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Investment Consultants Market Investigation  
Competition and Markets Authority  
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Dear Sir

Investment consultants market investigation  
Response to the Competition and Markets Authority's Working Paper on the supply of  
fiduciary management services by investment consultancy firms

#### Introduction

There are a number of conflicts, real or perceived, that can arise when trustees consider their governance structure, and the services they utilise from investment consultants that offer fiduciary management services ("IC-FMs"):

- i. Avoiding a full market search: As mentioned in the CMA's working paper, if Trustees are not made aware of a range of alternative options, it is not clear whether selecting a given provider is necessarily in their best interests.
- ii. Reluctance to consider liability and asset transfers: Advising clients to settle their liabilities through a buy-in or buy-out with an insurer would typically result in a reduction in IC-FMs' fee revenues.

In response to this working paper, we have drawn on our experience as an independent third-party evaluator.

#### Overarching principles

##### *Explicit definition of buying criteria*

There can be a lack of clarity on what trustee boards really want and need when buying investment services. To support transparency and accountability, we believe that all trustee boards should be required to produce a Selection Dashboard before conducting any vendor selection exercise which sets out clearly aspects such as their mission, objectives, investment beliefs, risk and return targets, de-risking plans, risk tolerances, reporting requirements, service quality expectations and, importantly, their policy on conflicts of interest. Having a clear purpose then allows the trustees, and other stakeholders, to be clear on their own specific requirements, separate out existing relationships with consultants and investment managers (to help manage any real or perceived conflicts of interest) and evaluate different firms objectively.

### *Objective decision making and documentation of rationale behind decisions*

To ensure that a high level of objectivity is retained in the trustees' decision making, we feel that trustees should be required to document why they have selected a given advisor against their Selection Dashboard, thereby capturing objectively what information was used to choose the preferred provider and what actions the trustees took to validate that information. To address the point of potential conflicts of interest in selecting a firm that has historically provided different services, trustees should document why this was felt to be the most appropriate firm, in light of:

- the trustees' views of the FM's investment process and philosophy;
- the resulting impact on the investment risk and return;
- the management of operational risk introduced by delegating services;
- consideration of fees and costs relative to current arrangements; and
- the ability of the FM service and fees to be "future-proofed" against future actions such as liability management exercises and insurance transactions where assets under management could significantly reduce.

Response to additional potential remedies set out by the CMA

#### Mandatory tendering of FM services

A change in the investment governance framework represents a significant change to the trustees' operating model. Given the material change in accountabilities when moving to a fiduciary mandate, we believe it is prudent and proper for trustees to take a step back, reflect on the existing Selection Dashboard, review their requirements from their fiduciary manager and then consider a range of providers, whether this is for a partial mandate or for a full mandate. Mandatory tendering at the point of adoption of a fiduciary mandate would ensure that trustees make an informed, unbiased decision, having considered alternative solutions.

Fiduciary management proposals can be complex and it can take time for trustees to fully understand each of these. We believe, therefore, that the use of an independent third-party evaluator can help trustees to validate that their reasons behind the selection of any given firm or service match with their Selection Dashboard criteria.

Once a fiduciary manager is in place, we do not believe that mandatory re-tendering necessarily adds value for trustees. Instead, we believe that regular re-appraisal within a clear monitoring framework should be used to assess if the Fiduciary Manager continues to meet the trustees' objectives and requirements, and provides value for money. A range of quantitative and qualitative measures should be used, recognising that fiduciary management is not a commoditised product, but rather a bespoke service. Again, the use of independent third-party evaluators who are able to benchmark fiduciary managers on a range of quantitative and qualitative factors on an ongoing basis can support trustees on this.

We do not believe that schemes that did not go through an initial tender exercise need to automatically go through a mandatory tendering process. However, we believe that trustees should need to revisit their Selection Dashboard, and satisfy themselves that the fiduciary manager is appropriate for their circumstances. Should it be viewed that the FM does not meet the trustees' requirements then we would propose a tendering exercise takes place, with the support of an independent third-party evaluator. Either way, we believe that it is important for trustees to then document their rationale for selecting their fiduciary manager.

