INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of hearing with KPMG LLP (KPMG) held on 14 November 2017

Introduction and scope of services

1. KPMG entered the investment consultancy market in 2005 as a complement to its pensions practice. By then its pension practice, working with trustees and companies, was well established and it recognised that it needed a strong investment team if it was to advise clients more broadly.

2. The pensions practice consisted of about 400 people, of which around 100 were in the investment advisory team. The investment team primarily advised trustees, while the wider pensions practice advised large companies as well as advising trustees. Both are small, relative to the size of KPMG's overall activities in the UK.

3. KPMG stated that they had about 120 investment advisory clients, a large number of whom had assets under management (AUM) of up to £250m and its bigger clients had AUM around/over £1bn. Around half of these clients will receive actuarial and investment advice services; the other half, which generally includes its larger clients, received only investment advice services. In their investment advisory work, KPMG offered the full range of advisory services. KPMG said that their current growth plan was to target attracting larger clients - those with assets under management of between £500m and £2bn.

4. KPMG said that they had Defined Contribution (DC) specialists in the investment and pensions team as DC is a specialist area. A lot of the work done for DC clients is project based and KPMG did less on-going monitoring work for DC schemes than for defined benefit schemes.

5. KPMG stated that they did not have a separate manager research team, but all members of the investment advisory team were involved in research, spending 20 – 25 per cent of their time on this. KPMG believe having this model better enables the communication of the advice they give to clients.

6. KPMG said that they did not seek to research all asset classes and they did not, for example, conduct significant research on hedge funds. Their approach to research was to place more emphasis on finding the right asset class and having the right strategy in place for clients first, before helping clients through the process of selecting a fund manager to manage those assets. KPMG subsequently helps clients monitor their investments typically on a quarterly basis.

7. KPMG said that they were not considering offering fiduciary management (FM) services to clients as they did not see FM having any fit with KPMG as an advisory firm. They thought their independence as an advisor was important, especially as KPMG is the auditor of some FM firms.

8. KPMG said that their advisory model can compete with the FM model and the choice was typically driven by trustee governance. FM is typically more expensive – for example, FMs may put together more complex investment models comprising various asset classes and fund managers. One benefit of an independent investment advisory model is it can alert clients to more opportunities, for example 'buy-ins' which do not involve FM (so there are no FM fees).

9. KPMG had a small FM oversight team which carries out a limited number of engagements each year assisting trustees to assess different FM providers. The FM oversight team work for clients with assets under management of between £70m to £2.5bn. They had not yet seen a pension scheme move from one FM provider to another or a scheme move from FM back into the advisory model. However, across KPMG's client base it has seen a few advisory clients switch to a delegated FM solution.

10. KPMG did not offer a master trust. However, they provided advice to trustees on master trusts as a part of their DC advisory work.

11. KPMG also had a couple of charity clients. However, these clients do not take as much investment advice as pension schemes.

Number and frequency of tenders

12. KPMG stated that they competed against a range of firms including: the 'big three'; Redington; LCP; Hymans; P-Solve; Cardano and Barnett Waddingham. They had seen the degree of competition grow in the last ten years, including significant new entrants such as Redington and Momentum. However, they thought that it would be harder to enter the market now as the requirement for manager research and investment in modelling tools is

greater. They noted that this could be overcome by buying off-the-shelf tools or external research.

13. KPMG said that they had grown organically and where business had been won from other advisors, the majority was from the ‘big three’ advisors. KPMG had observed two common themes emerging from clients that switch to KPMG - They found clients switch from other providers because:

(a) the clients felt that the arrangements are too complex for the scheme (for example, comprising too many fund managers) and the cost was high; and/or

(b) they do not believe their objectives are being fully met by their existing advisor through a lack of strategic focus.

In which case, KPMG had been asked to pitch alternative proposals.

14. KPMG said that it was fairly obvious what issues needed to be resolved for trustees when tendering, provided the trustees were open to having a discussion before the tender process started, in order to help advisors understand the areas that are performing well and those that are not. KPMG also found that fees are a commercial focus and strongly negotiated by trustees during tender processes.

