and consultants) focussing on the wrong issues and adopting a short-term time horizon, and ultimately worse outcomes for the end consumer.

III. With advisory services, clients are not buying a 'product'

The CMA needs to bear in mind that advisory services are not off the shelf products – the advice given to a particular client will reflect a whole number of factors; consultants have very different approaches, but equally important is that clients' own needs and views differ. Incorporating these needs and views into advice is part of consulting. Any attempts to adopt a uniform approach to measurement or to compare advisory services need to be mindful of this.

IV. There are differences between the Defined Benefit (DB) and Defined Contribution (DC) markets

For example, it should be easier to benchmark value for money in DC, yet there is little publicly available information on this.

V. Risk management

The key role of the investment consultant is to advise trustees on how to manage risk. This can lead to deliberately targeting lower asset returns in exchange for greater certainty that those returns will be delivered, and that the scheme's strategy will not be knocked off course. This would be counter to assessing success solely in terms of achieving higher returns. It is crucial that this is considered in the assessment of the performance of consultants.

In addition, consultants provide advice which trustees may choose not to follow, either because of their own views or driven by strong views from the sponsor. For example, the most significant driver of performance over the last 10 years and more is the level of interest rate and inflation hedging in place. If a consultant has recommended increasing hedging levels, but that advice has not been taken because of strong divergent views at the trustee or sponsor, the impact of that decision will dwarf that of other asset allocation decisions, manager choices and indeed fees.

3 The CMA's characterisation of the 'issues' in the market:

In our view there are a number of areas where the market hasn't been characterised accurately. Specifically our view is:

I. The investment consulting industry is already doing a good job

Independent surveys which assess the performance of consultants through the eyes of the clients suggest that performance of the industry is strong. Any simple assessment of changes to asset allocation and manager mandates over the last decade shows the adoption of liability management and diversification within pension schemes, driven by consultants, with very positive results. Consultants also have a long history of driving the development of products by asset managers which meet the needs of trustees, aligning the interests of all parties in the value chain. Recent examples include secure income funds, direct lending, longer term "Infrastructure" funds (rather than Private Equity refinances) and multi-asset credit strategies. These are all responses to consultants' identification of client needs, developed and implemented with the aim of improving outcomes.

As part of the process of driving the development of products by asset managers, consultants have also been successful in driving down the cost of asset management through volume discounting, using competitive pressure and ongoing assessment and challenge.

II. There is competition in the market and fees are being pushed down

There have been a number of new entrants into the market in recent years, and the market share of the three large multinational firms is lower now than it was 10 years ago. The regulatory environment already means that there are high barriers to entry for new players, and the Defined Benefit (DB) part of the market is mature and entering its run-off phase.

The implied view that a lack of competition means the fees of investment consultants (advisory) are too high does not reflect our experience in the market. Fees are continually under pressure from trustees. The profit margins of investment consultants (excluding fiduciary managers) are not high, especially relative to the wider financial services sector and asset managers in particular. The FCA identified a difference in the profits of consulting and fiduciary, and we agree with that assessment.

III. It is relatively easy for customers to assess investment consultants and they do so regularly

In our experience, customers have little difficulty assessing investment consultants, and do so regularly. Most schemes regularly conduct fee reviews and perform annual reviews of the service provided by investment consultants. The increase in professional trustees and third party procurement firms has significantly increased the availability of knowledge about the consultancy firms. It has also driven increased volumes of more formal reviews as well as more detailed performance assessment.

IV. It is not difficult for customers to switch investment consultants

We do not believe that the issue of switching in the market is properly characterised. A distinction needs to be made between advisory and fiduciary. It is very easy to switch investment consultants. For advisory clients the cost of switching is very low and there are no take on fees. We believe this review should focus on why trustees positively decide to retain their advisers as much as whether there are barriers that inhibit switching.

For fiduciary, the costs are higher, due to transition costs etc. In our view, fiduciary management should be considered alongside asset management.

