REDINGTON RESPONSE TO CMA STATEMENT OF ISSUES

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INTRODUCTION

On behalf of Redington Ltd, an investment consulting firm, we respond to the Statement of issues published by the CMA on 21 September 2017. We look forward to working with the CMA on its review of the investment consulting industry.

Since beginning operation in 2006 we have grown to advise over 86 pension schemes (48 of which are on a retained basis) with "assets under consulting" of over £360bn, of which £148bn relates to clients with long term contracts.

We start our response by highlighting three areas where we have strong views, or which we believe the CMA should focus on in more detail. These are the benchmarking and assessment of investment consultants, the buying process and nature of institutional advice and the asset management ecosystem/value chain.

We then comment on the main sections of the Statement of issues: Scope, Potential Detrimental Effects, Theories of Harm and the Possible Remedies, noting areas where we have insights or views, and where we think points may have been missed or should be viewed differently. Broadly, whilst we agree with the scope and the characterisation as presented, we would urge the CMA to reframe their characterisation of investment consulting services around those which are most meaningful to pension scheme *outcomes* - we discuss this further below.

Much of our response focuses on changes that could be made to improve outcomes for customers, because this is where we feel we can best add value to the CMA investigation at this early stage. Of course, as the CMA emphasises, the consideration of remedies is theoretical at this stage prior to any determination of whether there are features of the market having an adverse effect on competition (AECs). We expect that the CMA's consideration of what (if any) would be effective and proportionate remedies will need to evolve as the investigation progresses. We also expect our own thinking to evolve as the investigation progresses and we look forward to having the opportunity to discuss both remedies and other substantive issues with the CMA in due course.

THREE AREAS OF FOCUS

There are three areas that we would like to draw to the attention of the CMA. In our view these represent three of the most important areas to focus on as the CMA works through its review.

Assessing and benchmarking of investment consultants

For competition to work effectively and deliver good outcomes for underlying pension scheme members, it is important that pension trustees are able to assess and compare the overall impact of investment consultancy advice.

We believe that comparing the performance of investment consulting firms against each other could be made easier and more transparent for potential clients for the benefit of underlying members. It is true that the devil is in the detail, and benchmarking a consulting service is harder than benchmarking, for example, an asset manager (as mentioned in paragraphs 34 and 38 of the Statement of issues). However, we believe it is possible to devise appropriate benchmarks. We look forward to working with the CMA in proposing workable and sufficiently detailed metrics which can help prospective clients understand the performance and value-add of consulting firms. In our view, it would be a very worthwhile and impactful outcome from the CMA process for more clarity to be brought to this area.

We note there is unlikely to be a single perfect measure for this; however, this consideration should not prevent investigation into viable and informative measures that could improve buying power and customer choice.

We believe some important factors to consider when designing this measure include: objectivity and independence, accuracy, complexity, representation of actual outcomes delivered to members, comprehension by end members and the existence of a credible counterfactual. We believe that any measure should also be tested for possible unintended consequences.

In our view, a consultant's role is to propose investment strategies to achieve the scheme's objective of paying pensions with greater security. It is also to educate and gain the trust of stakeholders sufficiently to create the conditions for these to get implemented in a timely and effective way. Thus, we believe the most appropriate measure is a composite of the change in overall funded position of clients under the advisory remit of the consultant. In principle, we would support the remedy proposed in paragraph 104 and would welcome the opportunity to contribute to the CMA's work on this issue.

Clients should be in a position where they understand the importance of each component in influencing overall outcomes, such that they do not accord undue weight to any given metric. In particular, manager selection is much less impactful to the end outcomes than other key elements such as the agreement of a specific long-term objective, putting in place a clear framework which trustees use to guide decision making, and getting the right policies in place regarding risk management and strategic asset allocation.[1] We would thus emphasise the importance of strategic asset allocation (paragraph 38 (c)), ahead of the services mentioned in paragraph 38 (a) and (b). To be effective, benchmarking should focus buyer behaviour on the biggest drivers of pension scheme

[1]*Source: 'Does Asset Allocation Policy Explain 40,90, or 100 Percent of Performance' Roger G. Ibbotson and Paul D. Kaplan*

outcomes: i.e. risk management and strategic asset allocation. To focus on anything else ahead of this risks pointing clients in the wrong direction. We believe that this has happened routinely in the industry over the last fifteen years.

