

Dear Sirs

In January 2018, Xafinity merged with the actuarial, administration and investment consulting businesses of Punter Southall to create Xafinity Punter Southall (XPS). In the past we have responded to the investigation through our separate businesses but we will now do collectively as XPS. We are the largest UK pensions consulting firm outside of the 'Big 3'. As per our previous submissions by each predecessor firm, we provide services on an Investment Consulting (IC) basis and we do not provide Fiduciary Management (FM).

Below is our response to the working paper on the supply of FM services by ICs. We are happy for our views and suggested remedies to be in the public domain.

1. We believe that IC and FM are both credible solutions for trustees. The right choice for each trustee board will be based on their individual circumstances but there is a role for both in the world.
2. The choice of which governance model (IC or FM) best suits their needs should be made by the trustees, with no IC, FM or IC-FM advising on which route to take. Critically, we believe that this should also include the Scheme Actuary if working for an organisation that provides IC, FM or IC-FM as they are equally conflicted. This governance advice should only be given by an independent third party evaluator. The need for this independence of advice arises because it is essential that the benefits of each approach are considered impartially and any conflicts or fee-related issues are highlighted. However, we believe it is reasonable for an IC, FM or IC-FM to describe the benefits of the service they offer in a non-advisory capacity.

In particular, we do not think it right that an existing, incumbent IC of an IC-FM organisation advises on the suitability of FM within their own organisation. The initial findings show that most organisations have conflicts policies - and some organisations even refer to the conflict when talking to clients - but that approach is undermined by the copy board papers submitted, which indicate that growing FM services is a key area for those firms. This would indicate that the conflicts of interest are too great in terms of increased revenue for these not to influence behaviour and the issue is exacerbated as trustees are not well-equipped to recognise or deal with the strength of these conflicts. Even in organisations that provide only one of IC or FM there will be an inevitable bias toward the delivery model of that organisation (even if they are ruling themselves out of being the ultimate provider).

3. There are wider problems with organisations providing both IC and FM, because FM is often more lucrative. As shown by the research, the IC can guide the trustees over time towards a strategy or solution which needs a governance structure that is more suited to FM, hence creating a pipeline of IC clients that convert to FM over time. Such clients, if they had not been introduced to complex, high-maintenance IC approaches in the first place, may otherwise never be in a position of leaping straight to FM. This conflict is inevitable in any IC-FM organisation where management and staff share the benefits of success of an FM platform.

4. The growth in FM has largely come from the IC-FMs selling FM services to existing IC clients (we suspect using techniques in 3). The Asset Managers (AMs) have not managed to compete with the IC-FMs in converting existing clients, which is a frustration to the AMs and may not lead to clients getting the best outcomes in terms of service or price. In many cases, it is hard to see how the AMs would not be able to offer as good a service as the IC-FMs (given the experience in managing assets), so the conclusion must be that the IC-FMs have dominated the market by selling through their IC businesses.

5. The review highlights that the IC-FMs have suggested that the ICs have a bigger conflict in not recommending FM themselves. As mentioned in 2 above, if a client wants to consider the merits of IC versus FM they should appoint a third party evaluator. No IC, FM or IC-FM should be advising on the merits of different models as the conflict is too great.

6. The IC-FMs state that there is efficiency that comes from running the IC business alongside the FM business such as the sharing of costs and aggregation of manager fees. The latter implies that the separate IC and FM arms of the IC-FMs use the same fund managers and in fact in some of the business models they use the same research. That being the case, the advice given to IC and FM clients when selecting a fund manager should state this and the risks of doing so.

We believe that this reveals a fundamental structural issue in that IC clients of an IC-FM will almost inevitably lose out to FM clients of the same organisation where common funds are used by both. This is because within an IC-FM, the FM will swing material volumes of assets into and out of a fund manager before those of the IC clients because of the differences in the delivery models. This effect only happens in organisations that provide both services, but it is a logical inevitability that IC clients who 'buy later and sell later' than a wave of money from the FM clients of the same firm are likely to achieve worse outcomes than these FM clients. These firms can then cite to IC clients the 'superior FM performance' as a reason to adopt the alternative model. Note that this apparent outperformance only applies when comparing IC and FM of clients within an IC-FM and does not imply that FM is any more likely to outperform than IC. The CMA paper on IC, FM and IC-FM's lack of ability to select fund managers that outperform supports this.

7. The CMA paper shows 60% of trustees thought that IC-FMs steering clients into FM is a problem, with the more informed professional trustees and trustees of larger clients recognising it as a bigger problem. However, 70% of trustees think either that, whilst it may be a problem, it is generally well-managed or that it is not a problem or they don't know. This is alarming. This highlights that trustees don't seem to recognise the strength of the conflicts that exist in the IC-FMs which is what we have experienced. This is very apparent when the IC suggests that a particular asset class is managed by their FM arm ie partial FM. The IC cannot recommend their FM fund (as they are conflicted) but present it as the way forward. The evidence we have seen shows that conflicts are not explained, alternatives are not presented and fees are very opaque.

8. The findings of the CMA working paper agree with our assessment of the market. We therefore believe the suggested remedies are sensible options to explore but make the following comments:

a. Trustees have struggled to deal with the conflicts within the IC-FM so we believe training and further information being provided will have little benefit.

b. We also believe mandatory tendering will not solve this problem either as it has been seen that the IC-FMs win the majority of the time even if there is a tender. In fact, even third party evaluators have had little effect.

c. Therefore, we believe the only effective solution is to separate FM from IC. Importantly we also believe FM should be separated from the rest of the consulting business, specifically the actuarial business where the Scheme Actuary will also advise on investment matters and therefore can influence the trustees' decision making. This would therefore require ring-fencing of the FM business from the advisory business (IC and actuarial). This should include the complete separation of people, research, tools and remuneration structures, but this would still fail to remove the risk that this is undermined by a 'message from the top'. A further, cleaner step is to require mandatory legal separation, which in the long run should be good for the FM industry as it would remove the significant stigma that exists around the cross-selling issue. As suggested in the paper, the legal sale of the FM business would directly address the conflict. We note that firms have referred to the 'benefit' of offering integrated services, but that has not been quantified (thus far) and we do not believe that there is material benefit. Following legal separation, FM would then be left to succeed or not on its own merits.

We are mindful that as an independent IC in a market dominated by the Big 3, we have an interest in disrupting the status quo. However, we believe that a better-functioning market that eliminates conflicts so that customers are better-equipped to make an informed choice between IC or FM is better for the members of those pension schemes. We believe our suggestions, whilst significant, are the best way of achieving this as the current distortions are material.

We would be happy to expand further on any of the issues raised above if that is useful.

Regards

Patrick McCoy

Head of Investment

Xafinity Punter Southall

11 Strand, London, WC2N 5HR