REDINGTON

CMA INVESTMENT CONSULTANTS MARKET INVESTIGATION

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Redington response to CMA working paper- Trustee Engagement

EXECUTIVE SUMMARY

This is not the first time that governance has been highlighted as a challenge for pension funds. Guidelines and toolkits for trustees can be helpful but we would note there already exists an extensive body of guidance produced by the Pensions Regulator (tPR) on this, adding to this may not be particularly effective and may indeed place an increasing burden on many trustees and schemes, which would not necessarily be positive for engagement.

We suggest an approach more likely to be impactful would be a compact set of principles for the governance of pension schemes. We note that the Myners' Principles, produced in 2001, became fairly well internalized by trustees and in many cases were effective in influencing behaviour. We have produced our own set of 18 governance principles, based on our experiences advising a range of pension schemes. We would welcome the opportunity to share and discuss these with the CMA.

We note that while professional trustees, investment committees and in-house advisors can improve governance, this needs to be done thoughtfully and in relation to a scheme's resources and governance capacity. Hence we do not see it as a feasible solution to mandate in these areas, not least because of the complexities involved.

Conceptually we believe value for money is very important, however the key is having a consistent definition of this that schemes can work with, to avoid statements being too vague. Such a definition should, in our view, clearly look beyond price as a measure, and should also pay heed to the fact that some things are amenable to measurement and comparison over a short time period (eg fees and service metrics) whereas others, particularly investment performance are not. This is a crucial nuance in constructing a workable definition of value for money.

We view scrutiny and challenge by trustees as much better measures of engagement than switching rates (we see unintended negative consequences around mandatory tendering as discussed further in section 4). We believe the current guidance from the tPR on the principles of value for money in DC could be effectively extended to include a review of consultants and then further adapted for DB schemes. We would welcome the opportunity to work with the CMA and other advisers on what this may look like.

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We also believe that DB trustees reporting to tPR annually in a similar way to DC trustees, perhaps via a DB Chair's statement on a small number of clearly defined areas (as mentioned in the recent Department of Work & Pensions DB whitepaper[1] "Protecting Defined Benefit Pension Schemes") could be an effective remedy.

We find that engagement from trustees and sponsors for DC can vary greatly and this is sometimes reflective of whether the DC scheme is open or closed. There may be good reasons why trustees don't engage as much in the DC schemes they govern, however we agree there should be a consistent engagement level across all schemes. Our proposals above are designed to help all DC schemes, including smaller schemes, to help fulfil their duties.

MAIN RESPONSE

You have outlined your assessment of trustee engagement based on headline indicators (switching and/or tendering or undertaking a formal or external review of fees and/or quality) as well as broader measures (e.g. whether trustees are able to scrutinise and challenge the investment advice they receive and the role played by other stakeholders).
You have outlined your emerging thinking on potential remedies (not including those discussed in the other working papers to date) if you were to find an AEC with the level of trustee engagement constituting some or all of it:

- Measures to better inform trustees of FM switching costs
- Measures to empower and incentivise trustees to engage
- Measures to reduce FM switching costs

As Redington does not provide Fiduciary Management, we have limited our comments to the paragraph 129 measures to drive trustee engagement for DB and DC schemes. The rest of our response is structured around the following six areas:

1. Guidance to trustees
2. Measures to improve governance standards
3. Enhanced obligations on trustees to obtain value-for-money
4. Mandatory tendering or switching
5. Trustee reporting to scheme members or tPR
6. Engagement

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/693655/protecting-defined-benefit-pension-schemes.pdf

1.GUIDANCE TO TRUSTEES

We are supportive of issuing toolkits or guidance in principle, and agree that tPR is well placed to issue any revised guidance. We believe the CMA should consider whether existing guidance is sufficient to bring about desired change if followed, and whether there are adequate incentives for schemes to follow such guidance.