#### Segregation of marketing materials and advice

Advice from investment consultants would be in return for a fee being paid to the investment consultant, and therefore should not include marketing material (i.e. trustees should not pay for marketing material and it should not form part of formal advice). Such advice, however, should be able to include comments on governance arrangements generally, albeit exclude information on a consultant's own fiduciary management service. That said, we recognise that the details of the FM service can help to illustrate the impact of the advice on governance. In this situation, we believe that information on a consultant's own fiduciary management service / product should be marked clearly as marketing material with a declaration of a conflict of interest. Consultants should also be required to highlight to the trustees that there is a wider, established FM market and that the consultant's FM solution is just one of many.

We have also seen instances where Scheme Actuaries promote a fiduciary management service to clients, as part of discussions around integrated risk management. Trustees could view this to be advice to buy the Scheme Actuary's firm's fiduciary management offering. Whilst it can be useful for Scheme Actuaries to highlight the benefits through the use of an example, the material containing specific details of the firm's own fiduciary management offering should be marked clearly as marketing material and the additional points on declaration in the preceding paragraph should apply too.

#### Reporting to members

Member engagement is generally weak in UK defined benefit schemes, and so we do not believe that reporting to members will incentivise trustees to consider an appropriate range of options more actively. However, we feel that a change in trustees' reporting requirements can influence trustees' incentives to consider wider options.

As part of the initial mandatory retendering process, it is important for trustees to document the objective reasons why a given provider was selected. As a bare minimum, we believe that this should include explicit comments on at least the following:

- the trustee's views on the FM's investment process and philosophy;
- the resulting impact on the investment risk and return;
- the management of operational risk introduced by delegating services; and
- consideration of fees and costs relative to current arrangements.



For partial mandates, we believe trustees should document why the full portfolio was not delegated, under the same headings above. In order to manage any conflicts of interest if the fiduciary mandate were to be extended further, we believe that the same principles should apply – starting from revisiting the Selection Dashboard, considering whether the existing provider’s solution meets the trustee’s requirements, and then considering and evaluating alternatives, as appropriate.

In our experience, the stronger governance offered by fiduciary managers has helped improve pension schemes’ outcomes over the last five years, and we expect fiduciary management will continue to help trustees to reduce investment and operational risk, and in some cases reduce total investment costs. As the sponsor ultimately underwrites the pension scheme risk, we believe trustees should report to the sponsor on their governance approach, and the reasons behind their choice of advisor and / or fiduciary manager – again under the same headings mentioned above.

#### Restrictions on selling both advisory and FM services

There is a wide range of businesses globally that offer a range of different products and services, which may compete with each other, and may influence the firm’s revenues and profitability. The different products and services aim to cater for a wider range of clientele, and often knowledge learned from one part of the business passes on to other parts to improve the offering to all clients.

In terms of investment solutions, we believe that there are benefits from having fiduciary management solutions offered by a range of different providers, including investment consultants. One example is in the negotiation of investment management fees, where some IC-FMs have negotiated material fee discounts as a result of the scale of their overall IC and FM businesses. A loss of such fee discounts would represent a meaningful loss to trustees.

We do, however, recognise that there is information asymmetry in investment, where there is a large gap in knowledge between sellers and buyers. Therefore, some measures to protect trustees from being taken advantage of should be in place. We do not feel there need to be any restrictions on firms to operate advisory and fiduciary businesses, however, an initial move to fiduciary management should be achieved through mandatory tendering. We believe also that independent third-party evaluators can help bring about more objectivity to the process.

#### Summary

In summary, we believe that conflicts of interest can be managed successfully through a combination of:

- a requirement for consultants to mark any material that contains details of its own fiduciary services as marketing material and an upfront declaration of conflicts of interest;

- mandatory tendering at the point of adoption of fiduciary management services, utilising independent third-party evaluators that understand the details of different providers' capabilities;
- a requirement for trustees to document clearly the process and rationale for appointing any fiduciary manager; and
- a clear monitoring framework, including regular reappraisal of the FM, to validate that the fiduciary manager continues to operate in line with the trustees' requirements as set out in their Selection Dashboard.

We are grateful for the opportunity to make a contribution to this important inquiry, and we would be pleased to answer any questions or provide more detail.

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