V. More switching of investment consultants will not necessarily lead to better outcomes

There is a very real risk that more regular switching of advisers could drive behaviours that lead to worse outcomes.

This is for two reasons: First, if a client is forced to retender every so many years, there is a danger they could sack an adviser at the wrong time in the cycle and lead to strategy veering off course (the obvious parallel to the criticism of trustees changing managers to frequently made in the Myners' review should not be lost). The advice of consultants is long-term by nature. Short-term decision making is not conducive to achieving better outcomes. Frequent turnover in consultants is also likely to lead to higher transaction costs. Short-term measurement and retendering will incentivise consultants will seek to change strategy and managers to their preferred approach upon appointment.

Second, the cost of tendering is already high for investment consultants. It would be wrong to expect all market players to go for more tenders than they do already, particularly if reviews are driven by a requirement to tender rather than genuine dissatisfaction with incumbents. For example, we are generally reluctant to go through the cost of tendering where the likelihood of change is small. A mandatory tendering regime for use of a third party adviser could result in an even narrower group of advisers tendering (i.e. those with the resource). The unintended consequences could be significant.

To underscore this point, the 12 largest consultants may advise/control £1.6trn, but fees are £240m or 1.5b basis points. There are high costs of procurement/tendering but low fees as a percentage of assets. By contrast, asset managers have low costs of procurement/tendering and much higher fees. If the costs of tendering increase further this could lead to a reduction in choice for the end consumer.

Both assessment and switching are easy to do and take place already. We support the development of industry standards around information required for tendering, but not a fixed mandatory tendering regime.

VI. Long-term relationships can lead to lower prices, improved service quality and more innovation

The implied hypothesis that long-term relationships are to the detriment of customers overlooks the often considerable benefits of good long-term relationships.

While there are challenges in quantitatively measuring the value – particularly in improved service quality, risk reduction, innovation and reduced fees - that can come from the strength and tenure of a client/adviser relationship, there are benefits from an adviser having a deep understanding of the clients' objectives and particular needs, which is often strengthened over time. Trust is a key component of the client/adviser relationship, and that is built up over time.

An investment consultant may be able to provide more effective and appropriate advice as a result of this understanding, which could lead to more proportionate or appropriate fees. The time horizons of relationships are not the issue.

VII. The focus should be on improving results, not increasing adviser turnover

Higher consultant turnover is not in itself a better outcome. Improvement in results is. There are significant challenges in trying to measure or demonstrate short-term better outcomes for long-term investment decisions. This is even more pertinent given the lifetime of many DB schemes is not much longer than the measurement period would need to be.

VIII. 'Complex' investment strategies are implemented to drive better outcomes for clients

Where we recommend 'complex' strategies, we do so because they are appropriate and expected to drive better outcomes for clients, not for the sake of it or to make more money for us.

There are many examples of this, where the investment consulting community has driven and continues to drive fund managers to provide more suitable pension fund products for clients:

- Interest rate and inflation (LDI) hedging;
- Liability driven consulting;
- Cashflow driven consulting;

- Long-term income products like long-lease property;
- Capital efficient pooled funds that deliver large scheme solutions to small clients;
- Move away from closet passive active equity.

Under the “peer group” assessment model, the fund management community had no incentive to move from traditional “balanced management”.

In many instances “complex” simply means trustees taking some of the decisions upon advice rather than delegating to managers. This is not appropriate in all cases, but where the governance budget is sufficient, can result in better outcomes and lower fees. Trustee disappointment with multi-asset product returns has led to a view by many trustees that a higher level of governance is necessary to manage the pension scheme assets more effectively.

IX. *High cost of procurement is a barrier to competition – not the customers’ ability to switch investment consultants*

In terms of barriers to competition, the issue is not the cost of switching investment consultants for clients; it’s the cost of competing for the business by consultants. The cost of the due diligence process and the lack of appetite for change amongst clients (due to the importance placed on relationships and the generally high quality of advice provided), mean that investment consultants do not participate in every re-tender process they are invited to. The high cost of procurement can already be a barrier to competition.