We also see a role for a more straightforward "marks out of 5" rating and reviews by clients for consultants given the importance of softer skills in the consultant's role (such as gaining trust, and managing stakeholders) that may be difficult to capture directly in a quantitative track record. We note this is mentioned in the Statement of issues paragraph 107; we support this and believe it would be beneficial to competition. We would welcome the opportunity to contribute to work on how this should be done in practice.

When there are clearer ways to assess the overall impact and performance of consultants, it will become easier to make more direct comparisons of value-for-money in terms of value delivered *relative* to fees. However, this will also require more transparent and comparable definitions and disclosures of fees, including assessments of quoted fees versus actual fees. We believe the remedies mentioned on this point (paragraphs 98 - 101) could, in principle, be beneficial to competition and improve the value-for-money realised by underlying members.

Buying process

We do see the potential for improvements to the buying process that would engender more effective competition between providers of consulting services, and ensure like-for-like comparisons were being made in key areas such as price and service levels.

However, we would urge against making the tendering process highly standardised. This may have the consequence of giving firms less scope for showing true differentiation, and reduce the buying of consulting services to a "tick box" exercise focusing on criteria that might be measured easily (such as staff numbers) but are ultimately not particularly relevant to the quality of the advice given. We believe an over-standardisation of the buying and tendering process could have unintended consequences that would not be in the interests of competition or end members.

We do see scope though for central sources of core information about different consulting firms, which could save time and effort on both sides of the buying process in asking and answering similar factual questions in each tender process (as is normal today) and aiding comparability of data.

The CMA has rightly identified the differences between small and large schemes and it is important to bear this in mind here. Many larger, more resourced schemes are aware of some of the existing pitfalls of standard buying processes and are taking steps to address these. This includes tight scoping of mandate requirements for fee quote purposes, and use of third party selection agents who may be able to use their existing knowledge of a wide range of consultants to add to the process. The resource constraints of smaller schemes should be reflected in any remedies that might be proposed.

We note the inclusion of mandatory tendering as a possible remedy. We believe that mandatory tendering could have several potential unintended consequences which may impact the efficacy of the remedy and make it hard for it to meet the requirement for proportionality.

We believe that mandatory tendering would lead to a sharp increase in the number of tender processes, with many of these being "test the water" processes with no genuine prospect of the incumbent changing. Redington invests, on average, between 100-250 hours in each tender process, which is a significant investment for a relatively small, growing firm of 110 people. If mandatory tendering were to be implemented, we would likely find it impossible to respond to all relevant tenders, and would have to become highly selective to those that we invested the time and effort into. However, we would not be doing this on an informed basis, as it is usually difficult to establish whether the process being undertaken has a genuine chance of resulting in change or not. The net effect of mandatory tendering could be that small firms like ourselves waste a large amount of time in tender processes which are ultimately unsuccessful. It may also mean that genuine opportunities where there is a desire for a change and a need for new and fresh advice may not get the focus and attention they deserve from smaller firms. Overall, we believe this may not be in the best interests of competition, or the underlying members.

We understand that the evidence relating to the effectiveness of mandatory tendering for driving competition in the audit market is not conclusive. We understand data shows that the Big Four's market share of FTSE 100 firms fell only slightly from 99% to 98% between 2011 and 2015, while their share of all U.K. listed firms actually increased over the same period. [2]

Ecosystem/Value chain

We think a thorough appreciation of the broader institutional investment ecosystem is important to understanding competition issues in both the consulting and fiduciary management marketplaces as well as the interaction between the two - we support most of the statements made in paragraph 20 of the Statement of issues on this point. The nature and proximity of relationships is important here, particularly those between parties that provide advice with respect to strategy, implementation and manager selection, and parties that are involved directly in the actual implementation. The nature of information flow between such parties is also an important consideration that we would urge the CMA to consider, in order to ensure that potential conflicts of interest are managed, and clients are benefitting equally regardless of what type of service they are purchasing. Additionally, the affiliations between parties are relevant; for example, it is important to determine whether a party providing advice is affiliated to, or acts on behalf of, another party, or whether the advice is truly independent of commercial relationships. We look forward to helping shed light on these areas.

