LCP INSIGHT CLARITY ADVICE



# CMA Market Investigation – Investment Consultants

22 March 2018

## Response to working paper: information on fees and quality

This is LCP's response to the CMA's working paper: information on fees and quality, from its market investigation into UK investment consultants.

We welcome the opportunity to comment on the working paper and its potential remedies. We have commented on selected potential remedies in the tables below.

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| Potential remedy | LCP comments |
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| **1. Current clients information in fees** | |
| a. Mandating comprehensive disclosure of fees and charges with minimum frequency including in relation to third party fees. | For advisory services, we agree, in principle, that better disclosure of fees and charges would be beneficial. It is our current practice to provide clients with clear disclosure of their fees payable to us.<br><br>The CMA's findings suggest that advisory investment consultants' fees and charges are reasonably clear. Therefore, this proposal is primarily aimed at improving the disclosure of third-party fees and charges. Mandating that investment consultants provide this information does pose some practical problems, for the following reasons:<br><br>• A client may use an advisory investment consultant for limited or specialist services only which are separate and distinct from some or all of the third-parties that charge the client fees. It would need to be clearly set out which costs and charges it is appropriate for the consultant to disclose. For example, a consultant may only be used to provide strategic asset allocation advice and have no interaction or responsibility with the investment managers used by the scheme or in negotiating their fees.<br>• Investment consultants may not have the right to access all the relevant information. The third-parties providing services to the pension scheme are generally not contracting with the investment consultant. Data provision could be an issue.<br><br>We suggest, therefore, that the best approach for greater disclosure of schemes' costs and charges is for these |

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| | requirements to rest with the relevant third-parties to provide this information to trustees.<br><br>In particular, for DC schemes, we believe the quality of the data in the Value for Members assessment will improve this year as investment managers are now required to submit the data on relevant costs to trustee boards.<br><br>We propose that the desired outcome of this potential remedy is best achieved by making the guidance from the Pensions Regulator for DB schemes (quoted in this CMA Working Paper, page 26) compulsory, and for third-parties to be required to provide the necessary data. |
| b. Guidance to trustees on requesting and interpreting fee information, potentially including templates. | We would welcome this potential remedy.<br><br>However, there are a number of areas of complication that would need to be addressed to limit the costs of the remedy.<br><br>Clients' investment arrangements vary enormously.  Guidance and templates would need to have regard to a wide range of different approaches. |

| 2. Current clients. Information on performance. | |
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| a. Introducing a standard baseline level of scheme performance information including frequency, requirement for net/gross returns and focus on member outcomes. | We support the principle that clients would benefit from receiving regular, clear and comprehensive analysis of the performance of their scheme and of their asset managers.<br><br>For the majority of our clients we already supply information on overall scheme performance and the asset managers' performance.<br><br>There are certain features of this remedy that require careful thought on how they would be implemented:<br><br>• A client may use an advisory investment for limited or specialist services only which have little direct relevance to the overall investment performance of the scheme. It would need to be clearly set how this kind of situation should be addressed (if at all).<br>• We may not have the right to access all the relevant information. The third-parties providing services to the pension scheme are generally not contracting with the investment consultant. Data provision could be an issue. We would need to secure the provision of this data through contracts or SLAs with various parties, which may raise our costs.<br><br>We also think it worth highlighting here that there are different levels of detail used in performance calculations, striking a balance between the desired accuracy versus the calculation data requirements as well as the costs of producing such |

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| | reports. The exact specification of this potential remedy would need to carefully consider the implication for costs. There are specialist providers of performance measurement services who may be better placed to provide a fuller analysis of returns of the scheme and underlying funds. However, very few of our clients use these services as they see them as poor value for the additional information they provide compared with our summary reports. |
| 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. | We do not see what this guidance would add over The Pensions Regulator (TPR) guidance. In our experience clients generally do not lack the knowledge to understand and interpret performance information. |

## 3. Prospective clients. Information on fees.

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| 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. | We have no significant concerns with this potential remedy.<br><br>Our services are bespoke to each client. We would be unable to disclose a generic fee for services – since the services we provide are not generic.<br><br>We would like to see some sensible restrictions on this requirement such as: clearly, firms could decline from tendering completely, and would receive a minimum level of information about the client's circumstances before having to provide a fee quotation. |

| 4. Prospective clients. Information on performance. | |
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| a. Adoption of a standardised approach to FM performance and use of composites | We welcome this potential remedy. The IC Select performance standard (described on page 71 and 72 in the Working paper) appears to be dealing with this issue. |
| 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. | **Overall scheme performance**<br><br>We do not believe this would be appropriate remedy. Unlike an asset management or fiduciary management product, advisory services are not suitable for comparison across firms in this way.<br><br>The measurement of performance, as with all bespoke consultancy services, is a difficult problem. Like legal or management consultancy services, all of our advice is highly tailored to the client, and is purely advisory – clients may choose not to accept all or some of it; and it often needs to take into account the views of other stakeholders to the scheme, such as the sponsoring employer.<br><br>Any aggregate measure of performance in terms of an investment return is likely to be the average from a very wide |

distribution of circumstances and it may be inappropriate to draw any conclusions from it.