As already highlighted, consultants have high costs of procurement and tendering, but low fees as basis points of assets. The CMA’s remedies must avoid reducing the incentive for investment consultants to compete for business.

If the CMA, through its remedies, increases the cost and frequency of procurement and tendering, and at the same time drives down investment consulting fees, this will increase barriers to enter the market, reduce competition and consumer choice as well as lead to less innovation. The potential for unintended consequences for competition here are all the greater due to the fact that the DB market is shrinking with the majority of schemes closed.

In the DC market, re-tender volumes are low. This does not reduce the incentive to compete but has the opposite effect.

X. *Lower advisory fees could lead to lower service quality, less innovation and a reduction in competition*

If we see lower fees then there will be less research, less innovation and poorer outcomes. The Myners review rightly said that asset allocation - – making sure trustees allocate their assets in the most effective way to generate return and manage risk - is **the key decision** trustees make, and a key part of the role of consultants. In that context, there is an argument that the fees of investment consultants should be a higher proportion of the value chain, and asset managers should receive less of the overall fees. It is in asset management that we should seek to apply more downward pressure on fees. Reducing fees for advice will also make it less attractive for new entrants to enter the market.

XI. *‘Vertical integration’ is a separate issue to ‘conflicts of interest’*

The CMA is focussing on the power of consultants due to their provision of other services (such as fiduciary management, actuarial service, advice to employers on design of DC pension schemes and also providers) – i.e. vertical integration. Traditional investment banks and accounting firms have corporate networks not available to Employee Benefit Consultancies (EBCs)/investment consultants, but both provide advice to pension fund sponsors and trustees. Fiduciary asset managers provide advice but hide the cost within their fees and none of the above adhere to the actuarial profession’s quality standards. Hence, the benefits of vertical integration are just an aspect of business that affects all parties, and can act in a positive and negative way for EBC/investment consultants. This is not the same as managing conflicts.

NB: In the following three sections we expand on these views, particularly in respect of the proposed remedies.

4 ASSESSMENT AND SWITCHING

The CMA's question: ***Do customers have difficulty assessing, comparing and switching investment consultants and does that mean consultants have little incentive to compete for business?***

We have broken this question down and looked at assessment, comparison, switching and incentives to compete in isolation, giving a view on whether each area should be in scope, whether it's properly characterised and if there are any additional remedies the CMA ought to consider.

A: ASSESSMENT OF INVESTMENT CONSULTANTS

We are supportive of methods to improve the assessment of performance and the value add of consultants. However we do not believe this issue is properly characterised as:

- In our experience customers have little difficulty assessing investment consultants, and do so regularly.
- Moreover most schemes regularly examine fees and perform regular reviews of the service provided by their investment consultants.

Our view on remedies for improving assessment:

- ***Developing industry standard templates for reporting fees and performance***
  While we are supportive of developing industry standards, there will be challenges to make them meaningful. Reporting templates need to be appropriate and must reflect the scope of work requested. As clients' needs and objectives often differ, standardisation and 'like for like' comparisons will be a challenge. For this to be achievable, clients would need to have identical objectives and the same scope of work, which is rare.

  A further challenge to making reporting meaningful is that much of an investment consultant's service cannot be quantitatively measured. To solely focus on those elements which can be measured quantitatively – for example, manager picks - would not be sufficient. Worse still, it could drive the wrong behaviours, moving the focus away from trustees' ultimate goals and the chances of achieving them, and instead towards less meaningful short-term measures. If we look to the asset management industry, peer group benchmarking of managers drove products to benchmark hugging / quasi passive management and a lack of innovation. For many years now investment consultants in the institutional space have been driving asset managers to innovate, working against the unintended consequence of benchmarking.

  Another area that is difficult to measure quantitatively is the value that can be attached to service quality, – and the value that can come from the strength and tenure of a client/adviser relationship and the adviser having a deep understanding of the clients' objectives and particular needs. An investment consultant is likely to be able to provide more effective and appropriate advice as a result of this strong understanding, which can also lead to more proportionate fees. The time horizon of relationships are not the issue.