Rather than group all investment consultants as 'distributors', we believe it is important to emphasise that certain investment consultants such as Redington operate on an arm's length basis from asset managers, and are not acting on behalf of particular asset managers in relation to the provision of services. In addition, we would emphasise again that manager selection is just one service offered by investment consultants, and there are several other elements of the investment consulting service that are more meaningful to pension scheme outcomes.

[2] Source: Financial Reporting Council, 'Developments in Audit 2015/16', 2016. https://www.frc.org.uk/getattachment/2ac8e310-dcaa-4c85-8e8d-cb0c4687942b/Developments-in-Audit-2015-16-An-Overview.pdf

SPECIFIC COMMENTS ON STATEMENT OF ISSUES

Scope

We agree with the overall scope set out in the Statement of issues.

One area worthy of note is paragraph 14, where the CMA seeks to differentiate between, and define, fiduciary management and investment consulting. We support a more precise definition of the two services and the consideration of the merits of internal segregation of the two activities. If differentiation and segregation could be achieved in practice, then we believe this would be in the interests of competition and of underlying members. However, it is likely to be challenging in practice to set out clear definitions which unambiguously place a client in one category or the other, as the industry offers a range of implementation services. Depending on the definition, some asset managers may also feature in the same competitive landscape - which would be important to factor into the scope of the review.

We think it is important for the CMA to consider the extent to which fiduciary services compete with advisory services. We believe that real competition between advisory consulting services (which we offer) and fiduciary management services (which we do not) is healthy, but it is not always evident to us (as a participant in selection processes) when this is taking place. We believe that competition should take place on a level playing field, and that potential conflicts of interest should be managed properly.

We agree that it makes sense for pension schemes to be the focus of the CMA's work in this area - they are an easily-identifiable group with comparable structures and objectives. Pension schemes represent the majority of our revenues, and we would expect this to be true for many of our competitors. However, it is also true that investment consulting firms will derive revenue from other types of client including charities, endowments, family offices, sovereign wealth funds and private wealth managers.

We also note that other service providers may impact competition for investment consulting. For example, actuarial services are frequently "bundled" with investment consulting, which may allow firms to offer multiple business lines that are blurred.

Characterisation

We believe the CMA has identified and captured most of the key characteristics of investment consulting. We have noted below where we have views or insight, and two areas which we believe warrant further consideration.

Lack of clarity and precise definition of investment consultancy services and fiduciary management services, and potential overlap in the types of services offered.

We agree that the lack of clarity around exactly what these services constitute can make it difficult to assess competition. For example, asset managers sometimes provide services that might be considered to fall under investment consulting (e.g. asset liability modelling) or fiduciary management (providing FM services for schemes) and if defined in this way, should also be considered in the assessment of competition within these markets.

Challenges in assessing pension scheme performance

Pension scheme performance will be an important market outcome for the CMA to consider. However, this is easier said than done. Assessing pension scheme performance, and, specifically, determining the impact of investment consulting advice on pension scheme performance is not straightforward. We recognise the challenges involved but believe it is important to find an appropriate and effective way of doing so. Additionally, pension trustees' ability to measure scheme performance is essential if they are to assess the impact of investment consultancy advice and, based on that, exert competitive pressure on investment consultants for the benefit of underlying members. We have views on how to achieve this.

We believe the aim should be assessment of *overall* outcomes of consulting advice, rather than focussing too heavily on some of the component services such as manager selection. The latter may in some cases be easier to measure, but risks failing to capture aspects of investment consulting advice (like strategic asset allocation), which often have the biggest impact on outcomes.

We believe a consultant's role is not only to propose investment strategies to achieve the scheme's objective of paying pensions with greater security, but *also* to educate and influence stakeholders sufficiently to ensure decisions are implemented in a timely and effective way. Thus, we believe a composite of the *change in overall funded position* of the clients under the advisory remit of the investment consultant to be a sensible way of assessing the value add from consulting advice.

Understanding drivers of value add from investment consultants

Linked to the challenges in assessing pension scheme performance is the need to understand the relative impact of value-add factors from investment consultants. In paragraph 38, the CMA has proposed to explore areas with which we agree, but we encourage the CMA also to consider the magnitude of potential impact for each area. For example, asset manager recommendations and fees, whilst listed first, generally have considerably less potential to benefit outcomes positively than high quality strategic asset allocation advice.

