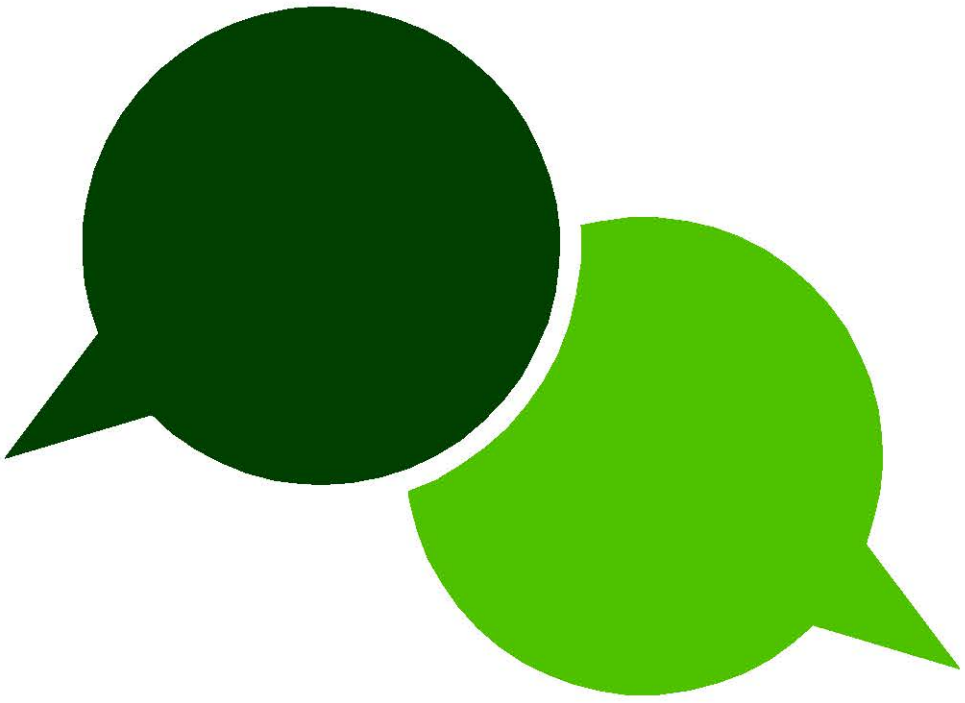
Cardano

Investment Consultants Market Investigation

Response to the Working Paper on the Supply of Fiduciary Management Services by Investment Consultants

Cardano Risk Management Limited



Overview

The investment consulting and fiduciary management industry is built on trust and has historically focussed more on relationships than financial outcomes. This has impaired growth and innovation, particularly in fiduciary management, and constrained new entrants' ability to enter the market. In turn, this has weakened competition and contributed to the poor performance that created ballooning deficits.

Ensuring there is sufficient focus for buyers and sellers on measurable financial outcomes, transparency and accountability will go a long way to solving the inherent problems.

We support many of the proposals set out by the CMA. However, we believe that significant improvements can be made with only a handful of the proposed remedies.

The problems cannot be solved by a single entity and we fully endorse the coordination with the different regulators.

We have an opportunity to improve a market that affects the quality of millions of lives. This opportunity should not be wasted.

Overview

We continue to believe that a comprehensive approach that considers the behaviour of sellers and buyers of the relevant services requires contributions from, and coordination of, the FCA, the CMA, tPR and the Department for Work and Pensions. Ultimately, we believe this is what's required to create better outcomes for defined benefit pension schemes and retirement security for their members.

We are encouraged by, and continue to be supportive of, the inclusive and pragmatic approach taken by the CMA.

About Cardano Group

Founded in 2000, Cardano is a purpose-built, privately owned specialist focused on integrated management of pension schemes' biggest risks: funding, investment and covenant. That's all we do. For the avoidance of doubt, we are not part of an employee benefits group, an actuarial firm, an insurance broker or a global asset gatherer with diverse lines of business and dissimilar clients. We are, therefore, less encumbered by conflicts of interest and organisational complexity, enabling us to offer specialist services of unusually high quality to a select group of clients.

