

Response to the CMA Paper on Fees and Quality

In this paper we provide our response to the specific questions posed by the CMA in their paper on Fees and Performance.

We find that the paper overall has effectively captured the issues facing the industry with regard to fees and quality and that the developing concepts are appropriate for the issues being faced.

Section 1: Current clients – information on fees

Remedies to improve the quality and utility of fee information to both current FM clients and current advisory clients are similar in principle:

- a) *Mandating comprehensive disclosure of fees and charges with minimum frequency including in relation to third party fees.*

The introduction of a mandatory minimum level of information would guarantee trustees receive relevant cost information but risks reducing flexibility.

Questions:

- *Should a remedy specify presentation as well as content?*

IC Select do not consider that mandating comprehensive disclosure of fees and charges would be beneficial for pension funds and that the template approach is preferable. However, presentation and layout should not be specified since this would remove the ability of firms to enhance the layout to improve communication of the results.

- *How to accommodate varying trustee abilities and requirements?*

Adoption of IDWG template will accelerate trustees understanding of fees and charges

- *How to incorporate different fee structures, service lines and fund types?*

Templates from IDWG should accommodate these requirements

- *To what extent are MiFID II and the outputs of the IDWG sufficient to address any issues identified?*

As far as IC Select are aware the IDWG is creating a fiduciary management template and we expect that they will also introduce something similar for advisory. We would hope that when they do their output will be sufficient to address the issues and that they will recommend a template approach which leaves scope for innovation and improvement

- b) *Guidance to trustees on requesting and interpreting fee information, potentially including templates*

Questions:

- *Should a toolkit based remedy specify presentation as well as content?*

The use of off-the-shelf templates would help trustees ensure they ask for and receive cost information at a sufficiently granular level, but is dependent on trustee engagement and confidence. However, if this approach is adopted then all that should be defined is a minimum level of information with trustees free to request and, firms free to add,

additional information if they thought it would be helpful. As the information requested may vary it will not be possible to specify the presentation layout

We would expect trustees that are not confident will tend to only request the template information whereas those that have a clear view on what they are trying to achieve from looking at the information will request additional data and specific presentations.

Ahead of any reporting by the IDWG we have set out below what we regard as the minimum template for DB advisory fees and a comprehensive template for DB advisory fees that captures the full cost of the governance solution.

Minimum Template for DB Advisory Fees

	2017		2016	
	£	%	£	%
Fund manager costs (Itemised by manager in separate schedule)	£AAA	a.aa%	£MMM	m.mm%
Fund Fees (Itemised by fund in separate schedule)	£BBB	b.bb%	£NNN	n.nn%
Custody costs	£CCC	c.cc%	£PPP	p.pp%
Performance measurement fees	£DDD	d.dd%	£QQQ	q.qq%
Investment Advisory Fees (Standard)	£EEE	e.ee%	£RRR	r.rr%
Investment Advisory Fees (Special Projects)	£FFF	f.ff%	£SSS	s.ss%
Transaction costs (Possibly in 2019 or 2020)	£KKK	k.kk%	£WWW	w.ww%
Total Cost	£LLL	l.ll%	£XXX	x.xx%

The minimum template for DB advisory fees as illustrated above has the advantage that the investment adviser should have all this information and, therefore, could be easily produced by the investment adviser as part of their regular reporting.

Comprehensive Template for DB Advisory Fees

	2017		2016	
	£	%	£	%
Fund manager costs (Itemised by manager in separate schedule)	£AAA	a.aa%	£MMM	m.mm%
Fund Fees (Itemised by fund in separate schedule)	£BBB	b.bb%	£NNN	n.nn%
Custody costs	£CCC	c.cc%	£PPP	p.pp%
Performance measurement fees	£DDD	d.dd%	£QQQ	q.qq%
Investment Advisory Fees (Standard)	£EEE	e.ee%	£RRR	r.rr%
Investment Advisory Fees (Special Projects)	£FFF	f.ff%	£SSS	s.ss%
Independent Trustee Fees (Investment related)	£GGG	g.gg%	£TTT	t.tt%
Legal fees (Investment related)	£HHH	h.hh%	£UUU	u.uu%
In-house costs (Investment related)	£JJJ	j.jj%	£VVV	v.vv%
Transaction costs (Possibly in 2019 or 2020)	£KKK	k.kk%	£WWW	w.ww%
Total Cost	£LLL	l.ll%	£XXX	x.xx%