As regards the elements making up quality of service, see our comments on page 7.

Relational nature of service

The role of an investment consultant to educate and influence also highlights the relational nature of the service being provided. We believe that it is important that the CMA recognises that a key part of the investment consultant's role is to build trust and reach consensus on (often) complex and technical matters. This takes considerable time, and to view competition in terms of a purely transactional relationship and product sales risks failing to capture a key dynamic that is important to the assessment of competition and that could also impact the success of one or more proposed remedies.

THEORIES OF HARM & POTENTIAL DETRIMENTAL EFFECTS

We refer to the potential detrimental effects as stated in paragraph 22 of the Statement of issues. Although we agree that these could result in detrimental effects for the end consumer, we believe there are a range of sub-effects under *quality of service* that are worth spelling out:

- The ability to understand the client's situation and objectives sufficiently to provide the most appropriate advice;
- The focus on the most important issues (i.e. is the advice directing focus onto the issues that are *most meaningful* to the scheme's outcomes);
- The quality of the advice given (i.e. is it the best advice in the circumstances to achieve the objectives of the scheme; are the investment products proposed appropriate and optimal);
- The ability to advise in a truly independent manner, with *only* the interests of the client in mind; and
- The ability to create trust and other conditions necessary to bring about meaningful change within the pension scheme (recognising that the role of the investment consultant goes beyond provision of cold advice "in a vacuum").

We refer to the three theories of harm as stated in paragraph 43 of the Statement of issues:

1. *Difficulties in customers' ability to effectively assess, compare and switch investment consultants result in weak incentives for investment consultants to compete for customers (Demand side and information issues).*

As we have outlined in our comments above on Assessing and benchmarking of investment consultants (page 2), we agree it may be difficult for prospective customers to effectively assess and compare investment consultants when contemplating a switch, in terms of a) the services provided, b) the outcomes likely to be delivered and c) the transparency on fees (actual fees vs quoted fees). We think it is right therefore for the CMA to investigate this as a theory of harm.

In our experience, prospective clients do find it hard to switch investment consultants, frequently anticipating that the costs (both direct and indirect) and the time taken to switch will be greater than they are in practice. We believe that with a proactive consultant and a motivated trustee board, the actual costs of switching firms can be kept to a minimum.

2. *Conflicts of interest on the part of investment consultants reduce the quality and/or value for money of services provided to customers (Conflicts of interest).*

We do believe that the business model of offering both investment consulting and fiduciary management services can result in conflicts of interest within the consulting firm and we agree that this merits further scrutiny from the CMA. We believe that when a consulting firm offers a fiduciary product, an incentive potentially exists to channel clients into higher revenue generating opportunities (for the firm or individual consultant) even if it is suboptimal, not entirely appropriate for the client or does not represent the best achievable value for money from the client's perspective.

Additionally, potential conflicts of interest may occur where there is an incentive to focus time and effort on channelling clients into fund management products ahead of addressing the most pressing issues facing the fund or where the remuneration of the firm (and/or the investment consultant) is linked to the volume of work undertaken on an advisory basis.

3. *Barriers to entry and expansion reduce competitive pressure on investment consultants, which leads to worse outcomes for customers (Barriers to entry and expansion).*

We believe that some barriers to entry and expansion do exist but we think that the growth of our firm from a start-up 11 years ago to our position today shows that these can be overcome, and we look forward to expanding on this in more detail with the CMA.

The barriers to entry and expansion that we have seen are:

- Bundling of services

As noted in the FCA Final Decision: Market Investigation Reference on investment consultancy services and fiduciary management services, investment consulting is typically demanded and bought in a bundled arrangement whereby strategic asset allocation, risk management, reporting, manager selection and other services are purchased together. Conducting manager research across a wide range of asset classes requires specialist teams and, for a newcomer firm, this takes significant time and investment to build up. When we entered the marketplace, we initially focused on strategic and risk management advice, but found that our potential for growth was constrained unless we could offer sophisticated manager research. It took us until 2014 (8 years) to build our manager research capability across every asset class.