We have a purpose beyond profit:

- **WHY?** We believe in a fair society in which financial services improve our quality of life
- **HOW?** We want to contribute to such a society by fighting for a fair and robust financial system that benefits all stakeholders
- **WHAT?** We strive to deliver better and more secure financial outcomes for our clients in a realistic and responsible way

Cardano employs 170 people based in London and Rotterdam to serve clients with assets of £120bn. In London, 100 professionals serve 24 UK defined benefit pension schemes with assets of £50bn. Our services include investment consulting, fiduciary management and implementation of derivative overlays.

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1. Introduction

Background

We support the Market Investigation being conducted by the CMA. The issues have been understood well. The focus within the Market Investigation on both the buyers and sellers is critical to help improve the overall functioning of the market.

This response

The evidence provided in the Working Paper on the Supply of Fiduciary Management Services by Investment Consultants (the 'Working Paper'), indicates that the market for FM services is *not functioning as an open, competitive market.* To solve this problem we believe that changes to the market are required. Your analysis suggests that a small number of IC-FM firms have come to dominate the market. This could be as a direct consequence of their clients not having undertaken a full FM market review.

We set out our thoughts on the potential remedies, along with responses to your specific questions.

You asked if there was further evidence of harm to help you with your analysis. We propose the CMA analyses the following areas:

- Whether the IC-FM firms have a higher 'hit rate' in tenders that are not managed by independent third-parties compared those that are
- Whether the outcomes delivered (risk and return) by IC-FM firms have been better or worse than other FM providers
- Whether the outcomes delivered (risk and return) by FM services have been better or worse than results achieved by Advisory clients, with the results published

We believe these lines of inquiry are critical components of the "outcomes for customers" area of assessment (Table 1 of the Working Paper), which will be the subject of a forthcoming working paper.

2. Improving the market

To drive better outcomes, buyers must be empowered to make more informed choices and the market needs to foster increased competition and innovation. This can be achieved through a combination of: clearer objectives; greater transparency; comprehensive regulatory guidance on the selection and assessment of providers and enhanced governance and accountabilities.

In our original response to the CMA's Statement of Issues we proposed that the CMA focus on four key areas:

- Objective setting
- Transparency
- Selection & evaluation of providers
- Governance & accountability

We have repeated our original thinking for the first two of these below as it provides useful context to our response to your feedback request on potential remedies.

Objective Setting

A market functions best, and relationships between sellers and buyers are improved, when the scope of work and commercial terms are set with respect to clearly defined objectives with measurable outcomes.

- For sellers: We believe best practice is for investment consultants and fiduciary managers to set objectives for the services they offer. Ideally, these objectives would define the need that sellers are trying to meet and link directly to their clients' objectives. To the extent possible, sellers' objectives should be less task-based and more outcome-driven. Outcome-based contracts are easier to agree in fiduciary management than investment consulting, given the level of delegated decision-making. Nevertheless, investment consultants and their clients should do more to reach implicit agreement and shared understanding of the desired outcome of services sold, making it easier to monitor progress and explain deviations from plan. **At a minimum, investment consultants' duty of care to act in the best interests of their clients should be strengthened, as envisaged in the Study for asset managers**[1]
- For buyers: We believe best practice is for trustees to articulate and document their investment beliefs and objectives. These objectives should focus on improvement in the solvency ratio over defined periods of time, taking the sponsoring employer's covenant into account. For example, trustees could identify target and required returns expressed as a margin over the return on their liabilities consistent with their long-term funding objective. Trustees should also identify target and maximum levels of risk expressed as tracking error of

[1] FCA, "Asset Management Market Study Final Report", June 2017, 10.24.

the solvency ratio. Clearly defined objectives make it easier to monitor progress toward specific and measurable outcomes, and to explain deviations from plan

Better objective setting would facilitate clearer accountability among sellers, buyers and sponsoring employers. In turn, clearer accountability would drive better outcomes for defined benefit pension schemes and their members.

