CMA Investment Consultancy Services and Fiduciary Management Services Market Investigation

A Response by the Pensions Infrastructure Platform (PiP)

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Executive Summary

Investment Consultants play a pivotal role in the UK in the value chain between both defined contribution and defined benefit pension schemes as ultimate asset owners and the investment managers they employ to acquire and manage assets on their behalf. Investment Consultants act as "gatekeepers" for the majority of UK pension scheme assets under management.

Within the value chain Investment Consultants wield significant influence over pension scheme strategic asset allocation decisions and then over which investment managers are employed to manage those allocations. Yet the quality of advice and value added is opaque (and therefore difficult to measure as noted in the Statement of Issues) and the interests of investment consultants and pension schemes are not necessarily fully aligned.

Misalignment of interests means that Investment Consultants can inhibit both innovation and value chain improvements that may serve the best interests of pension schemes.

PiP therefore supports the overall focus and scope of the proposed CMA market investigation. In particular PiP supports:

- Mandatory separation of the provision of investment consulting and fiduciary management services.
- Bringing both investment consulting and fiduciary management services within the regulatory perimeter of the FCA.

Overview of PiP Response

Introduction

1. The Pensions Infrastructure Platform ("PiP") is the UK infrastructure investment management business set up "by pension funds for pension funds". Its objective is to facilitate investment into UK infrastructure projects by UK pension schemes, by developing investment vehicles aligned to their needs in terms of structure, returns and cost.

2. PiP was established in 2012 following the signing of a Memorandum of Understanding by the National Association of Pension Funds ("NAPF"), the Pension Protection Fund ("PPF") and HM Treasury. The development was supported by 10 of the UK's largest defined benefit pension schemes ("Founding Investor Schemes").

3. The Founding Investor Schemes established a set of operating principles at PiP which ensure all pension scheme investors achieve better value and alignment of interest than generally achievable in the established third party infrastructure investment management market:

    - Buy and hold investment strategy to minimise transaction costs.
    - Sole focus on UK infrastructure assets generating long term, low risk, inflation linked cash flows.
    - PiP as manager should only cover its costs, NOT make a profit.
    - Transparent, simple low fee structure with no additional profit sharing or management carry.
    - All investors benefit from same terms and conditions regardless of size.
    - Economies of scale are returned to all investors through progressively lower fees.

4. These principles were designed by the Founding Investor Schemes to ensure PiP was a disrupter of the established infrastructure investment management market status quo.

5. The PiP principles become more effective, and deliver increasing amounts of value to pension scheme investors as the scale of assets under management grow.

6. PiP has a subsidiary company, PiP Manager Limited, which is authorised and regulated by the FCA as a full scope AIFM. PiP has passed all investor operational and investment due diligence tests.

7. In October 2016 PiP completed a £175m first close of its PiP Multi-Strategy Infrastructure Fund. This is the first infrastructure investment Fund to be designed and supported by pension schemes for pension schemes and is managed internally by the dedicated PiP team. A further £430m of pension scheme commitments were completed in September 2017 for investment into a portfolio

of operating UK core infrastructure assets. This takes the Fund up to its £600m target size.

8. PiP has also established two separate accounts for two single investors. The first invested £20m in one asset in November 2016, the second £114m in one asset in July 2017.

9. Since its establishment, PiP has helped secure almost £1.75bn of committed investment into UK infrastructure projects. This includes 15 direct investments during the last 12 months.

10. Despite PiP's establishment by major UK pension schemes and over five years of support from them, proven investment success, and clearly delivering better value to investors, the manager research teams of major UK investment consultancies have shown limited enthusiasm to engage.

Background

11. The FCA Asset Management Market Study identified the key features of the UK investment advisory sector and the weaknesses of the demand side (i.e. pension schemes) for their services. Most UK pension schemes do not have FCA authorisation and their Trustees are therefore required by legislation to seek "proper advice" when making significant investment decisions.

12. It has become standard practice for pension schemes to employ investment consultants in the process of appointing new investment managers.

13. The three largest investment consultants have adopted different economic models for the provision of manager research and selection services for pension schemes

    - Detailed screening of a self-defined universe of managers to arrive at a "preferred list".
    - Low intensity pre-qualification with detailed research only when requested (and paid for) by pension scheme clients.
    - Discretionary selection of new managers to be subjected to in-depth research.

14. Each model has its own form of opacity and each is open to the risk that providing best advice to pension scheme clients is not necessarily in the financial interest of the investment consultant.