- ***Detailed fee information before appointment/re-tender***
  This is already standard practice. We can provide examples.

- ***Fees charged vs quoted for incumbents***
  Again, this is standard practice. We can provide examples.

- ***Industry standard for disclosing the impact of a course of action on fees the client would have to pay following that course of action. Explanation of investment strategies, pricing models etc. before making the investments***
  Again, this is standard practice. We provide quotes ahead of any course of action and can provide examples. This, however, may be an issue for firms providing both advisory and asset management

("fiduciary") services. It is worth highlighting that changing advisers is likely to lead to increased transaction costs, assuming new advisers will wish to implement at least some of their ideas.

- ***Banning certain price models, such as pay to play and ad valorem fees***
  We would question the need to ban fee models if they suit a client. Both 'pay to play' and 'ad valorem' fees are uncommon. Most clients agree a combination of fixed price and budgets for projects. However, mutual agreement and transparency on fees is what is important, not the model (particularly if it suits a client's preferences).

- ***Develop industry standard benchmark for relative returns. So investment consultants would have to report on relative performance of fund vs benchmark***
  The industry already reports on the performance of portfolios against a scheme's benchmark.

  Each scheme is different and we see significant risks in a simplistic approach to industry standard benchmarks as it may drive consultants' behaviours to outperform that benchmark, rather than do what is right for the client in their specific circumstances, particularly in terms of risk reduction.

  Developing an industry wide benchmark for DB investment consultants will come with significant challenges, without creating unintended consequences as detailed above.

  In DC, value for money is easier to quantify. At the moment there are no publically available benchmarks for value for money, yet, there is arguably a need. We are keen to work with the industry to create value for money benchmarks in this part of the market, but as with DB the quality of advice is difficult to compare from one consultancy to another for the reasons set out above. Once again our focus is on achieving the best risk adjusted outcome for members, so risk has to be a key component of measurement alongside returns.

- ***Industry standard for the disclosure of fund manager fees, and consultants to report on how and to what extent they've reduced fees for clients***
  This is common practice so we are supportive of creating an industry standard. Seeking the more competitive fees for our clients enhances net returns and is therefore always an objective. We estimate that annual saving for our trustee defined benefit clients relative to rack rates is in excess of £[✂]. We can provide examples.

- ***Placing a requirement on investment consultants to report on the performance of manager recommendations based on standardised performance metrics***
  We are supportive of this. We already report on the performance of manager recommendations and have these reports audited. This is based on a metric we've devised. We're happy to share our methodology or adopt another.

- ***Work with trustees and pension schemes to develop an industry standard reporting tool for the quality of investment consultant services to be made publically available***
  We are supportive of this remedy provided it captures all aspects of the service provided. We're keen to work with others to develop a tool, providing it is not purely quantitative and is fair to all participants across the industry. Consulting by definition means providing advice and a significant part of that is trust, which is difficult to measure.

In DC for Master Trusts specifically this should be do-able and there is arguably a strong need.

Remedies missing/ not considered?

- Another influential industry participant that should be considered is the independent trustee community. They hold increasing sway and influence on trustee boards, and have a key role to play in the tendering process and broader decision-making process of trustee boards.

B: COMPARING INVESTMENT CONSULTANTS

We are supportive of measures that make this easier. However, as many aspects of service provision are qualitative, not quantitative; and given advice is not always taken, finding ways to measure and compare consultants against one another will be a challenge.

Our view on the proposed remedy

- ***Creation of an independent benchmarking service***
  This would need to be fair and cover all relevant aspects, including the strength of relationships, strength of understanding of clients' objectives and whether the advice given was appropriate to meet those objectives. One key challenge, as detailed above, is comparing the advice which is not taken, for example to hedge more liability risk, as that is a key driver of success.

C: SWITCHING INVESTMENT CONSULTANTS

While supportive of this being in scope, we do not believe this is properly characterised, as we have outlined in Section 3 above:

A balance needs to be struck between encouraging more competition in the market, but not imposing more costs on the consumer, or indeed, making cost a barrier to competition.