Transparency

Both the CMA and FCA have correctly identified inadequate transparency as a problem for both Investment Consultancy Services and Fiduciary Management Services. We agree with the FCA's conclusions:

- "We have concerns about conflicts of interest in fiduciary management, which is increasingly offered by investment consultants and fund managers."[2]
- "Fiduciary managers' performance and fees appear to be among the most opaque parts of the asset management value chain. A lack of publicly available, comparable performance information on fiduciary managers also makes it hard for investors to assess value for money."[3]

We add that:

- Conflicts of interest in investment consulting and fiduciary management can be highly nuanced. Both the CMA and FCA focus on conflicts that arise when a firm sells multiple services e.g. investment consulting and fiduciary management. But, the services a firm does not offer can also skew advice to clients in ways that may not be obvious to them. For example:
  - Investment consultants who do not offer fiduciary management may discourage clients from considering that solution, as they would effectively be advising their client to stop using their own services
  - A fiduciary manager may discourage clients from exploring insurance buy-ins/outs or other settlement transactions that would reduce the manager's assets under management and fees.
- For buyers, it is not always clear which type of organisation they are dealing with, the range of services they offer and hence when advice could potentially be conflicted
- There are industry-led initiatives underway to produce standardised, comparable performance measures for Fiduciary Managers. We support and contribute actively to these initiatives, but we are frustrated by limited progress to-date
- Measures of risk-adjusted net returns suggested in the FCA Study[4] are no less relevant for Fiduciary Managers than asset managers. These measures should be solicited and provided to help buyers assess value for money
- Investment Consultants have track records, too – but these are rarely solicited or provided. The CMA has mentioned that it is a particularly challenging area in which to undertake quantitative analysis[5]. However, a similar performance assessment to those used for Fiduciary

[2] FCA, "Asset Management Market Study Final Report", June 2017, 10.1.

[3] FCA, "Asset Management Market Study Final Report", June 2017, 10.1.

[4] FCA, "Asset Management Market Study Final Report", June 2017, 1.16.

[5] CMA, Investment Consultancy Services and Fiduciary Management Services, Market Investigation, 38(c), 38(d)

Managers can also be applied to Investment Consultants. This focuses on changes in clients' solvency ratios over time

3. Comments on Theory of Harm

Theory of harm

The theory of harm addressed in the Working Paper is that "when IC firms act as advisors to their customers and also offer FM services, customers are steered towards consultants' in-house FM services, when an alternative solution or deal could have been in their best interests."[6]

Evidence seems compelling

The Working Paper included some interesting evidence about trustees' buying behaviour[7]:

- When appointing their first FM provider, around half of all schemes selected their existing IC
- Fewer than half of schemes sought advice from a third-party when buying FM for the first time
- Only a third of schemes asked a third-party to run a tender when buying FM for the first time

Our interpretation of the above statistics is that the IC-FM firms have been disproportionately successful as a consequence of their clients *not testing the market*. Alternatively, the IC-FMs have a significantly higher level of skill in winning tenders than their competitors i.e. their 'hit rate' is significantly above that of their competitors. However, if this were the case, their hit rate should be above their competitors in *tenders that are managed by independent third parties as well*. If the IC-FM hit rate is lower in tenders that are managed by third parties, this is likely to mean their dominance in this market has been achieved at the expense of healthy competition.

Our experience as a FM supports this. In our c. 10-year history, we have participated in c. 50 FM tenders, which represents only one-sixth of the total number of FM appointments made to date in our target market. Our success rate in FM tenders has been around one-in-three[8]. Obviously, we do not know whether five-sixths of those clients who adopted FM over the last 10 years considered a broad range of providers, but simply excluded us from the process. However, we strongly suspect that is not the case, as:

- We believe we are 'buy rated/approved' by all of the major third-party evaluators
- We routinely appear on the short-lists of third party led selections

Therefore, we strongly suspect that many of the five-sixths of the market that did not consider Cardano, did not, undertake a full review of the FM options available. We believe that a significant proportion of pension funds that have appointed their incumbent IC as an FM provider would probably have reached a different conclusion if they had undertaken a full market review. Consequently, **the dominance of the three large IC-FM in this market, does not represent a fair competitive outcome**.

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[6] CMA "Working paper on the supply of fiduciary management services by the investment consultancy firms", March 2018, 20

[7] CMA, "Working paper on the supply of fiduciary management services by the investment consultancy firms", March 2018, 64 & 67.