15. The development of Fiduciary Management services in recent years has exacerbated these risks.

16. We now provide views on a number of the points raised in the Statement of Issues paper.

PiP Views on Specific Issues

17. (para 21) PiP supports the proposed scope and focus of the CMA investigation. The relationships and influence of investment consultants with pension schemes and asset managers is the critical issue.

18. (para 26) PiP believes the correct detrimental effects have been identified. The PiP experience particularly illustrates how the current system raises barriers to entry for new fund management providers and products.

- **Investment Consultants inhibit innovation and improvements which would benefit pension funds.**

- Even if a pension fund Trustee Board is prepared to decide to appoint a particular investment manager, they will not do so without their Investment Consultant vetting that manager and providing a "Section 36" letter.

- There is little incentive for an Investment Consultant to do this quickly as the likelihood of losing the overall investment consultancy mandate for this one issue is low.

- From the Investment Consultant's point of view, such a client initiative will cost them money, divert their resources from other things they may have prioritised, and may not fit their overall business model.

- Since the Investment Consultants are an oligopoly, they can easily impede developments, even those which would obviously benefit their clients and have actually been promoted and supported by those clients.

- Specifically, the major Investment Consultants have been unenthusiastic about engaging with PiP, a new platform offering a different approach to infrastructure investing that was established by pension schemes for pension schemes, without specific requests to do so from a 'sufficient number' of their pension scheme clients.

- **Investment Consultants inhibit the growth of small investment managers**

- The costs of researching an investment manager are similar whether the manager has a large or small scale of assets under management.

- Investment Consultants typically charge a fixed fee to each pension scheme for whom they perform a manager selection exercise.

- Investment Consultancies can therefore maximise their own profits by only researching managers who have already achieved a threshold level of AUM and have the capacity to accept multiple individual additional allocations from pension schemes.

- It is also unlikely that a pension scheme will be prepared to pay their Investment Consultant to conduct research on a potential new investment manager if there is the possibility that at the end of the process, the consultant will deliver an unfavourable recommendation.

19. (para 34(d)) Since the aim of pension schemes is to provide accrued pension benefits to their members as and when they fall due, PiP believes that the best measure of pension scheme investment strategy performance is the change in size of scheme deficit (or surplus). To reflect the long-term nature of pension schemes, deficit changes should be measured over rolling time periods, for example 3 years (to match triennial actuarial valuation cycles), 5 years or 10 years.

20. (para 34(e)) The legal requirement for pension trustees to obtain and consider "proper advice" has been the single most important factor in the growth and influence of Investment Consultants. Almost invariably, and almost regardless of the knowledge and experience of trustees, no investment decisions are taken without first seeking the advice of an Investment Consultant. Over time this inevitably means that trustees tend to stop making their own proposals and instead become reactive to the suggestions of their investment consultants.

21. (para 38(b)) PiP's core proposition is to offer a lower fee route for pension schemes to invest into UK infrastructure assets. The mandate developed in conjunction with our Founding Investor pension schemes is only to cover our operating costs, NOT to generate and retain operating profits. This approach has been widely communicated to Investment Consultants, but none have sought to use PiP to introduce price competition in the infrastructure investment management sector.

22. (para 64(a)) PiP believes there are significant potential conflicts of interest where Investment Consultants offer both investment advice and fiduciary management services.

23. (para 105) PiP would support a requirement for increased disclosure of asset manager fees and for Investment Consultants to report on how fees have been reduced for pension schemes.

24. (para 114) A requirement for pension schemes to appoint at least one professional trustee would risk creating another system of undue influence where actions of pension schemes become driven by the views of a small number of dominant professional trustee services companies. It would also increase overall

pension scheme costs and therefore potentially be detrimental to member returns.

25. (para 118) PiP is only supportive of a long term mandatory tender regime for fiduciary management services (ten years or more). Shorter timescales would risk introducing "short termism" into the investment strategies adopted by the fiduciary managers to ensure retention of their mandate rather than to maximise long-term returns for pension schemes.

26. (para 120) PiP supports the mandatory separation of provision of investment consulting and fiduciary management services.

27. (para 122) PiP supports bringing both investment consulting and fiduciary management services within the regulatory perimeter of the FCA. Both have at least as much potential influence on the value of pension scheme investments as any individual asset manager who would currently have to be FCA regulated.

Further Information

For further information or to discuss the points made please contact:

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