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JLT Employee Benefits

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Dear Peter

Response to Working Paper: Asset Manager Product Recommendations

We have pleasure in providing some comments on the above paper and responses to the proposed remedies. As you will be aware we have chosen not to participate in the confidentiality ring set up in regard to this paper. Our view is that there will be a limited number of parties, independent of the firms who are the subject of investigation, who have the knowledge of the sector and the necessary statistical expertise to critically examine the findings. We expect the larger firms to participate and we have no reason to believe further investigation by our appointed adviser would provide any unique findings which would invalidate the analyses.

The conclusions of this paper are unsurprising to the extent that had the analyses come to radically different opinions to that of the FCA study, it would have cast severe doubts over the FCA study and its conclusions. Indeed we would be surprised if the further working papers do not reach similar conclusions. This confirms our earlier thoughts that a reference to the CMA was unnecessary and time was being lost until any new regime was put in place. That is not a criticism of the CMA's work or thoroughness with which we continue to be impressed. Rather it is the necessity which we would question.

Turning to the findings of the WP, we are surprised that the relevance of the asset manager recommendations in the total "performance" is given so little prominence being only referenced in page 6. Whilst it is not insignificant, the larger plays are around strategy (growth/matching and fitting to the clients' objectives), long/short term funding plans, covenant aspects (ability to withstand volatility shocks), and attitude to risk (appetite and needs for predictability, low volatility, higher matching strategies, passive rather than active). These aspects are suggested as accounting for 90% of the returns. What is more important is that this represents 90% plus of the considerations in setting strategy and setting the benchmark.

Our next comment is in relation to the gross/net performance issue. Comparing gross to benchmark is a measure of the ability of the manager to vary the shape of the portfolio and to pick stocks, i.e. what active management is about. The question as to whether the performance net of fees exceeds the benchmark is really about the merits of active versus passive managements. This presupposes that any constraints (e.g. ESG; value investing or large cap) which the client requires of his portfolio are similarly reflected in the benchmark. Whilst you correctly state that investors can only invest on a net of fees basis, then the benchmarks should equally be set on a net of fees (albeit passive) basis, which we suggest is not the standard approach. Our last concern about the net of fees comparison in this investigation is that this emphasises that the larger firms who invariably can command the larger clients would, other things being equal, be the best performers and one would conclude that the current dominance of the big 3 should be further encouraged by directing more funds to the managers who command the largest discounts.

We are somewhat surprised at the findings on page 28 in relation to ratings. We accept that had we participated in the confidentiality ring then it may have been obvious, but if an IC rates a manager as a buy in 2006 and retains that rating until 2015 (however likely that may be in practice) does this constitute 1 buy rating or 40. Second does the figure of over 80,000 single rating suggest that a manager may be rated by different IC's in different quarters or by the same IC in different quarters, otherwise this implies 80,000 different products have been buy rated over the 10 years whereas only circa 4,000 other and different products have been rated by one or more ICs. This seems bizarre.

Finally, before addressing the proposed remedies we note that you covered Hedge Funds but did not appear to cover LDI, MAC or DGF, which form a significant element of our clients' holdings.

<u>Your Proposed Remedies</u>

1. *Are trustees easily able to compare claims regarding the impact of asset manager product recommendations made by different firms during a tender, for instance?*

   As said earlier in this letter we believe asset manager product performance not to be the major factor in driving the performance of the scheme nor a good assessment of whether overall the scheme is meeting its objectives. In assessing which manager is appropriate this is more complicated than looking at performance relative to a benchmark and is at times more a matter of selecting managers not to appoint. We would therefore suggest that trustees need to be educated as to what they are looking for and how they may demonstrate the success, or otherwise, of the IC in undertaking such services for other clients. This is more important than validating the claims made in marketing or tender material.

2. *Would trustees benefit most from information on returns achieved by recommended asset manager products on a gross or net basis?*

   We believe that returns both on a gross and a net basis should be made available to trustees.

3. *How could the presentation of the impact of asset manager product recommendations be made more comparable, comprehensive, relevant and useful?*

   We do not believe there is an issue here as trustees do appear satisfied that they can measure the performance of the managers. In regard to the performance of an IC in helping the client meet its objectives there are many aspects which the IC needs to discuss with the clients and which trustees need to demand of advisers. This is not capable, however, of a simple pro forma analysis.

4. *What are the challenges of developing a common methodology? Should this be mandatory and, if so, should there be scope for divergence in specific circumstances?*

   There are many challenges in developing a common methodology such as establishing risk adjusted returns and relevant (risk adjusted) benchmarks and building in the larger plays of testing whether a strategy has achieved the effect sought or not. We therefore question whether the objective is achievable in practice. However were a common methodology developed which allowed for these facets JLT would fully support the initiative and opt itself in as a participant, whether this is mandatory or not.

5. *Should any claim in relation to the impact of a firm's recommendations be subject to external benchmarking or scrutiny and should this be assessed against a common methodology for presenting impact?*

   No, as can be gleaned from the answers to potential remedy 3. However, were a common methodology adopted as in remedy 4, we believe claims should then be evidenced through the output from this common platform.

6. *How should any change in presentation be implemented and enforced?*

   In line with the comments above the most we would require to be implemented would be, within a regulatory regime for ICs, a principles based code of practice.

We do hope you find our comments useful. If you have any queries in respect of our response or more generally please get in touch with us.

Yours sincerely

Phil Wadsworth

Director