CMA Market Investigation – Investment Consultants

26 April 2018

Response to working paper: trustee engagement

This is LCP's response to the CMA's working paper, "trustee engagement", which forms parts of its market investigation into UK investment consultants.

We welcome the opportunity to comment on the working paper and its potential remedies. We have commented on selected potential remedies in the tables below, focussing on what we see as a number of key issues.

Potential remedy	LCP comments
1. **How can switching costs be reduced**	In our view many of the fiduciary management services available create complex and costly portfolios that add little benefit over a simpler and lower-cost portfolio. This complexity is a key cause of the potentially relatively high switching costs (and high ongoing costs) of fiduciary management. We understand that the CMA will be covering the complexity of portfolios and its associated costs in its analysis of the outcomes for customers.
2. **Can FM providers present better information on switching and exit costs in advance?**	We would welcome better disclosure of information on the costs of switching to and exiting from an FM service in advance. This would assist customers in making a decision about whether to employ an FM manager and the comparison between different providers. We recognise there are challenges in providing meaningful information on switching costs. However, we do believe it is important for trustees to consider the costs of an investment service over its entire lifetime. We would support any approach that encourages a more rigorous framework for considering the full costs. We view an FM service as a form of asset management. Any measure imposed here should apply to asset management products as well in order to have a level playing field between them. This is especially true when comparing a partial-fiduciary management service and a fund-of-funds management service. If this remedy is applied to all asset management services, it would potentially represent a material change from today's practice.

a) What are the challenges for FM providers in providing accurate exit or switching costs in advance, e.g. when tendering?	We appreciate that this is a complex issue. There are a number of challenges that need to be considered. An ideal potential remedy would allow customers to receive an accurate view of a) how much it will cost to switch from the existing strategy to the FM service; b) how much it will cost, at a later date, to switch out of the FM service to some new strategy. There are particular issues around: • When using pooled funds, how to anticipate if the pooled fund will impose an anti-dilution mechanism on the price of sale / purchase? An anti-dilution levy or swinging price may or may not be imposed depending on the size of the subscription to or redemption from the fund and on whether other investors are buying or selling at the same time. • How to anticipate the cost savings that may be possible from unit reregistration, secondary-market purchase / sale of funds or in-specie transfer of securities? • The fact that the costs of b) cannot anticipate the changes in exit costs resulting from yet unknown future changes to the portfolio, it may be of limited value. Nb any such changes may be due to the customer changing the FM service provider's objective or brief and not at the discretion of the FM provider. • Decisions around some fund holdings that may be taken by the customer, rather than the FM manager. For example, on whether to sell an investment quickly and accept a redemption penalty or delay the sale and avoid it. It is, therefore, necessary either to set out clearly what assumptions have been made in estimating the costs, or to provide a range of costs under different assumptions, or both. Given these complexities we suggest that it would be difficult to set out detailed rules on how the switching costs should be calculated. It may be better in the first instance to agree a set of principles that FM providers agree to abide by when customers wish to exit or switch – eg to provide to the maximum extent possible an in-specie transfer of assets, with some indication for what that would mean for the customer presently (eg when tendering).

3. Potential remedies in other working papers and ongoing developments

a) Would any of the remedies included in other working papers be an effective and proportionate way of driving engagement either individually or collectively?	The CMA's working paper on fees and quality contained a potential remedy for ICs to publish a track record of their returns. In our response to that working paper we highlighted some concerns with this potential remedy, noting that the role of investment consultant is broad and that a sole or primary focus on investment returns (or even risk-adjusted returns) may not be appropriate. The findings of the CMA survey of trustees highlighted in this working paper (figure 4) show that trustees agree that increasing investment returns is not the primary reason for using an investment consultant.

4. Others potential remedies

Require the inclusion of at least one professional trustee for each pension scheme/enhance training for trustees. Paragraph 129(b).	We do not think this is appropriate for all schemes. We have no significant objection to this being encouraged, but for some schemes with very simple arrangements the extra cost incurred may be for little additional benefit and in some cases it may hinder the relationship (perceived or otherwise) between the employer and trustees.
Enhanced obligations on trustees to obtain value-for-money. Paragraph 129(c)	We believe a requirement for trustees to consider value for money from all service providers would help improve trustee engagement. These requirements should include DB schemes as well as DC schemes.
Trustee reporting to scheme members or TPR. Paragraph 129(e)	We think this may be an appropriate way to improve trustee engagement and encourage market testing of IC services. In most circumstances where an IC service is used, by far the largest proportion of scheme running costs is the fee paid to the asset manager(s). This remedy may, therefore, wish to include a similar requirement for asset manager appointments. Where an FM service is used, the asset manager fee is usually considered part of the total costs, and so reporting on the FM provider's appointment and testing the market will include these more material costs.