In relation to taking a view on existing guidance, we would note that there is currently a large volume of guidance from tPR – this in and of itself can be a challenge for trustees. The guidance is also arguably quite complex to follow, which is likely to prove particularly challenging for schemes with less resource and governance bandwidth - typically those schemes that would stand to benefit most.
We would suggest that distilling current guidance into a more practically accessible format would help schemes better interpret it and encourage engagement. This is where it may be helpful to draw a distinction between those schemes that have sufficient resource and time (typically larger), and those that do not, to ensure guidance is focussed on practical advice for those schemes that require help the most.

2.MEASURES TO IMPROVE GOVERNANCE STANDARDS

Mandating the use of professional trustees, investment committees and in-house investment advisors

In our view, it is not the existence of a professional trustee, investment committee or in-house investment advisor that improves governance per se, but their quality and how they fit within a scheme's wider governance structure.

In our experience adding a professional trustee to a board generally helps improve governance. A professional with wide experience and good technical and people skills can improve outcomes. However, we are anecdotally aware of scenarios where individuals without these capacities have become professional trustees. Without the requisite skills and experience, costs may rise but decision-making or engagement may not improve. To meet this challenge, the industry body (the Association of Professional Pension Trustees) has developed draft standards for professional trustees (see http://appt.co.uk/wp-content/uploads/2017/12/PTSWG-Professional-Trustee-Standards-Dec-2017.pdf), but at this stage they are voluntary.

It should also be noted that professional trustee market is capacity constrained. Should the CMA mandate their use, we believe that the industry would struggle to meet demand.

Investment committees are generally found in larger schemes that have a greater number of trustees. With a large board, it is perfectly logical to divide responsibilities between different groups to allow matters to be covered more effectively, either through specialist knowledge or the delegation of

responsibilities which allow more ground to be covered. However, if a smaller scheme has only 3 trustees it makes no sense to divide responsibilities, indeed it would likely be counterproductive to form an Investment Committee.

Developing in-house investment expertise can be valuable, but expensive. Our experience suggests that only the largest schemes invest in this area, where they can see the economic value of building in-house resource vs. reliance on external advisers.

In summary, all three of these areas can improve governance and engagement, but this will only happen if done thoughtfully, i.e. in relation to a scheme's resources and governance capacity. We therefore suggest that it is not feasible to mandate these areas.

3. ENHANCED OBLIGATIONS ON TRUSTEES TO OBTAIN VALUE-FOR-MONEY

We believe that conceptually this is very important and that the CMA in conjunction with tPR should try and find a way to do this, perhaps by extending the concept of a Chair's statement from DC to DB.

For this to work across an industry with varying degrees of both capacity and complexity, it is crucial that there is a definition of value for money that is robust, easily calculable and is truly reflects the concept of value-for-money (vfm) rather than simply price. In DC, tPR already provides detailed guidance on what trustees should consider. This could be extended further to include a review of consultants and then used as a basis to form a DB vfm framework.

The challenge is that whilst certain elements of vfm are amenable to comparison over short time periods others are not. Fees and certain service metrics (if properly defined and captured) can be measured on an annual basis, whereas investment performance against objectives needs to be evaluated over longer timeframes. To avoid negative unintended consequences of a race for minimum fees rather than maximising outcomes for members, a sensible framework should be used. For example, trustees could compare quoted fees versus actual fees each year. This would incentivise ICs to quote accurately and provide trustees with more reliable data to inform their choices. We believe this could be effective in promoting engagement.

However, a key part of whether value has been generated -the consultant and client working together to design and implement effective strategy- can only be accurately determined over a far longer period.

We would thus caution on too frequent assessment of performance, which could have unintended consequences, e.g. creating a culture of short-term thinking. One way to address this might be to provide guidance that performance should be noted and published on an annual basis, but formally reviewed over a less frequent basis.

As we have stated previously, we believe that unless clear understandable metrics are in place for this element, there will be a default towards what can be easily measured, e.g. cost. We suggest that some composite series of measures would be most useful in helping trustees practically decide when to review/re-tender. These might include:

- Significant changes in fee levels (on a year to year basis, or quoted vs. invoiced).
- If agreed service levels are not met.
- Significant changes in personnel, philosophy of the Investment Consulting firm
- To the extent that in can be validly assessed, performance not meeting expectations.

We recognise this is a complex area and we would be happy to work with the CMA and other advisers to help devise a measure that will help drive trustee engagement and outcomes.

