CMA Market Investigation – Investment Consultants

11 May 2018

Response to working paper: financial performance and profitability

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

We welcome the opportunity to comment on the working paper.

Relative profitability of IC and FM services

We agree with paragraph 27 that the key area to examine is the theory of harm concerning incentives of IC-FM providers to steer clients into their own in-house FM services.

We note that the working paper does not highlight a difference in the relative profit margin between IC services and FM services at integrated firms. However, paragraphs 76 and 86 of the working paper on the supply of fiduciary management services by investment consultancy firms does suggest that FM profit margins are higher than those of IC service. To the extent that FM services are a replacement for IC services, there is a clear financial incentive to steer existing IC clients into an in-house FM service.

Potential detriments

The CMA makes an important point in paragraph 4 that a detriment could arise from low quality advice provided by IC or FM providers resulting in poor investment decisions by pension schemes; and/or in excess profits earned by IC or FM providers.

We note the CMA's view that it is not proportionate to undertake an assessment of economic profitability. It is, in our view, therefore, important that the CMA focus on ensuring no detriment is arising from low quality advice provided by IC or FM providers.

Compass Lexecon submitted a paper to the CMA in December 2017 (published on the CMA's website on 1 March 2018) (CL Paper) which set out a number issues that may indicate potential conflicts of interest around the quality of advice. We refer to these issues below using the same numbering as in the CL Paper.

- The IC-FM firm may have an incentive to set a "soft" risk/return objective for the purpose of benchmarking the fiduciary manager (Issue 1 CL Paper).
- Fiduciary managers may have an incentive not to propose certain insurance solutions that reduce their assets under management (Issue 4 CL Paper).

- The IC-FM firm may have an incentive not to advise a client to replace its FM service provider. It may also have incentives not to be fully transparent over sources of underperformance (Issue 5 CL Paper).

The issues raised in the CL Paper are important and we look forward to the CMA's analysis of them in due course.