CMA Working Papers – trustee engagement

Please find below the comments of Hyman Robertson LLP relating to the CMA's Working Paper: trustee engagement ("Working Paper").

We are in broad agreement with the points raised and the conclusions drawn in the working paper.

On page 5 the CMA states that this working paper forms a central part of the demand side and information theory of harm. Specifically that “difficulties in customers’ ability to effectively assess, compare and switch investment consultants result in weak incentives for investment consultants to compete for customers.”

Based on the analysis that the CMA has carried out for defined benefit schemes and the feedback received, trustees appear to have no difficulty assessing, comparing or switching investment consultants.

Specifically backing this up from the perspective of an investment consultant (IC):

- As shown on page 20, effective switching rates for IC switching are 30% over last 5 years and as noted this is materially higher than the equivalent FM rate.
- On page 21, the analysis shows that almost two-thirds (63%) of schemes have carried out a formal review of IC fees/quality in the last 3 years and the presence of an investment committee tends to mean that this is more likely to happen.
- Importantly, of those not switching IC, 75% said this was because they were happy with their current provider, i.e. not that they find it hard to switch (Figure 4.4, page 61 of IFF Research report of CMA commissioned survey).
- As shown on page 24, 89% of trustees found it easy to monitor the quality of service from the IC and 82% found it easy to judge the overall quality of IC firms tendering for IC services (page 73 of Working paper: information on fees and quality)
- For those trustees who did decide to switch, (as shown on page 28) 82% of trustees switching IC found the process very or fairly easy. In these circumstances, there are likely to be some costs of making the change, but, in our experience, these are largely understood in advance by the trustee in deciding to switch, or the costs may well have been incurred anyway (for example, in replacing an underperforming asset class or de-risking).

In our opinion, this combined evidence and feedback does not imply that there is a requirement for the CMA to impose burdensome regulatory changes on how ICs operate.

Our observations for defined contribution (DC) schemes can be summarised as follows:

- On page 2, the observation has been made that DC schemes appear to be significantly less engaged than average based on a rate of switching of 16% (compared to 27% across all schemes) and the rate of tendering is 29% (compared to 41% across all schemes). We don’t think the above results are surprising in an environment of strong absolute returns across equity and bond markets over the past five years (and beyond). Many DC objectives are linked to delivering cash-plus or CPI-plus return targets and these have been easily met across recent reporting periods. We believe it’s important to go one step further in the approach to monitoring by providing trustees with analysis on:
    - the impact of returns on member outcomes (reporting on the performance of different cohorts of members based on years to retirement);

- encouraging the presentation of long-term performance monitoring rather than focusing on quarterly figures and commentary; and
- an assessment of whether underlying investment strategies are delivering value for money in the context of DC objectives. This is always a crucial part of our investment strategy reviews and the annual assessment required for the Chair's Statement. We make sure that value is defined on a number of different metrics, not just cost.

- On pages 9 and 10, a connection is made between the low engagement levels in DC schemes and areas such as the low prevalence of investment sub-committees and the time spent on DC within trustee meetings. We agree with this general point. For combined DC and DB schemes, where the DB scheme is much larger in assets and members, trustees necessarily have to spend more time on the DB issues which tend to be financially more significant and immediate. Our approach is to combine the focus on long-term DC issues and trends with the latest and most relevant "hot topics" for DC schemes. This can refer to product development and innovation, sharing the findings from our latest proprietary research or market research, or the latest regulatory announcements that will impact all schemes.
- On page 15, it is stated that reducing or managing risk appears to be an important motivation for using consultants relative to increasing overall investment returns. Our approach and perspective is a little different. Our overall objective is to improve member outcomes on a risk-adjusted basis, taking into account that risk is a changing concept throughout a member's career. For example, our core advice framework leads us to recommend significant levels of growth assets when a DC member is far from retirement, which will lead to an increase in expected returns even though member pots will be volatile (we don't believe this is a significant risk when a member is far from retirement).
- On page 23 the point is made that many schemes do not regularly monitor member outcomes and do not appear to be complying with their value for member requirements. The experience for our clients is somewhat different. We offer a variety of modelling tools that allow trustees to further monitor member outcomes. On the value for member requirements, our annual template gives trustees a number of options related to the level of detail they wish to express. The simplest template has been designed to comply with all the regulatory requirements and is updated after every refresh of regulations. The most detailed template follows best practice guidance from the Pensions Regulator and ensures that trustees provide the backing evidence to support any value for member claims. For example, over the past couple of years:
  - Our clients have benefitted from reduced investment charges following platform provider reviews;
  - Seen increased levels of member engagement by using our member outcomes modelling tool;
  - As advisers, we also need to be demonstrating value for members. We produce annual budgets for clients on both core and project work – each scope demonstrates what value we are aiming to add;
  - Improvements in risk-adjusted returns following recommendations from an investment strategy review; and
  - We have developed a comprehensive fee benchmarking database that helps trustees assess value for members.

These are all aspects of demonstrating that trustees and their advisers are providing value for member.