[8] Source: Cardano

To help the CMA further test their Theory of Harm, we propose that the following areas of further research are conducted:

- Whether the IC-FM firms have a higher 'hit rate' in tenders that are not managed by independent third-parties compared those that are
- Whether the outcomes delivered (risk and return) by IC-FM firms have been better or worse than other FM providers
- Whether the outcomes delivered (risk and return) by FM services have been better or worse than results achieved by Advisory clients

4. Potential remedies

Within the Working Paper the CMA expanded the range of potential remedies that could be used to address aspects of any adverse effects on competition (AEC) that may be found as part of their review. These potential remedies were categorised as either:

a. Seeking to encourage trustee engagement; or

b. Reducing the risk of conflict by controlling or incentivising firms' behaviours

We set out our thoughts on these potential remedies below.

Measures to encourage trustee engagement

Potential Remedies

The following remedies have been put forward to promote trustee engagement by encouraging more active consideration of the choice of FM provider, particularly on first appointment.

- 128 (a) Mandatory tendering on first adoption of FM Services
  - A formal tender process applied when first adopting Fiduciary Management, either an open or closed process but would need to adhere to a set of minimum criteria
- 128 (b) Trustee reporting to scheme members or TPR
  - A requirement on trustees to report and demonstrate how they plan to test or have tested the market... requirements could be introduced, such as disclosure of trustee approach to tendering on first appointment and dates of proposed future market testing
- 128 (c) The provision of guidance to trustees on the adoption and selection of an FM provider
  - ...This could include both: (i) advice on choosing whether FM (full or partial) is a service which would be appropriate for the scheme; and (ii) best practice on how to choose a provider, whether to use a third-party evaluator and how to test the market

The CMA noted that the above remedies may not affect schemes where an appointment had previously been made and therefore additional remedies may be necessary, either on a transitional or ongoing basis:

- 129 (a) Mandatory tendering within a fixed period after first appointment
  - A requirement for a one-off tender within a fixed period to ensure there is market testing whilst giving trustees flexibility to decide how to make their initial appointment
- 129 (b) Measures to require mandatory switching
  - Mandatory switching after a certain period to ensure that any conflict on initial appointment was addressed
- 129 (c) Periodic mandatory tendering
  - Requiring trustees to conduct a periodic tender process would ensure that trustees are required to actively consider other potential providers. However, each subsequent tender would be less relevant in addressing the conflict (and particularly where the FM provider changed)

Our response

We believe that most trustees would benefit from the use of an independent third party when evaluating a move from IC to FM.

However, rather than compel trustees to employ third-party advisers, we believe that **the best remedy is for tPR to provide guidance to trustees on the selection and evaluation of providers**. This should be in the form of a best practice guide on how to choose a provider, whether to use a third-party evaluator and how to test the market.

We set out our proposed disclosure below.

tPR Guidance

While tPR has issued regulatory guidance on "working with your investment advisors" and "fiduciary management", their guidance is not particularly prescriptive in some areas:

- "If you are considering appointing a fiduciary manager, you may wish to consider appointing an independent consultant or intermediary who has specific expertise in this area."[9]

This is in striking in comparison to very detailed, comprehensive guidance tPR issued on other topics e.g. asset-backed contribution arrangements (ABCs) and appointing a covenant advisor:

- "The regulator is aware that ABCs are being promoted heavily and has seen a significant rise in the number of DB schemes entering into this type of arrangement . . . It is important that trustees considering investing in an ABC fully understand the risks, complexity and costs involved, and obtain appropriate advice so that they can make an informed decision . . .'we expect trustees to carefully evaluate proposals and ask probing questions of their advisers."[10]
- "Ensure your approach to assessing the strength of the employer covenant is robust and effective . . . 'Here is a suggested, non-exhaustive list of questions and prompts to help trustees decide how to appoint an appropriate covenant adviser."[11]

On the topic of fiduciary management, tPR does say:

- "If you consider this an option for your scheme, you should commit sufficient time and resources to the process of selecting and appointing the fiduciary manager. This includes . . . considering a suitably wide range of potential managers . . . You should carry out enough due diligence to be comfortable that the proposed fiduciary manager has the appropriate experience and skill-set for the mandate . . . This is particularly relevant if you propose to appoint your existing investment consultant; the skills required to be a successful consultant are not exactly the same as those required to be a successful investment manager."[12]