However, we believe that the primary objective of fee reporting is to capture the full costs of a governance solution and the minimal solution misses out some key investment related costs, mainly, independent trustee fees, legal fees and inhouse costs. These costs should be captured as at many schemes, for example, with an in-house investment manager or team, the costs incurred on advisory fees would be reduced as a result of work undertaken in-house. Likewise, legal fees may be significantly higher if a complex investment solution is adopted. For example, we have seen six figure legal fees for the negotiation of ISDAs where principal to principal ISDAs are used as part of an LDI

approach, costs that would not be incurred if a fund approach were adopted or if agency ISDAs were used.

The disadvantage with the comprehensive template shown above is that the investment consultant would not have the information required to produce a fee template and would have to gather the information from other sources, increasing the cost of producing such a template.

- *Would multiple templates need to be developed?*

There should be different templates for different DB and DC circumstances e.g. fiduciary management, advisory

- *How could use by trustees be encouraged?*

Trustees should be encouraged in this regard by advice on best practice from the Pensions Regulator, including adding this to the Trustee Toolkit, information and training from other industry bodies such as the PMI and the PLSA and advice from their advisers on best practice.

Section 2: Current clients – information on performance

Remedies to improve the quality and utility of scheme performance information to current advisory clients (and potentially FM clients for best practice):

- a) Introducing a standard baseline level of scheme performance information for advisory firms would standardise the information provided. However, there remains a question of how to measure the performance of advisory firms.***

The performance of advisory pension funds should be measured as the asset return relative to the liability benchmark since this is the objective that relates directly to improving funding. This measure would represent the performance of the governance solution of a pension scheme. It does not seek to separate out the different elements of the collegiate decision making process of a fund, notably, the trustees decisions, the advice from their investment consultant and the input of any other advisers that work with the trustees, such as independent trustees.

This performance measure would provide a basis for comparing the performance of a pension fund with other similar pension funds and could be used to benchmark the overall performance of the governance solution.

Questions:

- *Should advisory firms have any responsibility to report on the performance of the investment decisions of trustees and AM providers?*

The performance of a pension fund should be viewed as a collegiate outcome involving the decisions of the trustees, the advice from their investment consultant and the input of any other advisers that work with the trustees, such as independent trustees. Separating these different elements for any particular pension scheme is virtually impossible. If trustees do not follow the advice provided by an investment consultant, then the consultant must share responsibility for that outcome. It is quite possible that the advice presented was sub-optimal. Had the consultant delivered the advice more effectively then potentially the outcome would have been different.

There may be some funds that use a separate performance measurer or, particularly at larger funds, complete the work themselves in-house. Where this is not the case advisory firms must be prepared to report on performance if the trustees request it. If they fail to do so then the trustees should sack the firm.

- *Is there value in increasing the standardisation of information received?*

As noted in the CMA working paper on information on fees and quality, the quality of information presented to pension funds is often poor with little detail on risk or on higher level strategy. Increasing the standardisation of information received by outlining a 'best practice' report would improve the information provided to many pension schemes. If this were done, then there would be little scope for consultants to charge additional fees for presenting key information which would improve the information provided with minimal additional cost to trustees.

- *Are trustees able to request performance information in the format they require?*

Trustees should be able to request performance information in the format they require, however, they must accept that there may be additional costs in creating customised reporting for their fund as opposed to relying on the standardised reporting. If the consultant refused to provide the information in the requested format, or if the costs of providing this were considered prohibitive, then the trustees could retender their investment consultancy services.

- b) ***Guidance to trustees on requesting performance information and how to interpret it could help trustees ensure they ask for and receive the appropriate information but is dependent on trustee engagement and confidence.***

Questions:

- *How to draft useful and meaningful guidance to cover a range of scenarios?*

Guidance based on high level content and not detailed layout would ensure a range of usual information is covered. An example of high level content that we believe would be appropriate for a report would be:

- Performance and risk of the assets against liabilities
- Attribution of asset performance against liabilities (note: a similar breakdown to attribute change in funding level could be provided) into
 - a) return from under hedging
 - b) return relative to liabilities of matching asset
 - c) return relative to liabilities of growth assets
- Ex-ante risk attribution from asset classes and return drivers
- Scenario analysis for a range of different scenarios
- Sensitivity analysis from market movements e.g. 1% change in rates or inflation or 30% fall in equities
- Performance and risk of each asset managers over one, three, five and since inception relative to their benchmarks.