We firmly believe the “added value” in the asset allocation advice is not simply the financial return from this advice. Asset allocation advice to DB pension scheme trustees should take into account many elements, including the timing of liability payments, the scheme’s financial position, the attitude of the trustees to risk and/or complexity, the strength of the sponsor’s covenant, regulations, the scheme rules and available practical ways to implement the selected investment portfolio. The relative importance of each of these factors varies considerably between pension schemes.

Similarly, for DC schemes, the strategic advice on asset allocation of a default option is impacted by various factors, including: the nature of the workforce, contribution levels, scheme size, and sponsor views.

Measurement of the “value added” by the advice, ideally, needs to take into account all relevant factors. An overly simple, standardised way to measure asset allocation advice, which focuses only on the financial return, could encourage consultants to recommend portfolios with inappropriate levels of risk in order to maximise returns, which may not be in the best interests of the clients or members of the pension scheme.

In section 2 of the working paper, the CMA notes that it has “…not seen any example in which overall scheme performance is benchmarked against other schemes.” (page 46). There is a good reason that this is not done: no two schemes are the same. Comparing the performance of schemes between different advisory consultancies is also invalid and would provide little meaningful information.

Advice from investment consultants is usually based on very long-term investing – our advice is often based on achieving an investment objective over 15 year periods or longer.  The advice is not attempting to create a portfolio that will outperform an alternate portfolio over shorter (and somewhat arbitrary) measurement periods.

Risk-adjusted returns have been suggested by some as a more appropriate metric.  These metrics usually use the volatility of portfolios as the measure of risk, but other metrics can be used.  Any single metric, though, is unlikely to be a good proxy for the key risk a pension scheme runs, namely, an unacceptable outcome for members at a future date, possibly decades away; and cannot take into account all of the factors outlined in this section.

The danger is that any single quantitative measure of performance could be used inappropriately as a means of judging the overall level of performance of a provider of advisory investment consultancy services.  There is a risk that clients or potential clients could make poor decisions on selecting an investment consultant based on this measure because it is one of the few quantitative measures available.  As with any professional service, choosing an investment consultant is unlikely to be best achieved by focusing on one aggregate quantitative measure.

There is a risk that measuring the performance provides an incentive for consultants to recommend a riskier strategy than would otherwise be appropriate to seek higher returns for the consultant's track record.  Measuring risk-adjusted returns using, for example, volatility as the risk measure, provides an incentive for consultants to recommend assets that have a lower volatility, but not necessarily a lower "risk" – such as private market assets that are not subject to mark-to-market volatility.

**Asset manager recommendations**

We have no significant objections to this proposal, but we question its value to many clients.

Providing manager recommendations for each asset class is an important part of our role. Typically, though, over the longer term, manager selection does not have a significant impact on the performance of a client's portfolio and this measure may be used inappropriately as an overall measure of the performance of an investment consultant.

Increasingly, some of the asset classes used by DB pension schemes do not have explicit benchmarks or have flaws in the benchmarks that would make this type of comparison inappropriate. DB pension schemes invest much of their portfolios into liability driven investments, real estate and other private assets that do not have well defined benchmarks or have significant flaws in the standard benchmarks. There is also increasing use of bespoke fixed income portfolios designed around matching the specific benefit cashflows of the particular pension scheme client. Thus in the context of DB pension schemes, this comparison, of recommended fund returns versus appropriate benchmarks, can only be done on a shrinking portion of the assets.

For DC pension schemes and other investors, listed equity and standard fixed income mandates are more common and the comparison with benchmarks here is more appropriate although in time we may see more assets without explicit benchmarks appearing in DC portfolios as well.

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| | There are many considerations in selecting managers that do not relate directly to an ability to outperform either their peers or benchmarks. In some cases, there is a complex interaction between asset allocation and manager selection. The selection of a manager is often influenced by considerations of other elements in the portfolio. The decision making process is not always as straightforward as simply setting the asset allocation and then selecting managers to fill these weights. Adjusting the asset allocations may depend on the style of manager; or, conversely, selecting a manager with a style that is complementary to the other managers held.<br><br>There are also considerations as part of the due diligence process to only select managers and funds that have reached minimum standards for operational due diligence and governance. We consider that these operational reviews have reduced risk for our clients, and driven changes in the industry. This filtering process does, however, reduce the pool of managers that we consider suitable and our chance of selecting an outperforming manager. Another investment consultant that ignored these operational risks may be able to pick a manager with better returns, but these would be subject to an unmeasured risk. For example, we could assess that a manager has weak operational controls and there is an unacceptable level of risk of operational failure leading to financial loss. |
| c. Introducing a tender toolkit would potentially reduce the burden on trustees and improve the quality of the information requested. | We have no comment on this proposal. |

| 5. Other information on quality | |
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| 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 | We do not have any comments on this proposal. |