Therefore, **we propose that tPR issue regulatory guidance to the effect that best practice involves trustees' written disclosure to members about:**

- The rationale for choosing a particular governance model, recognising there are alternatives:
    - Internal investment team
    - Advisory with input from investment consultant

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[9] http://www.thepensionsregulator.gov.uk/guidance/db-investment-one-governance.aspx#s24034

[10] http://www.thepensionsregulator.gov.uk/press/pn13-43.aspx ; http://www.thepensionsregulator.gov.uk/guidance/asset-backed-contributions.aspx

[11] http://www.thepensionsregulator.gov.uk/trustees/decide-how-to-assess-employer-covenant.aspx

[12] http://www.thepensionsregulator.gov.uk/guidance/db-investment-one-governance.aspx#s24034

  - Fiduciary management with partial delegation
  - Fiduciary with full delegation
  - Hybrid approaches
- The criteria used to select and monitor a fiduciary manager e.g.:
  - Investment performance
  - Management of risk
  - Value for money
  - Understanding of scheme's and sponsoring employer's objectives
- The rationale for the process followed to select a fiduciary manager e.g.
  - Number of fiduciary managers considered and interviewed
  - The role of any incumbent investment consultant or fiduciary manager
  - The use (or not) of independent advisors, with a requirement to justify why an independent third-party was not used (if that is the case)

TPR has been an invaluable resource for trustees since its founding in 2005. In our view, trustees would welcome additional guidance on selecting and evaluating Investment Consultants and Fiduciary Managers. TPR has a role to play in improving the function of the market to complement the work undertaken by the FCA and the CMA.

We continue to believe that **mandatory tendering is not required** (128a) as long as tPR provides guidance on the selection and evaluation of providers and increased performance transparency is introduced. We first discussed this in our response to the CMA's Statement of Issues where we expressed the view that:

- Trustees of pension schemes are the best placed to decide whether they should review the services being provided and good governance suggest that this should be done on a regular basis
- However, if the CMA review shows there to be a problem in this area, it could be useful when procuring services for the first time
  - If it is used, we propose to limit mandatory tenders for a five-year period as this should give the market sufficient time to improve
  - Once an initial appointment is made, there may be bias towards the incumbent in any subsequent one-off tender (apathy, wanting to justify the original decision, the strength of the relationship with the incumbent etc.)
- We felt that the following alternative actions would mean that mandatory tendering is not required:
  - A statement of best practice for trustees when selecting and/or reviewing providers issued by the tPR
  - Standardised tender documents making it easier for trustees to access the information
  - Disclosure to members of the approach taken by trustees to conducting tenders
  - Increased transparency of performance
  - Require investment consultants to give greater clarity to trustees that they are moving into a different arrangement, and that they could seek this service from other firms

However, we did note that:

- Continued testing of the market would be required to ensure the disclosure remedies are effective, which could include Investment Consultants and Fiduciary Managers supplying their tendering information to the FCA
- If the disclosure remedies are not put in place, then we would support mandatory tendering as a 'second best' solution

Trustees should report and demonstrate to members why they have chosen their preferred governance model and their approach to selection (128b). We believe this should be covered by tPR best practice guidance.

We do not think guidance as to whether FM (full or partial) is appropriate for a scheme is necessary (128c). Trustees are best placed to decide whether FM is a service which is appropriate for their scheme based on their own understanding of their situation and needs. **Increasing transparency of performance information for Advisory and Fiduciary Management mandates would be a more effective route.** It would allow Trustees to compare the different approaches in view of their own objectives. As part of the fact-finding process, the CMA should have sufficient information to achieve this and we encourage this course of action.