Our views on proposed remedies related to switching investment consultants

- ***Mandatory tendering for consulting, fiduciary management services and master trusts (every 5, 7 or 10 years). In addition encouraging schemes to review services on a regular (annual/biannual) basis***
  We would question why it should be necessary to force re-tenders when trustees already have the ability to re-tender, or test the market in other ways, whenever they wish to do so.

- ***Industry standard rules to improve tendering and make more transparent***
  The cost of procurement for investment consultants is high. Arguably this can be a barrier to more competition. Care needs to be taken to avoid a significant increase in the costs of tendering for consultants as this could have a detrimental impact on competition. Having said that, we welcome transparency and any process that helps reduce the cost of procurement.

- ***Standardised off the shelf tender documents for smaller schemes/employers***
  There will be challenges in making this effective, but in principle we would be supportive.

D. DO CONSULTANTS HAVE LITTLE INCENTIVE TO COMPETE FOR BUSINESS?

While this should be in scope, in our view this is not properly characterised for reasons set out in Section 3. To recap, the main factor that might cause a consultant to not compete for business is where the process is driven by factors other than dissatisfaction with the incumbent. If the process is driven by a time based review process only, we are unlikely to see this as a sensible use of our resources. We seek to target our new business efforts at situations where we perceive a reasonable chance of a return on our investment in the process.

5 CONFLICTS OF INTEREST

The CMA's question: ***Do conflicts of interest on the part of investment consultants reduce the quality and/or value for money of services provided to customers?***

Here we look at fiduciary management, Master Trusts, providing services to investment managers and hospitality separately.

A: Fiduciary Management

- We believe this should be in scope and that the issues are properly characterised. The proposed remedies are effective and proportionate. We would argue that bringing fiduciary management into the FCA's regulatory perimeter is a must. The only area where we would encourage caution is around mandatory tendering for fiduciary management, for the same reasons we would caution against mandatory tendering for advisory services.

We are supportive of developing business separation rules between investment consultants and fiduciary management.

Additional potential remedies for consideration:

- The need for independent fiduciary oversight.
- Overcoming the challenge of firms offering both consulting and fiduciary asset management giving preferential access to their fiduciary mandates for manager products that have limited capacity, to the detriment of advisory clients.

B: Master Trusts

We believe that this should be in scope and most elements are properly characterised.

Our views on proposed remedies for Master Trusts:

- ***Prohibit investment consultants advising an employer on the establishment of a pension scheme from offering an in-house Master Trust to the employer***

  The issue is not a consultant offering a DC fiduciary solution (a Master Trust arrangement). The issue is ensuring the employer is making an informed decision. Problems arise when there is a recommendation from a consultant to use its own in-house product. This could be avoided if an independent procurement/evaluation process is run. In some areas of the market this is already happening. The key to ensuring this works in customers' best interests is that the consultant competes on an even footing with other providers. This needs to be made mandatory.

  Where there is a consultant Master Trust in place, there is a need for fiduciary oversight of that offering. Particularly where the investment consultant is the adviser to that Master Trust.

- ***Review existing price cap in place for Master Trusts and look at the impact it has on competition and outcomes, potentially reviewing level or scope***

  We would argue there is little to be gained from pushing the cap down further. It would rule out the potential for areas of investment requiring or benefitting from active management, it could reduce competition and drive providers out of the market.

Additional potential remedies for consideration:

- Where there is already a consultant Master Trust in place and the consultant is the adviser to that Master Trust, remedies to deal with the conflicts here should be explored.

- Linked to the above, the need for independent oversight of Master Trust arrangements, whether the Master Trust is provided by a consultant or not.

- Investment consultants disclosing where they have commercial relationships with providers of Master Trusts. There needs to be more transparency here to make customers aware of potential conflicts.
- CMA should require EBCs to evidence impartiality in any selection exercise.

