CMA Working Paper – competitive landscape

Please find below the comments of Hymans Robertson LLP relating to the CMA’s Working Paper on the competitive landscape.

We agree with the broad conclusions of this working paper. We also think the analysis is important in identifying the risk of the FM market becoming less competitive in future under the current operating model.

We believe that the findings in respect of the IC advisory market are in line with many of the earlier comments made by market participants, namely that the IC market is not overly concentrated.

The FM market is more concentrated, and while this is perhaps not unusual given it is a younger industry, there is a genuine concern that it becomes more concentrated over time rather than more competitive:

- We note the comparison of IC revenues (c£260-280m pa) and FM revenues (c£200-240m), and the number of schemes using IC services (4,300) compared with the number using FM services (980). These figures give revenue per scheme amounts which indicate that average FM fees are approximately c3-4 times those for IC services. This illustrates a potential incentive for IC-FM providers to move schemes into FM.

- We note that the big 3 IC-FM firms have increased their share of the FM market from 10% to between 40% and 50% in the last 10 years, and they have growth plans to continue to exceed the growth in the overall market.

- The FM conflicts working paper states that 71% of mandates won by the largest IC-FM firms were from the firm already supplying IC services to the client.

- As noted by the CMA, barriers to entry are greater for the FM market than IC market.

These points highlight the genuine potential for concentration and competition issues to continue to evolve in FM over the next few years, and, by implication, there is a need for ongoing monitoring of this, even if it is decided that there is no need for immediate action at this time.

The CMA appears to conclude that there are separate relevant markets for IC services and FM services to pension schemes. Whilst we agree that there are some distinct differences, we stress that FM is simply a combination of two services: IC advisory and delegated asset management. To the extent that the key difference between IC advisory and FM is the delegated decision-making on a number of strategic and implementation issues, we think the overlap is significant rather than distinct. By default, providers of FM will incorporate a material proportion of what would otherwise be considered investment advice within their proposition; thus they are competing directly with IC advisers. This does mean that there is more choice for pension scheme service purchasers (i.e. more competition), but it also means that the industry needs to find ways to ensure transparency of the two services provided within FM, in order to ensure a fair and competitive landscape.

More specifically:

- We note paragraph 13(b) on page 4 relating to suppliers being capacity constrained and the full range of options not being available for customers looking to switch providers. We also view capacity constraints from an investment and active management angle. As FM assets under management continue to grow through market returns and contributions, we would raise the following questions:
  - for a “best ideas” active asset class portfolio, will the FM have to dilute the potential for excess returns by choosing “second best” managers once their best ideas have hit capacity constraints?
If a dilution is necessary, how should the FM determine a fair split between these “best ideas” with their FM and IC clients?

If a large proportion of the FM assets is ultimately passed over to passive managers, this would imply the FM should reduce their fees as their value from manager selection is diminishing.

From paragraphs 92, it can be implied that the concentration of IC services in the DC segment appears to be lower than the corresponding figure for DB. Paragraph 129 implies that DC schemes make up a very small proportion of FM assets under management. Whilst we agree with this view of the current position, we think this is likely to be significantly affected by the future growth and consolidation of master trusts, meaning that the position will look increasingly concentrated over the next few years. We would therefore recommend keeping a close watch as this trend evolves, so that there remains appropriate investment governance at scheme level.