INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of hearing with Hymans Robertson LLP (Hymans) held on 15 November 2017

Market

1. Hymans stated that the investment consultancy market was viewed as being in three tiers by size and style of firm: the three multinational consultancies (who offer advisory and ficuciary models) in tier 1, a range of independent firms like Hymans, LCP, KPMG, Redington in tier 2 and many small firms in tier 3.

2. Hymans believed that high turnover of investment consultants is not an appropriate objective for the outcome of the CMA review, and that remedies should be based on seeking better outcomes for users of the services offered. The PLSA submission suggests that the standard of service offered is regarded by users as high and most believe they have the expertise to challenge consultants and manage costs effectively.

3. Hymans worked with a wide range of schemes in terms of asset size ranging from the small (under £100m of assets) to the large with multiple £billions of assets.

4. Hymans have consistently grown their business amongst private sector Defined Benefit (DB) schemes; work for local authoritiy pension schemes (LGPS) has remained significant, although LGPS schemes represented a minority of Hymans' revenues. Local authority schemes had different priorities as they tended to be still open and so cashflows were positive and the covenant is different (ie no access to the PPF).

5. Hymans have typically won clients through competitive tenders, of which they expected to win a competitive percentage of the tenders they bid for. The cost of procurement for investment consultancy firms is high relative to the revenues earned, so Hymans sought to participate in new business situations which are driven by a need for change and the prospect of a long-term relationship rather than simply for due diligence purposes where the client is entirely satisfied with the incumbent.

6. Hymans viewed competition in the market as strong, evidenced by the PLSA submission which suggests that around ⅓ of investment consultancy mandates come up for tender every two to three years and another ⅓ every four to five years.

7. Hymans explained that the Defined Contribution (DC) market currently had a lower value of assets invested. However, as the schemes grow and mature, they expected the focus of governance to shift. The current cap on charges for DC schemes limited their investment choices.

Demand side

8. Hymans believed that the Myners principles of good scheme governance still hold today. In particular, Myners recommended that trustee boards should have sufficient investment expertise. Sponsoring company CFOs are often no longer scheme trustees as a result of being conflicted, but the presence of professional trustees with investment expertise has expanded greatly in the past five years to help fill that gap.

9. Hymans did not think consultants' performance could be measured effectively by simply examining the quantitative performance of investment returns. Performance of an adviser also requires subjective assessment of other factors such as trust, confidence, effectiveness of communication and standards of service. This reflects the fundamental difference between investment consultants, who are advisors not the decision taker, and asset managers. The analysis of outcomes for pension schemes must be evaluated on the basis of an appropriate time period, which is often the longer term, and not simply on a 12 month returns achieved basis.

10. Hymans considered that trustees had access to the resources necessary to assess investment consultants, given that they were able to make use of independent expertise in the form of independent trustees and expert procurement firms.

11. Hymans welcomed transparency in the area of comparison of fees and recommended a methodology which allows comparison of cost for the same scope of work. The scope of many services can vary, for example, a strategy review can be a large or small exercise, and firms can quote on a different basis depending on their desire to win work at any given point.

12. They noted that investment consultancy is often bundled with actuarial services, but not for the majority of their clients. Smaller clients often prefer a 'full service' of scheme administration, actuarial and investment consultancy

whereas larger clients may run some services in house or seek best of breed in each service area.

Conflicts

13. Hymans stated that the provision of fiduciary management by investment consultants could give rise to a conflict of interests, but that a robust and independent selection and appointment process would help to mitigate that conflict. Ongoing monitoring of the fiduciary management provider by an independent advisor is an additional component of managing potential conflict.

14. The Hymans business model is based on the provision of independent advice, so they generally did not recommend fiduciary management to their clients, but have done so on occasion.

15. They also noted that local authorities have formal regulations regarding the need to tender for a wide range of services, including investment consulting services.

16. Hymans stated that the provision of advice by asset managers as part of a fiduciary management service raised conflicts as it is hard to demonstrate that a decision has been purely in the client's interests, for example, when the firm recommends its own investment products above others.

17. Hymans did not think structural separation of advisory and fiduciary management services would be necessary. However, advisory services are often bundled within the same fee as asset management services by fiduciary managers. At the very least, the fees for the (i) investment advice and (ii) asset management elements of the service need to be unbundled and provided separately, and cross-subsidies rendered transparent. This would ensure scope to procure the provision of these services separately, and for trustees to more easily retain independent investment advice under the fiduciary model.

18. Hymans thought that gifts and hospitality no longer tended to give rise to significant conflicts. They have always had internal disclosure of gifts and hospitality. Hymans thought that the provision of gifts and hospitality to pension trustees should also be considered, although noted that trustees generally have to disclose it to each other. They acknowledged that there may be issues elsewhere in the industry.

19. Hymans did offer some services to asset management firms, but not to investment consulting firms. They use internal information barriers to manage

potential conflicts. They have previously run conferences exclusively for asset management firms and charged an attendance charge to the cover related costs; this was done on a break-even basis with any surplus going to charity. They have not run any conferences of this nature over the last year and have no plans to do so at this stage.

20. Hymans stated that the master trust market is highly competitive with over 80 schemes, of which around 20 are serious players. Hymans have provided independent advice to, and overseen projects for, many clients transferring to master trusts. Hymans view is that if a client is considering switching to the master trust offering of their existing investment consultant they should seek independent advice (from another firm) and consider other offerings before embarking on the change. Remedies that nudge clients towards tendering would be more appropriate than harder remedies at this early stage in life of industry.

21. Hymans was an ‘authorised professional firm’ as less than 25 per cent of its revenue resulted from FCA-regulated activity. However, Hymans applies FCA standards across all of its investment activities. They suggested that any expansion of FCA regulation would need to demonstrate a clear boundary between investment advisory and actuarial activities.

Outcomes

22. Hymans worked with asset managers to develop products that meet the needs of their clients, and in the full expectation that the product would not be exclusive to Hymans’ clients.

23. In terms of driving asset management fees, Hymans found that the market was more competitive today than in the past. Today, discounts are often available through negotiation, although the extent of this varies by asset class. Hymans also noted that hedge fund costs have fallen a lot in recent years (from a very high level), driven by pressure from investment consultants on behalf of clients.