C: Providing services to investment managers

We believe this should be in scope. There are some elements where the characterisation could be clearer (as per below).

Our views on proposed remedies where investment consultants provide services to investment managers:

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- ***Developing business separation rules between investment consultants and the services that asset managers purchase from investment consultants***
  A distinction needs to be made between consultants selling services to asset managers related to products that the consultant might then advise on (including hosting conferences attended by clients) and services unrelated, such as, advising on their own pension fund or selling a model into an online toolkit they offer to retail, for example. The former should be separate, the latter covered by disclosures.

  It is worth recognising, however, that such separation could be a) disproportionate (for example, in terms of additional costs) and b) unnecessary provided there is transparency and EBCs can demonstrate an objective, impartial approach to, for example, manager selection.

- ***Full disclosure of business interests to trustees***
  We support full and better disclosure.

D: Hospitality:

We believe this should be in scope and the issue is properly characterised.

Our views on proposed remedies:

- ***Impose limits on the value of hospitality ICs are allowed to receive from investment managers; the type of hospitality (e.g. legitimate business meetings and conferences only) and full disclosure of hospitality received***
  Supportive of these measures, but an outright ban would be unhelpful to the effective working of the industry.

Additional potential remedies for consideration:

- Independent trustee firms are increasingly powerful and should adopt similar policies and disclosure.

6 BARRIERS TO COMPETITION

The CMA's question: *Do barriers to entry and expansion mean there are fewer challengers to put pressure on the established investment consultants to be competitive, leading to worse outcomes for customers?*

In summary, we are supportive of this being in scope. We believe that the barriers to entry are currently sufficiently low. However, care must be taken not to increase them. As outlined above, while remedies for assessing, comparing and switching investment consultants are on the face of it sensible, we need to be wary of inadvertently increasing barriers to entry through greater regulation, particularly in DB as much of this market has a finite time to run.

We disagree that there is a lack of competition in the market. Competition has been increasing and we must create an environment where it can continue to do so. Neither do we share the view that barriers to entry and expansion are leading to worse outcomes. Fees are already being pushed down by trustees through effective competition and there are plenty of examples where consultants are driving better outcomes. We expand on these points below.

1. Barriers to entry

We believe that barriers to entry are low. The cost of setting up a competitor is low in both DC and DB.

For fiduciary management, there are greater barriers to entry than pure advisory. The main barrier is the cost of building or buying in all the back office functions required of an asset manager, along with the additional manager research personnel that would be required. In addition to the three largest firms (Aon Hewitt, Mercer and Willis Towers Watson) which have built fiduciary management businesses in recent years, we have seen the arrival of others into the UK market including Cardano. Given resources, it is far more likely that more asset managers will enter the fiduciary market than other advisory firms (all of which are much smaller in scale than the "big 3" and are therefore unlikely to have the resource to do so).

To enter the market for investment consultancy, while the barriers are comparatively low, it would be necessary to create the framework to operate within the current regulatory environment. It would also be necessary to recruit a credible team of consultancy and support staff, to buy or build the necessary tools to allow the required financial analysis and reporting to be carried out, as well as to build a credible research function (capital markets, manager research, liability driven investment etc). Demonstrating a competitive advantage in the market with no history of success in the market is a challenge for new entrants. Our firm has a long and distinguished history in the industry, which helps us in terms of brand awareness.

2. Barriers to expansion and competition

The barriers to expansion in the market are related primarily to the existence of competition in the market and the competitive tendering process to expand the client base, as outlined above. It takes a long time to build a sustainable bespoke growth business in this market. That's because the fixed costs are significant and the number of adviser contracts with considerable revenue is not high and is shrinking. Given the fixed costs coupled with high cost of procurement exercises, any material shortening of contract terms (which are not typically fixed, but typically run for many years reflecting the nature of advice being around long-term investment) or an increase in the cost of procurement would lessen the attractiveness of being an adviser in this market.

Added to that market credibility is difficult to attain. Accreditation is no substitute for reputation. Market share is in many ways self-perpetuating. It is a problem to gain credibility in the marketplace, but there are no easy ways to overcome this.