We do not believe that the following remedies should be adopted:

- 129 (a) Mandatory tendering within a fixed period after first appointment
- 129 (b) Measures to require mandatory switching
- 129 (c) Periodic mandatory tendering

Retrospective disclosure, increased performance transparency and guidance on good governance should achieve the stated aims of the CMA. The three potential remedies stated above could:

- Incur unnecessary costs
  - Trustees are unlikely to switch provider if they have only just appointed one so a tendering exercise could be pointless
  - Pension schemes will incur additional costs from mandatory tendering and there is no guarantee that the scheme will be better off following the exercise
- Lead to poorer outcomes
  - If the incumbent is achieving better outcomes than that of an alternative provider then the pension scheme could be worse off if they are forced to move

Measures to reduce the risk of conflicts through controlling or incentivising firm behaviours

Potential Remedies

The following remedies were put forward relating directly to the conduct of business by firms. These measures include:

- 130 (a) Segregation of advice and marketing materials
  - Keeping advice on the merits of using FM services separate from the firm's own FM service provision … (i) there could be a minimum period both before and after any decision to adopt FM and the provision of marketing materials (ii) this could further be

extended to exclude reference to the provision or performance of the firm's FM services when tendering for advisory services (unless the two were being tendered together)

- 130 (b) Measures to reduce firms' incentives to promote their own FM services
  - There are a range of approaches which would either prevent or mitigate the incentives to promote an advisor's own FM service to their advisory customers (i) Legal separation of advisory and consultancy practices, requiring firms to potentially sell their advisory or FM businesses (ii) Prohibition of cross-selling advisory and FM services (iii) Internal separation and controls

- 130 (c) Regulatory disclosure on adoption of FM
  - Advisory firms could be required to present a standard regulatory disclosure to trustee boards when first advising on the use of FM services … this disclosure could be evidenced and reinforced by a requirement that trustees sign a confirmation that they have noted the relevant considerations of moving into FM and also on the risk of appointing an incumbent. This confirmation could either be retained by the firm or sent to the TPR

- 130 (d) Regulatory obligations on firms' conduct
  - Such remedies could introduce a requirement for firms to act in trustees' and members' interests. This could be through specific requirements on cross-selling

- 130 (e) Prohibition of IC-FM firms acting as an evaluator or offering comparative advice
  - To ensure that tender processes or other selection exercises are conducted without perceived or actual bias IC/FM firms which are potential suppliers of FM services could be prohibited from being involved in any aspect of management of the process or assessment of offers

Our response

We believe that conflicts can be best managed by:

- Having clearer objectives which would facilitate clearer accountability among sellers and buyers
- Improving transparency of the information provided by the sellers on the services they are providing as well as performance track records

This is set out in more detail in the Section 2.

We **do not believe that advice and marketing needs to be separated**. However, firms should be clear that:

- Advice: Relates to the generic background on FM and differing approaches along with the advantages and disadvantages etc. It should include information of the different approaches, on the firms who offer a service and generic fee levels etc.
- Marketing: Specific services and fees for a specified mandate

Where an independent investment advisor is being used alongside the IC-FM or FM, the above requirements may not necessarily need to apply as clients will be able to manage the conflict of interest.

It will be important that there is a market standard definition of Advice and Marketing, which is made publicly available.

Putting in place a time-gap between advice and marketing could lead to unintended consequences and is not required. For example, if an FM service leads to better outcomes than Advisory, delaying the marketing and ultimate implementation could lead to poorer results being achieved in the intervening period. As a result, **we do not think this is necessary to have a gap between advice and marketing** (130ai)**.**

Until we have clear performance standards in place for Investment Consultants we believe that including an FM track record in an advisory tender is beneficial. It allows the buyer to understand 'what the firm would do if they were them' and the performance of their investment views etc. Without this it is very difficult to assess the quality of the investment consultant. **We do not think that the inclusion of FM performance in an advisory tender should be prohibited** (130aii)**.**

We do not believe there should be a legal separation of advisory and consultancy practices or prohibition of cross-selling advisory and FM services (130bi 130bii). This could lead to poorer outcomes for trustees and could potentially increase costs. This could be due to either losing talented people from one part of the business (e.g. from IC to FM, or vice versa) and having to duplicate effort such as with manager and market research, compliance, legal etc. It is difficult for us to be categoric on whether poorer outcomes would result as we do not know whether good outcomes are currently being achieved. With transparent performance information it will be clearer to all whether good outcomes are being achieved.

It can be argued that if FM is suitable for a client then stopping the cross-selling could lead to a worse outcome for the pension scheme.