The layout of the report would be left to individual firms to create in line with their house brand.

- *To what extent would additional guidance be useful to trustees and would it be used?*

Information on how to interpret the report content and suggestions of other types of information that the trustees may wish to consider would be helpful if provided.

Section 3: Prospective Clients – information on fees

Remedies to improve the quality and comparability of fee information would be similar in principle for prospective advisory and FM clients:

- a) ***Introducing a duty for firms to provide a minimum level of fee information would standardise the information provided and ensure that trustees receive it.***

Questions:

- *Should this be in a fixed template?*
Fee information requests in tender documents should reflect the individual requirements of each fund as provided in the tender material. In our experience, trustees are often not clear enough about their requirements when tendering for investment consultancy services (e.g. specifying exactly what the consultant will be required to do, the frequency, location and duration of meetings they are expected to attend and the complexity of the investment governance solution). A fixed template could provide a structure for setting out the requirements which would enable better pricing information to be provided.

The issues mentioned in the paper with regard to different fee structures with some based on time cost and others fixed costs will also make direct comparison of fees challenging. At IC Select, the preference is to request pricing for each individual element from the template of service requirements plus a fixed cost covering everything on the template together with an ‘whatever it takes’ fee. However, no matter how detailed the requirement template is we still find that we have to spend significant time on each tender clarifying fees quoted to ensure that they are on a similar basis.

- *Should there be a detailed calculation methodology provided?*
We do not believe a detailed calculation methodology should be provided since firms have different approaches to how they charge fees and it is unlikely a detailed calculation methodology could be determined that would fit with all firms.

Section 4: Prospective clients – information on performance

Remedies to improve the quality and utility of performance information to prospective FM clients:

- a) ***Adoption of a standardised approach to FM performance and use of composites***

Questions:

- *How would composites be defined to ensure relevance?*
The formation of composites should be left to the discretion of the fiduciary manager so that the composite construction is aligned with their approach to fiduciary management. If firms were forced to comply with a specified composite structure then this may have the unintended consequence of changing how they manage client accounts.

Leaving the construction of a fiduciary manager firm’s composites entirely at the discretion of the fiduciary management firm fully aligns the Standard with the GIPS standard. The CFA Institute has taken the view that ultimately the market will decide

what the most appropriate composites are and, firms that do not have composites that align with the market needs, will not be successful in winning new business. The IC Select Fiduciary Management Performance Standard Steering Group accepted this view in allowing firms to design their own composites. However, they did take the view, that it will take some time for market needs to become clear to all fiduciary managers. Consequently, as the Steering Group felt that the membership of the Group, reflecting independent trustees and third-party evaluators, was, to some extent representative of the market, it would be helpful to recommend a structure that they believed reflected the market needs as a guide to the fiduciary managers.

- *Is the proposed IC Select framework sufficient and appropriate for trustees?*
As the developer of the framework we are obviously biased in responding to this question. However, we do believe that is sufficient and appropriate for trustees. The key issue is to ensure that trustees have the necessary knowledge about how the standard works to gain the maximum benefit from using it.
- *How should any standard be maintained and developed?*
Standards should be maintained by the CFA Institute, a global organisation committed to ensuring the highest professional standards in asset management. The CFA Institute already maintain the Global Investment Performance Standard for asset management, so a fiduciary management standard would be a natural extension of their work.

Remedies to improve the quality and utility of performance information to prospective advisory clients:

- b) ***Introducing a standard baseline level of scheme performance information for advisory firms** would standardise the information provided. However, there remains a question of how to measure the performance of advisory firms. (Firms to provide example performance reporting information.)*

The performance of advisory pension funds should be measured as the asset return relative to the liability benchmark since this is the objective that relates directly to improving funding. It is the same approach to measuring performance as underpins the IC Select Fiduciary Management Performance Standard which has already been accepted by fiduciary managers. This measure would represent the performance of the governance solution of a pension scheme. It does not seek to separate out the different elements of the collegiate decision making process of a fund, notably, the trustees decisions, the advice from their investment consultant and the input of any other advisers that work with the trustees, such as independent trustees.

