INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of hearing with Lane Clark & Peacock (LCP) held on 27 November 2017

Introduction

1. LCP explained that it was important to distinguish between investment consultancy and fiduciary management. LCP offered investment consultancy (ie. advisory services) and had deliberately chosen not to offer fiduciary management services. They did however provide fiduciary management oversight services, which was a limited but growing area of business.

2. In terms of investment consultancy LCP thought that it was easy to switch and buyers were generally well informed. They did have concerns however about competition in fiduciary management. There was a potential conflict in providing both advice and implementation services/asset management services. There was also an element of lock-in with fiduciary management and various impediments which meant that switching away was more difficult than in investment consultancy. These issues had led to demand for fiduciary management oversight services. LCP considered there had however been some improvements in how firms managed the potential advisory/fiduciary management conflict, potentially partly due to the FCA/CMA oversight.

3. LCP also urged extreme caution about the use of narrowly focussed performance measures in investment consultancy due to potential unintended consequences.

Competitive landscape and barriers to entry and expansion

4. LCP stated that they competed with a wide range of companies – at least 10 – 12 firms. They provided investment consultancy services for a wide range of pension schemes – ranging from some small schemes (less than £100m) to much larger schemes. They predominantly offered advice to Defined Benefit (DB) schemes but their Defined Contribution (DC) advisory services were growing rapidly. LCP undertook some work for charities and endowment funds where the size of its clients varied.

5. LCP said that they also provided advice to employers on their DB schemes to help them understand potential risks. They rarely advised both the employer and also the trustees of a scheme as the norm was to have separate advisers. Services to employers were often on an individual project basis rather than on a retainer. In terms of competition differences between charities and pension schemes, LCP thought that the dynamics were relatively similar.

6. LCP stated that they had approximately 100 staff in its investment team. The majority of individuals have a mixed role between client-facing consulting and research. [✂].

Demand Side

7. In terms of LCP's experience of pension scheme trustees, they said that they found it varied and there was no clear correlation with size as scheme circumstances and the nature of individuals involved were factors. For example, some small schemes can be very involved in the detail of the investments and generate their own particular challenges. The presence of professional trustees was also a factor and has been growing and their role varied depending on the scheme. In some circumstances, a professional trustee firm acted as a single sole trustee for a scheme. This was not very common currently and was sometimes seen where schemes were more mature.

8. In terms of advisory fees, LCP typically charged a single fixed fee for projects and services or hourly rates. The trend has been towards more extensive use of the fixed fee approach. This provided trustees with clarity and control over their fees and LCP did not consider it provided any mixed incentive to do more work than necessary – which they thought would be a very short-term ineffective approach to take.

9. LCP observed that fiduciary management fees were generally on an assets under management (AUM) basis and it was sometimes not very clear what was included or not in those fees (for example: asset manager costs; advisory costs; management/movement of asset managers) as sometimes these costs were wrapped up together. There could also be a lack of clarity when using a fiduciary manager about who was responsible for monitoring them and their objectives.

10. LCP also considered that switching fiduciary managers was more difficult than switching investment consultancy provider, and there was more incentive to stick with the current provider.

11. In relation to potential remedies relating to performance reporting for investment consultancy, LCP considered that this would be very difficult as nothing was standardised and there were many factors which influenced the advice given and, hence, performance (for example: employer covenant; maturity of scheme; risk appetite etc). The biggest single factor driving outcomes over the last five to ten years was the use of hedging / liability-driven investment (LDI). However, some scheme trustees had their own strong views on whether or not this was appropriate and in some cases this could also be influenced by the sponsoring company. Performance reporting would be easier for fiduciary management as long as there were clearly agreed investment objectives set.

12. In relation to a potential remedy relating to a qualitative review of performance by clients, LCP stated it already provided case studies/references from previous clients when tendering. In terms of tendering remedies, LCP's experience was that the way tenders were run and the processes involved, were fairly similar. However, they supported greater standardisation. They were not supportive of mandatory tendering as it thought this could turn into a tick box exercise.

Conflicts of Interest

13. In relation to advisory/fiduciary management potential conflict; LCP stated they were not comfortable clients could easily identify and mitigate all these potential conflicts. They had concerns that, whilst the use of in-house products might be operationally easier for providers, their fees were potentially less transparent and it was unclear if a particular in-house product was always best suited to a given client's needs. Pooling assets could give some benefits in terms of scale but it also tended to create additional complexity.

14. LCP also stressed there were perhaps greater conflicts where there was a partial fiduciary management solution for a particular asset class, as this could potentially create an incentive to over-weight this class.

15. Given its concerns about potential conflicts, LCP considered that the most appropriate remedy was for there to be a separation of these functions for clients – firms should not be the advisor and the FM provider to the same client.

16. Although not offering fiduciary management services itself, LCP had advised some of its clients on investing on a fiduciary management basis. There were also a range of other potential conflicts faced by both fiduciary managers and providers of investment consultancy; for example, a potential conflict not to

advise a buyout of a pension scheme's liabilities as this removed the client entirely. However, LCP's approach was to ensure it was doing what was best for its clients – in line with the professional standards to act in the client's best interest.

17. LCP was not regulated directly by the FCA but by the Institute & Faculty of Actuaries ("IFoA") in its role as a Designated Professional Body ("DPB") and therefore abide by the standards set by the IFoA. MiFID II and relevant matters such as changes in disclosure of costs and charges had not yet had any direct impact on LCP as a DPB firm. In practice and where relevant / appropriate, LCP expect to operate under the new rules – much like other FCA regulated investment advisers.

18. In relation to revenues from asset managers, LCP only received revenue in relation to consulting on their pension fund or insurance assets; and LCP had a separate investment panel which assessed the basis for its recommendations. They noted that some schemes had MFNs in place – sometimes negotiated directly by schemes rather than through the investment consultants. In relation to asset manager fees, clients do see these as important and LCP did negotiate to try and get the best deals/discounts to get the best value for money – although they don't always have responsibility for the manager selection role. They also conducted their own regular fee survey of asset managers.

19. On gifts and hospitality, LCP supported limits but saw some value in informal meetings with asset managers.