ClientEarth

John Wotton
Competition and Markets Authority
Investment Consultants Market Investigation
Victoria House, 3 Southampton Row
London WC1B 4Ad

info@clientearth.org
www.clientearth.org

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Dear Mr Wotton,

Subject: Investment Consultants Market Investigation - Accountability Gap in Relation to ESG and Climate Change-Related Financial Risk Factors

ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are environmental lawyers working at the interface of law, science and policy. Our Company & Financial Project conducts research into the legal implications of climate change-related financial risks for a wide spectrum of market participants, including companies, investors, company directors, their professional advisers and regulators.

We understand that the CMA Investment Consultants Market Investigation (**Investigation**) is considering whether any features of the relevant markets for the supply and acquisition of investment consultancy services and fiduciary management services by institutional investors and employers in the UK are having an adverse effect on competition (**AEC**) in those markets. In particular, we understand that the investigation will focus on the potential detrimental effects on customers of investment consultancy services and/or fiduciary management services resulting from any AEC(s), considering both short and long term impacts, such as: higher prices to customers; reduced service quality; reduced choices of provider and/or products; and less innovation.

Consistently with the findings of the Financial Conduct Authority's (**FCA**) Asset Management Market Study Final Report (**FCA Report**), we believe that there is a significant accountability gap in relation to the provision of investment consultant and fiduciary management services. As we noted in our submission to the FCA Asset Management Market Study we also believe that this accountability gap is particularly acute in relation to the quality of advice provided by investment consultants regarding environmental, social and governance (**ESG**) issues generally, and climate change-related risk factors more specifically. In our view customers – particularly pension trustees – find it difficult to monitor, challenge and assess the quality of consultants' advice on these matters, despite the relevance of these issues for their own legal duties.

Numerous studies have now indicated the extent to which ESG and climate change-related factors can have significant implications for the risk/return profiles of investors' portfolios over a range of time frames, and particularly over the longer term time horizons relevant to trustees and managers of UK pension funds.[1] Accordingly, the Pensions Regulator (**TPR**) has now updated relevant guidance to make it clear that it expects trustees of pension funds to assess the financial materiality of ESG factors, such as climate change, and to allow for these in the development and implementation of investment strategies.[2] In our view, such steps are now likely to be necessary for trustees to meet their existing legal duties.[3]

Despite this mounting evidence and clear guidance from TPR, our work has indicated significant inconsistency in the extent to which pension funds are adequately addressing these issues. In our view, a key reason for this failing is the poor quality and inconsistency of services provided by investment consultants in relation to these matters. A recent study by the UN Principles for Responsible Investment (**PRI**)[4] and the final report of the EU High Level Expert Group on Sustainable Finance also provide evidence to substantiate this view.[5]

In light of these observed shortcomings we have recently released a report which identifies that investment consultants who fail to advise their clients on financially material climate change-related risk factors may be in breach of their own legal duties.[6] In this respect, we also note a recent initiative by the UK Sustainable Investment and Finance Association (**UKSIF**) and the Association of Member Nominated Trustees (**AMNT**) to secure public commitments from sixteen investment consulting firms that they will bring the TPR's ESG guidance to the attention of their clients and which notes that they are obligated to do so.[7]

Notwithstanding our analysis of consultants' legal duties, and the commitments secured by AMNT and UKSIF, in our view, the particular dynamics of the market for investment consultant services combined with limited direct regulatory oversight means that there are likely to be inadequate legal or commercial incentives for consultants to appropriately integrate these issues into their service offerings. In our view this accountability gap is undermining service quality and innovation in relation to ESG and climate change-related factors and is ultimately exposing pension funds and their beneficiaries to significant and detrimental financial risks.

Accordingly, we believe that the CMA should be directly considering these issues in its Investigation and we would welcome the opportunity to discuss this matter with you further.

Yours sincerely,

Alice Garton
Company and Financial Project Leader
ClientEarth

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[1] See, eg, BlackRock, 'Adapting portfolios to climate change: implications and strategies for all investors (September 2016) https://www.blackrock.com/investing/literature/whitepaper/bii-climate-change-2016-us.pdf ; Mercer 'Investing in a time of climate change' (2015) https://www.mercer.com/our-thinking/investing-in-a-time-of-climate-change.html.
[2] TPR, 'A quick guide to defined benefit investment' (2017) http://www.thepensionsregulator.gov.uk/trustees/db-investment-strategy.aspx.
[3] See Keith Bryant QC and James Rickards, 'Opinion on the Legal Duties of Pension Fund Trustees in Relation to Climate Change' (2016) http://www.documents.clientearth.org/library/download-info/qc-opinion-the-legal-duties-of-pension-fund-trustees-in-relation-to-climate-change/.
[4] UN PRI, Investment Consultant Services Review (2017) https://www.unpri.org/download_report/45165
[5] EU HLEG, Final Report (2018) https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en
[6] ClientEarth, 'Risky business: climate change and professional liability risks for DB investment consultants' (2017) https://www.clientearth.org/new-reports-bring-light-climate-liability-risks-facing-pensions-advisers/.
[7] UKSIF, AMNT, 'UK investment consultants publicly back UK Pensions Regulator guidance to consider environmental and social issues' (2017) http://uksif.org/wp-content/uploads/2017/09/Press-release-AMNT-UKSIF-250917-LR-003.pdf.