This performance measure would provide a basis for comparing the performance of a pension fund with other similar pension funds and could be used to benchmark the overall performance of the governance solution.

Questions:

- *Is standardised performance for advisory meaningful given that the responsibility for decisions ultimately rests with trustees? Would it be feasible to design comparable performance metrics?*

As described above, standardised performance for advisory is meaningful even though the responsibility for decisions ultimately rests with the trustee. The data for any individual fund

will not provide insights into the value added by an adviser, since this will be a combination of the trustees' decisions and the consultant's advice. However, when the average performance is calculated across a large number of funds, the vagaries of different trustees' decisions at different funds will tend to disappear and the added value of the investment consultant will become visible.

- ***Could this be supported by firms providing indicative reporting up front?***

If all firms adopt the same standardised performance approach and organise their information into composites according to various characteristics; such as the governance approach, hedging level and return objective relative to liabilities, then it would be possible for firms to provide indicative reporting up front.

- ***How should any standard be maintained and developed?***

Any standard should ideally be developed in consultation with the industry. We would hope that the CFA Institute could be persuaded to maintain such a standard as this would be closely aligned with their work in asset management. Their mission statement of; "to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society" suggests this may be possible. However, we note that their definition of the core investment industry does not currently include investment advisers.

Remedies to improve the quality and utility of performance information to all clients could include:

- c) *Introducing a tender toolkit would potentially reduce the burden on trustees and improve the quality of the information requested. (A duty on firms to provide information in accordance with the toolkit or other minimum standards on a comparable basis and against relevant benchmark.)*

Questions:

- ***Would trustees be sufficiently confident to act on information received?***

In our experience if trustees were presented with performance information on a standardised basis they would have the confidence to act on it. The major issue however is not that they would not have the confidence to act but that they would place too much emphasis on any performance data. We believe that performance information should form the start of a conversation in order to understand how the performance history had been achieved rather than being used to simply select the firm with the best historic track record. Such a conversation would enable the trustees to gain a much better understanding of the investment approach of an organisation and, consequently, enhance their decision making.

- ***Who should develop, maintain and promote a toolkit?***

If the toolkit is seen as being mainly performance based then we believe, as stated above, that the CFA Institute is the best placed organisation to develop, maintain and promote a toolkit and the governance required around it.

- ***Should it be supported by an obligation on firms to provide information according to the toolkit?***

If the provision of performance information were not obligatory then there would be a tendency for firms who perceived that they were not competitive on performance to not comply. Therefore, to be useful to trustees there would need to be some element of obligation on firms to supply the information.

Section 5: Other information on quality

Remedies to improve the quality and comparability of performance information for all clients:

- a) *A remedy that requires the collection of objective client feedback and dissemination to prospective clients would mean that trustees would be able to consider service levels on a comparable basis.*

Questions

- *Should this be published on supplier website, a central hub or just on request?*

We do not believe that a requirement to publish service information on a supplier website would be beneficial as it would just create a feeding frenzy for journalists in producing articles, often misinterpreting data, that compared the service levels of different firms. Instead, we believe that this information should only be provided to a potential client by a consulting firm on request by a verified bona-fide potential client. This is the approach adopted for GIPS information.

- *Should the firm be responsible for collation or a third party?*

To be comparable the information should be collected as part of an industry wide standardised questionnaire. Ideally, the firm should not collect the data as they could influence the trustees in how they respond. Instead, the information should be collected by an independent third party via a web-based database.

- *What would the potential cost impact of this be?*

If a standardised web-based data collection form were used for trustees to complete and the data was input into a central database then it would be possible to collect, benchmark and feedback this data for minimal cost, possibly no more than £50 per fund.

- *What areas of service should trustees be surveyed on?*

Areas of service that trustees should be surveyed on would include:

- How clear is the written advice?
- How clear is the verbal advice?
- How well does the consultant understand our needs?
- Is the advice appropriate?
- Are reports delivered within agreed timescales?
- How effective do you perceive the strategic advice to be?
- How effective do you perceive the tactical asset allocation to be?
- How effective do you perceive the manager selection to be?
- Does the consultant provide value for money?
- How likely would you be to recommend the consultant firm?

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