

Response to working paper: barriers to entry and expansion

This is LCP's response to the CMA's working paper, "barriers to entry and expansion," that forms parts of its market investigation into UK investment consultants.

We welcome the opportunity to comment on the working paper. We make a few selected comments on its contents below.

Incumbency advantage in FM services

The CMA makes a number of points that, when considered in combination, highlight the incumbency advantage of FM service providers.

- Paragraph 13 notes the low levels of switching in FM services;
- Paragraphs 35 and 36 note the increasing importance of scale economies;
- Paragraphs 65 and 66 note the significant level of tender costs; and
- Paragraphs 51(b) and 57 note the advantage that an incumbent IC provider (at a combined IC-FM firm) has in winning FM mandates. This business is often acquired without a tender meaning significantly lower business acquisition costs.

Complexity of portfolio construction as a barrier to entry or expansion

In paragraphs 76 and 77 the CMA highlights that the costs of switching from an FM may affect the frequency of formal tender processes or the propensity to switch FM service providers which could, therefore, be a barrier to entry or expansion.

The CMA's working paper "Trustee engagement" also considered the switching costs of FM services. These costs can be affected by the portfolio management decisions taken by an incumbent FM service provider.

This was highlighted as a potential conflict of interest issue – the existing FM service provider has an incentive to increase complexity and exit costs – in a paper submitted to the CMA by Compass Lexecon in December 2017 (published on the CMA's website on 1 March 2018). There is a risk that, although fiduciary management is competitive at the time of appointment, it may be highly insulated from any competitive pressure subsequently due to the difficulties and costs in switching to another provider.

Offering IC and FM services as a barrier

We do not believe that being a bundled IC-FM provider creates a barrier to entry or expansion of FM services (paragraphs 78 – 83). This is particularly true of the three largest IC-FM firms. There is no evidence that they are experiencing significant barriers to expanding into FM (quite the contrary). We believe that some clients do value the

3414512 independence of pure IC providers, but it is in our view a real stretch to characterise this as in any way raising entry/expansion barriers for bundled IC-FM providers.

Page 2 of 2