4. MANDATORY TENDERING OR SWITCHING

We believe that mandatory tendering could have several potential unintended consequences which may impact the efficacy of the remedy and make it hard for it to meet the requirement for proportionality.

We believe that mandatory tendering would lead to a sharp increase in the number of tender processes, with many of these being “test the water” processes with no genuine prospect of the incumbent changing. Redington invests, on average, between 100-250 hours in each tender process, which is a significant investment for a relatively small, growing firm of 130 people. If mandatory tendering were to be implemented, we would likely find it impossible to respond to all relevant tenders, and would have to become highly selective to those that we invested the time and effort into.

However, we would not be doing this on an informed basis, as it is usually difficult to establish whether the process being undertaken has a genuine chance of resulting in change or not. The net effect of mandatory tendering could be that small firms, like ourselves, waste a large amount of time in tender processes which are ultimately unsuccessful. It may also mean that genuine opportunities where there is a desire for a change and a need for new and fresh advice may not get the focus and attention they deserve from smaller firms. Overall, we believe this may not be in the best interests of competition, or the underlying members.

We understand that the evidence relating to the effectiveness of mandatory tendering for driving competition in the audit market is not conclusive. We understand data shows that the Big Four’s market share of FTSE 100 firms fell only slightly from 99% to 98% between 2011 and 2015, while their share of all U.K. listed firms actually increased over the same period. [1]

As discussed in ‘Strengthening requirements to consider value for money’, we believe that trustees can create a workable framework that will help them make a good decision on when to review/tender.

5. TRUSTEE REPORTING TO SCHEME MEMBERS OR TPR

Having the Chair of Trustees, or CEO of the Sponsor for DC only schemes, reporting annually to tPR on the following may act to improve engagement but this should not be just a tick-box exercise and should be designed to ensure that it is an easy to prepare document that does not present a disproportionate burden. The contents might include:

- Principles that the scheme follows regarding governance and decision-making.
- Whether they have changed investment consultant or fiduciary manager that year and what process they went through e.g. formal tender, types of firms included.
- Whether they have monitoring in place for their current investment consultant or fiduciary manager i.e. warning factors discussed above.
- What that monitoring is currently showing.
- Whether they have carried out or are planning to carry out a review of fees and performance or a formal tender.

Given the sheer number of DB and DC schemes under the remit of the tPR, it would be important for the chair's statement to be feasibly processed by tPR across that range of schemes.

6.ENGAGEMENT

Scheme size and engagement

We believe that there is a relatively simple answer to your question on lower levels of engagement for small schemes – governance capacity. We believe that *on average* smaller schemes dedicate less resource and time to the management of their schemes.

This issue has been debated many times in the industry, see the PLSA's DB Taskforce's 'Opportunities for change' document (https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2017/DB-Taskforce-third-report-Opportunities-for-Change.pdf).

Thus, whilst a combination of informational and toolkit/guidance remedies that you have outlined could work, we suggest:

- As per the comments in 'Guidance to trustees', any guidance is streamlined.
- Strong incentives need to be created to compete for trustees' limited time and resources.

DC and engagement

For DC, we note your comments that there appear to be lower levels of engagement from trustees and sponsors for DC than for DB and your finding that DC schemes are more likely to use Investment Consulting to satisfy legal and regulatory requirements. We will be interested to see the results from your upcoming Working Paper – Gains from Engagement to see what, if any, differences you find regarding outcomes.

We find that the level of engagement across DC schemes can sometimes be in relation to whether the DC scheme is closed or open. Many companies have auto-enrolment compliant DC schemes which may

not be trust-based and therefore are not bound by the same regulatory duties. For legacy DC schemes, there may be reasons why there is a lower level of engagement, for example they may have with-profits funds with guarantees over them, which means there is little for the trustees to do except monitor the funds and charges on a regular basis.

However, we agree that trustees of all DC schemes should engage in order to improve member outcomes and our proposals set out in this letter are designed to also help all DC schemes, including small schemes, fulfil their duties.

Yours sincerely,

Dan Mikulskis, **Head of DB Pensions**