INVESTMENT CONSULTANTS - MARKET INVESTIGATION

Summary of hearing with BlackRock Inc. (BlackRock) held on 20 November 2017.

How asset managers work with investment consultants

1. BlackRock was a global asset manager. In the UK, BlackRock provided fiduciary management (FM) services to UK defined benefit pension schemes. They noted the significant influence of investment consultants on the decisions of pension schemes in the UK, in part because of the legal duty to get proper advice.

2. BlackRock described a general life cycle of a new product idea and the extent to which investment consultants were involved:

   (a) BlackRock would start with a view of what a type of investor (for example defined benefit pension funds) needs;

   (b) They would develop a concept;

   (c) This concept would be discussed with investment consultants to test the market and potential interest in the concept;

   (d) BlackRock would then construct the fund legally;

   (e) They would seek early-stage investors and then launch the product.

   (f) They would then have a series of research meetings with investment consultants over a period of anything from six weeks to two years to develop their understanding of the product. They have found that some investment consultants have a fairly fixed ‘buy list’ approach while others are more flexible.

   (g) The investment consultant’s ‘field consultants’ then speak to BlackRock and may then recommend the product to their clients.

3. Some investment consultants may require up to a three-year track record before they would recommend a new asset product to a client, but this has changed over the last few years, particularly in relation to alternatives which don’t require the same track record; this can be a barrier to new product

development. BlackRock couldn't think of other examples of investment consultants declining to rate a strategy.

4. When introducing a new product or strategy, BlackRock would sometimes speak to a panel of over 25 investment consultants of different sizes (globally, it works with over a hundred).

5. BlackRock stated that investment consultants' manager research lacks industry-wide standards which can make it difficult for pension trustees to make informed choices on the basis of a comparison. It is hard for investment consultants to recommend an investment product without a track record as clients seek this.

6. BlackRock noted that pension schemes with in-house advice may be more open to investing in new products without an investment consultant rating.

7. The process of fee negotiation with investment consultants varied. It tended to come after product selection.

8. BlackRock stated that they subscribed to [✄] global investment consultant conference in addition to attending very small local conferences where as an example, they might pay [✄] to attend. BlackRock did not see this as financially significant, nor did they believe this created a conflict for BlackRock. They found the FCA's characterisation of these relationships as dated in this respect. That is because:

   (a) The manager research/rating function is not involved in the investment business which looks for ratings for the benefit of the client, and

   (b) BlackRock engages with the client at the strategic level.

Growth of fiduciary management

9. BlackRock stated that pension trustees had a difficult job. BlackRock said that they had seen research from The Pensions Regulator that suggests that those pension schemes with good governance in place were able to achieve better outcomes. Trustees' desire to reduce the burden of scheme governance is one factor that has led to the growth of FM. BlackRock said that the market for both partial and full mandates had been growing. In the past few years, partial FM has been growing more strongly.

10. [✄]. They noted an increase in the use of open tenders and use of third-party evaluators (who are sometimes investment consultants and at other times they are specialist FM evaluators).

11. BlackRock said that they supported an open tendering process for the services of any type of provider as this is an effective way for a customer to get information about the options available to them. However, while mandatory tendering could have benefits, it would incur costs and resources, and there are other ways available for trustees to get information on the options available to them.

12. BlackRock said that pension trustees needed clear information on the performance of FMs linked to clear scheme objectives which will generally be the scheme funding level. FM can help clients access parts of the investment market that they would otherwise be unable to.

13. BlackRock are involved in the work with IC Select to measure performance of FM providers. They can see that many of the same principles could be considered when evaluating investment consultants.

14. BlackRock's FM fees vary by client and depending on the type of mandate. They noted that MiFID II and other initiatives will create a benchmark for cost disclosure across the industry.

Conflicts of interest:

15. BlackRock said that there were potential conflicts in any business where you have two different types of businesses and stressed that what is important is how you think about and manage those conflicts.

16. BlackRock stated that where they have conflicts, such as where they offer their own products to FM clients, these are managed appropriately and disclosed to clients; [✂].

17. They did not see any conflict in their providing Pension Act 1995 advice on strategic asset allocation. This is only provided as part of an FM mandate, not on a stand-alone basis.

18. BlackRock said that there are potential benefits to trustees if standards for conflicts of interest disclosure and management were applied to both the provider of advice and the implementer of that advice, but this does not take into account the cost or any unintended consequences. This would help the trustees to evaluate any possible conflicts. BlackRock discloses conflicts up front to its clients.

19. BlackRock stated that their approach to corporate hospitality had changed in the recent past due to the MiFID II requirements. With regard to corporate hospitality, they noted that industry practice has already changed greatly as the industry gets ready for MiFID II introduction. There was now a prohibition

on travel and accommodation as well as sporting and social events. They do have meals, but these are business focussed. All gifts and hospitality must be recorded in a register. Approval from a line manager is required above a *de minimis* level.

Remedies

20. BlackRock was fully FCA-regulated, so if their activities in providing strategic asset allocation advice were to become FCA-regulated, they could accommodate that. However, they could not say whether FCA regulation would be beneficial for all providers. BlackRock was not subject to the actuarial conduct requirements of the Institute of Actuaries.

21. BlackRock stated that they do not support full separation of FM from other parts of investment consultant firms as this could reduce the number of firms in each sector and so reduce choice for clients.

22. BlackRock said that all institutional investors should have a choice of which services they use and who provides those services. Institutional investors should be able to make well-informed decisions when selecting their provider, be they investment consultants, master trust providers or fiduciary managers. In order to do so, institutional investors need good qualitative and quantitative information.