As DB is in run-off, many market players are not increasing investment in their businesses. This is why it is important to avoid a situation where advisory fees are driven lower, as this will adversely impact innovation. In DB in particular, we are unlikely to see significant investment from new entrants into this market.

One remedy mooted is divesting investment consultancy businesses. This makes no sense for consulting firms, as funding, investment and settlement are all linked. It is hard to see where a line of distinction can be drawn between actuarial or investment advice.

Where divestment could apply is with pure asset management players (fiduciaries). There is also a need to place controls on fiduciary asset managers providing advice "for free" given they have such a large fee take relative to consulting firms.

While we have not sought to enter the fiduciary management market, primarily due to the potential conflicts of interest that arise by offering both advisory and fiduciary services, there is value to trustees in the provision of fiduciary oversight. To date this market is very limited in size as the majority of fiduciary appointments are through an existing adviser.

Competition

In addition to the three largest firms (Aon Hewitt, Mercer and Willis Towers Watson) which have built fiduciary management businesses in recent years, we have seen the arrival of others into the UK market including Cardano. Given resources, it is far more likely that more asset managers will enter the fiduciary market than other advisory firms (all of which are much smaller in scale than the "big 3" and are therefore unlikely to have the resource to do so).

The advisory market has also seen a number of new entrants in recent years (including Redington, Deloitte and Momentum). All have managed to build some market share in their chosen areas of the market through marketing relevant propositions to the market, and through competitive tendering when the opportunity arises. It is also worth noting that some firms that offered advisory and fiduciary (previously through fund or fund provision) have scaled back the advisory element, e.g. Russell Investments.

We also see evidence of fiduciary managers offering advisory services "for free", as they can deliver this through the cost base of their fiduciary appointments.

3. Evidence of worse outcomes

We would challenge the implied view that a lack of competition means the fees of investment consultants are too high. In our experience fees are being pushed down effectively by trustees. The profit margins of investment consultants (excluding fiduciary managers) are not high relative to the wider financial service sector and asset managers in particular. The FCA identified a difference in the profits of consulting and fiduciary asset management.

7 AREAS THAT DO NOT WARRANT FURTHER INVESTIGATION

Further analysis of the performance of active equity managers will reveal nothing new. This type of analysis focuses on the wrong factors:

We consider manager selection simply as one aspect of implementation, not a business area in its own right. We do not have a history of high manager turnover, recognising that this can be costly for a client and, particularly in respect of traditional active equity management, choices and timing of any change can be subjective.

The predominant reason we advise on the appointment of new managers, when appropriate, will be to add exposure to new asset class rather than replacing one manager with another for the same role. This has become particularly relevant as pension fund asset allocation has shifted away from traditional equity and bond markets. Within equity and investment grade bonds, where a higher proportion of pension funds now use passive management, manager searches are now less frequent or necessary.

The extent to which the proportion of traditional equity and bond searches is declining is illustrated below.

Proportion of searches	2008-10	2011-13	2014-16
Equities/investment grade bonds	44%	24%	14%
Other searches	56%	76%	86%

Our research team focuses as much on identifying appropriate asset types to invest in as they do identifying managers who can then capture or access that asset class. This reflects a move on our part and our clients towards investment strategies focused more on sustainable predictable returns and income, as befits the nature of maturing closed DB schemes.

Regulation to drive aggregation/consolidation of pension trusts to benefit from economies of scale

Aggregation is already taking place at an investment level through pooled funds, platforms and other collective vehicles. We support the concept, but regulatory action on investment only solutions is not needed as the market is already responding.

Requiring the inclusion of at least one professional trustee for each pension scheme

It is trustees' responsibility to make sure they have sufficient expertise on the trustee board or that they hire an independent trustee (this is what they should already be doing). We do not think trustees should automatically have to hire an independent. This simply pushes an identified issue elsewhere. And crucially, who will monitor the independent trustees for quality/value for money/conflicts?