The regulatory regime should be the same for all ICs and FMs. Appropriate controls at IC-FMs should already be in place. We do not expect that any advisor should be directly rewarded for selling FM services to their clients. Before an advisor recommends an FM service to their clients we expect it to be reviewed and approved by senior members of the business. The CMA are the best placed to judge as to whether more controls are needed (130biii).

Requiring Advisory firms to produce a standard regulatory disclosure to trustee boards when first advising on FM would be helpful. We don't think that trustees should be required to sign a confirmation that they have noted the relevant considerations and considered the risk of appointing an incumbent. Enhance member disclosure such as that stated in Section 2 above should be sufficient (130c).

It is difficult to comment whether regulatory obligations are required on a firms' conduct (130d) as it will depend on the exact nature of the regulation. However, we note the following:

- It is important that any new regulation is not perceived to oblige IC-FMs to market FM services to their clients
- The existing provisions to act in clients' best interests would not prohibit promoting or recommending in-house FM services that are suitable for the client. Suitability should already take into account trustees' and members' interests
- Merely expanding the perimeter is unlikely to work, as firms may well take steps to manage the conflict by focusing on justifying suitability of the FM services they offer and being transparent about the conflict. This may or may not result in making a written disclosure of the conflict of interest depending on how the firm perceives the risk to the client. As clients should already be aware of the conflict (most trustees are aware of this and other potential conflicts of interest), merely putting it in writing is unlikely to change behaviour

- Care should be taken to ensure that the proposed remedies are within the regulatory perimeter, expanding the perimeter as required
- Unless a very rigid set of suitability factors that must be considered are set out by the regulator, firms may be able to relatively systemically justify FM over advisory mandates as being in the best interest of trustees and members. However, given the range of pension schemes and situations (strength of covenant, funding level etc.) and changing environment, a rigid set of suitability considerations is likely to increase the likelihood of sub optimal outcomes

Investment consulting teams who also offer FM services should be prohibited from offering tender services (130e). The conflicts of interest are too great. We have experience of Secretarial teams at investment consultants managing tender processes well, although clear Chinese walls need to be in place and information held confidentially. We note that investment consultants who do not offer FM services and run tender exercises are also conflicted and the same Chinese walls are required between the teams conducting the FM research and the investment consultants providing day-to-day advice.

5. Questions on additional potential remedies

1) Mandatory tendering at the point of adoption of FM or within a fixed period after first appointment.

a. What could be the minimum scope of an acceptable competitive tender process (for example the number of firms invited to participate)?

The minimum scope of an acceptable tender should be:

- Request for proposal drawn up including details on:
    - Proposed solution in context of the scheme's objectives and any preferences or constraints
    - Firm background, resources available for the mandate, investment beliefs and philosophy, portfolio construction and approach to research
    - Performance track-record on an industry standardised basis for the firm and mandate in question (net of fees, risk adjusted returns, before deficit contributions)
    - Perceived conflicts of interest and how they will be managed
    - Proposed fees and associated expenses and how these may evolve over the course of the mandate
- Three to five parties should be invited to participate in the exercise

The FM landscape has matured such that there is increasingly obvious segmentation e.g. FMs who use external funds only (effectively funds of funds), FM's who manage a significant share of investments in-house, FMs who are mostly passive / static, FMs who are more active / dynamic, etc. Schemes which have informed preferences should be encouraged to see several FMs in a particular segment. Schemes without a view should be encouraged to see FMs in different segments to help develop trustees' preferences.

b. How long should an initial FM mandate last before the requirement for an initial tender?

n/a

We encourage all mandates to be awarded as part of an open tender rather than after. Once a mandate has been awarded, conducting an open tender

shortly afterwards is likely to increase costs and not lead to change

c. Should such an approach have a requirement for an open tender process?

We believe that the TPR should provide guidance to use open tenders but not make it a requirement. The trustees are best placed to judge the approach they want to take. Enhanced disclosure, along the lines of Section 2 of our response, should encourage participants to consider the best approach

d. Should there be a requirement or encouragement to use a third party evaluator?