- The role of brand

In our experience, trust and excellent relationships between us and our clients are essential if we are to achieve the client's desired outcomes. This is because the issues at stake are technically complex and there are significant consequences to pension scheme decisions. It is vital that clients trust their advisors to help them make good decisions. In any event, our experience has been that prospective clients often find it challenging to entrust a newcomer firm with the role of advisor. We have invested in building and strengthening brand and trust throughout the past eleven years.

REMEDIES

The CMA has outlined a substantial number of remedies in its Statement of issues. Where we have views/insight in relation to the questions asked in Section 94, we attach our comments to the relevant group of remedies.

Insufficient information is available to trustees and employers to compare investment consultants' fees and quality

- *Require investment consultants to provide clear, consistent information to trustees in relation to all fees*
- *Require consistent reporting of fees charged compared to those quoted or estimated*
- *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*
- *Require investment consultants, when providing advice, to be clearer on the impact of a course of action on their own fees*
- *Ban certain investment consultant pricing practices*

It is currently difficult for trustees to make accurate like-for-like comparisons with respect to fees across different investment consultants. Under particular pricing models it can also be difficult for trustees to assess whether the advice they receive is conflict-free in relation to the fees incurred. We believe greater transparency and independent benchmarking of total fees (including transparency in quoted vs actual fees incurred) could be an effective and proportionate remedy to counter this.

We also note the importance of consideration of *performance benchmarking* alongside fee transparency. Focusing solely on fees, rather than value/quality, may not lead to the best outcomes for members.

- *Require investment consultants to report on pension fund returns against agreed benchmarks*
- *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*
- *Require investment consultants to report the performance of their manager recommendations based on standardised performance metrics*
- *Require pension schemes and employers to provide reviews of investment consultants, with aggregate results shared/available on websites*

Performance of manager recommendations

We have shared our views in relation to assessing investment consultant value-add, and the importance of incorporating strategic asset allocation advice in this assessment given its significant influence on outcomes. Performance of manager recommendations, whilst more easily measurable, are not the key driver of member outcomes.

Another potential unintended outcome of standardised performance metrics for manager recommendations is that whilst they can generally be applied consistently to liquid benchmarked strategies (for example global equity funds), trying to do so for less standardised products (such as absolute return funds) is more complicated. It risks assumptions and groupings that may lead to a less reliable and less accurate measure of manager selection advice.

It is also worth noting that measuring the performance of recommended managers does not necessarily reflect the benefit that has been delivered to clients and underlying members as it does not take into account if and when these managers were actually put in place for individual clients.

Customer reviews

With respect to requiring pension schemes and employers to provide reviews of investment consultants, we believe this could be an effective and proportionate remedy particularly to help capture some of the more relational aspects of investment consulting advice which we believe are fundamental to the role, and which we have provided more thought on in our comments on Characterisation (page 5).

Performance benchmarking generally

Although we generally welcome performance benchmarking to assist trustees in their choice of investment consultant, we note a potential unintended outcome of standardised performance metrics could be to disadvantage new entrants to the investment consulting market who do not have established track records. This may be particularly true for manager recommendations, given the significant investment required to build capability to advise in this area.

Above all we believe that the job of an investment consultant is to guide the pension scheme to better outcomes for the underlying members, not simply to provide a menu of advice services. Therefore, we believe that an effective - and relatively simple - comparison method would be to aggregate the track records of the outcomes achieved by clients under the remit of the consultant. Individual services such as manager selection could be benchmarked separately but, as mentioned above, we would urge the CMA not to focus exclusively on this area as it is not a primary driver of outcomes and could be misleading to clients.

Investment consulting (as noted by the FCA) is a credence good, in economics terms, which is to say there is a strong role for relationship and trust in the consulting process. These are not factors that can be captured easily using a quantitative track record but we believe they could be captured using independent qualitative surveys (some such industry surveys already exist).

There is insufficient and/or ineffective tendering and market testing

- *Introduce mandatory tendering for consulting, fiduciary management services and/or master trusts*
- *Establish rules to improve the tendering process*
- *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*
- *Recommend some form of aggregation/consolidation of pension trusts to benefit from economies of scale*

We believe that mandatory tendering could have a number of potential unintended consequences which may impact the efficacy of the remedy and make it hard for it to meet the requirement for proportionality.

See our comments above on the Buying process (page 3).