15. KPMG’s stated that a primary source of sales opportunities was through word of mouth from independent trustees and through the quality of work KPMG does.

16. If an AEC was identified, KPMG could support moves towards more standardised tendering / tender documents as that may help ICs to focus a pitch on the client specific solution and the costs. They considered that compulsory tendering would need to take into account the fact that a tender process can typically last six months, incur a high level of costs and a lot of time for both pension scheme and the investment consultants (every client investment strategy is different from others).

Demand Side

17. KPMG stated that they believed that trustees have improved in their effectiveness in the last five to ten years due to:

(a) the appointments of independent trustees – most KPMG clients now have these;

(b) having investment sub-committees who are primarily focussed on investment (most boards now have such sub-committees) with quicker decision making and working better with employers;

(c) training, if they have an advisory model; and

(d) greater focus in seeking value for money at the tender stage.

18. KPMG indicated that the success of an investment consultant should be measured by how well the advice given has helped the client meet their strategic objectives. For example, if the objective is to diversify, whether the diversification has been beneficial and whether it has helped manage risk. In KPMG's view, just beating the market could miss the bigger picture. However, an IC's influence can be complex to measure as clients do not always follow advice.

19. KPMG offered many clients a performance fee option. The client chooses, based on its judgement as to the performance of KPMG, whether to pay above or below the quoted fees. KPMG has found that the majority clients elect to pay a performance fee above parity due to satisfaction of advice given.

20. KPMG saw Liability Driven Investment as a critical tool to ensure assets are aligned to liability risks. It has encouraged its clients to look to reduce this unrewarded risk by hedging the interest rate and inflation exposure.

21. KPMG said that they could be supportive of benchmarking of investment consultants. However, there was a need for clarity in how advisors would be benchmarked, as this would be a difficult undertaking and the CMA would need to engage fully with the industry when considering how and if it could be done. KPMG believed that as 'no one size fits all' and the whole picture needs to be looked at, it would be difficult to rank consultants by metric (for example, whether an advisor beats the market).

22. KPMG highlighted the importance of the independent trustee community in the market, which has been increasing, and suggested the CMA should consider reaching out to them during the market investigation to obtain their views.

Conflicts of Interest

23. KPMG stated that it did not see any obvious conflicts between actuarial and investment consultancy mandates.

24. KPMG explained that before they took part in a tender, KPMG ran the potential engagement through an internal global tool, which checked for conflicts.

25. With respect to fund manager research and helping clients evaluate fund managers to manage their assets no KPMG staff who carry out this research do any work for asset managers.

26. Also during pitches, KPMG usually includes responses to questions in the ITT to determine how it would need to manage conflicts.

27. KPMG stated that, subject to any other restrictions and its wider audit regulatory requirements, generally it is acceptable for KPMG to be the investment consultant of the pension fund of an audit client since their IC engagement is with the trustees (not the sponsoring company).

28. KPMG said that it still saw certain hospitality such as meals taken but very little, especially since the FCA review. KPMG's investment team keeps a register of gifts and hospitality that are offered and declined and all staff are subject to wider KPMG policies on such.

Barriers to entry and expansion

29. KPMG stated that there wasn't the level of client dissatisfaction observable in the market to trigger a significant volume of re-tendering. While KPMG believed they outperformed their market share when it came to tendering (i.e., won more tenders than their market share would suggest), a low volume of tendering has had some restriction on potential growth.

30. KPMG said that they had observed from their own FM survey that there were eight to ten credible FM suppliers in the market. KPMG believed a lot of movement from advisory to FM services is not taking place in an open market environment. I.e., it is possible that clients are moving from the advisory model to the fiduciary model without a full tender process, although this position was improving, as evidenced by KPMG's recent FM market survey.

31. KPMG also said that they believed that investment consultants should be regulated for all advice as this would be a logical extension of the FCA's current remit and improve the quality of advice provided to schemes. Regulation could involve those newly regulated advisors taking additional exams and KPMG sees no practical issues with this.