We think that trustees would benefit from the use of an independent third party when evaluating a move from IC to FM. However, we don't think there should be a requirement to use one. Instead we believe the tPR should issue guidance over the selection and evaluation of providers along with a disclosure code to members.

We note that some Investment Consultants who act as a TPE may well themselves be conflicted. If trustees were required to use a TPE the CMA, and other parties, would need to address these potential conflicts first.

e. Should this requirement exist for both partial and full FM mandates?

A partial mandate should be treated in the same way as a full FM mandate.

f. Should there be specific requirements for any incremental expansion of an FM mandate (such as additional asset classes)?

If the areas for 'incremental expansion' were considered during an initial competitive process then there should be no further requirement placed on trustees.

However, if a competitive tender process was not undertaken then any incremental expansion should be treated as a 'new' mandate.

g. Should any other requirement be imposed in relation to schemes which have already adopted an FM approach? If so, what? Should this be limited to schemes that did not competitively tender for FM?

Retrospective disclosure should be brought in along the lines of what we set out in Section 2 and should be limited to those schemes who already have FM in place and did not competitively tender.

2) Segregation of marketing materials from advice

a. Are there currently business models where separation of marketing and advice would be problematic?

No.

b. How could the key differentiators of marketing and advice be defined?

Advice on FM by an IC should be generic on the background to the approach and the advantages and disadvantages. We would expect the IC to include information of the different approaches and including those of the firms who offer a service (including the names of the relevant firms).

Marketing by an IC on FM should be considered to be where they only discuss their own service and quote specific fees for a mandate.

c. Could marketing and advice be further separated through a time gap between the decision to adopt FM and the provision of marketing materials?

No. If the trustees of a pension scheme have decided to appoint a FM they should proceed at the pace in line with their own governance structure. Forced 'time-gaps' between advice and marketing could lead to unintended consequences such as increased deficits.

3) Reporting to members

a. Would a requirement to report the actions of trustees to members be sufficient to incentivise trustees to more actively consider an appropriate range of options?

Yes. We believe this to be the case. However, it would need testing in future years.

b. What should be in the scope of this report and should there be any enhanced power for members to challenge any decision.

In Section 2 we set out our proposed disclosure to members. This is set out below for completeness.

- The rationale for choosing a particular governance model, recognising there are alternatives:
  - Internal investment team
  - Advisory with input from investment consultant
  - Fiduciary management with partial delegation
  - Fiduciary with full delegation
  - Hybrid approaches
- The criteria used to select and monitor a fiduciary manager e.g.:
  - Investment performance
  - Management of risk

- Value for money
- Understanding of scheme's and sponsoring employer's objectives

- The rationale for the process followed to select a fiduciary manager e.g.
  - Number of fiduciary managers considered and interviewed
  - The role of any incumbent investment consultant or fiduciary manager
  - The use (or not) of independent advisors

4) Restrictions on selling both advisory and FM services

a. Would the benefits to trustees of receiving both advisory and FM services from the same provider outweigh the potential harm?

Yes. We believe that there are benefits to trustees receiving both advisory and FM services from the same provider and that these outweigh the potential harm. However, conflicts do need to be managed and improved disclosure put in place.

As noted in our original response to the CMAs Statement of Issues, the focus of fiduciary management is to help trustees solve a funding ratio problem, not a pure asset management problem. The scope of fiduciary management is therefore a lot broader than most asset management services as it includes advice and asset management. This is likely to be a key reason why a number of investment advisers have started to offer fiduciary management services.

To reflect this, we believe that the definition of Fiduciary Management Services should be clarified to include investment advice which is provided to clients including that covered by the Pensions Act. For example, the provision of advice covering objectives, long-term strategy and asset allocation. These aspects ensure an integrated service and hence play a key part of the role of a UK fiduciary manager

We therefore propose that the following definition is used:

Fiduciary Management Services

- Provision of a service to institutional investors where the provider advises on and makes and implements decisions for the investor based on the investor's investment strategy. This service may include responsibility for all or some of the investor's assets and may include, but is not limited to, responsibility for asset allocation and fund/manager selection

b. Could any restriction be limited to situations where advisory and FM services have not been subject to an open tender process (either separately or in combination)?

n/a

Cardano