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CMA Market Investigation – Investment Consultants

24 May 2018

Response to working paper: gains from engagement

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

We welcome the opportunity to comment on this working paper which we note is the last working paper in the investigation.

Issues covered in the working papers

Before commenting specifically on this most recent working paper, we have the following more general comments.

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 of issues that may indicate potential conflicts of interest around the quality of advice.

We have been told by the CMA that the working papers would not necessarily address all issues being examined by the CMA, and thus omission of issues from working papers does not imply those issues will not be addressed in provisional findings.

Nevertheless, we note below the specific issues that do not appear to have been covered in the working papers (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).
- The IC-FM firm may have an incentive to use favourable assumptions to set higher allocations to an asset class in which it offers a partial-fiduciary product (Issue 2 CL Paper).
- An IC-FM firm may have an incentive to recommend one approach for a given asset class or be overly prescriptive in favouring certain combinations of asset classes that align with its in-house fiduciary products (Issue 3 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 in our view important and testable. The CMA investigation is a one-off opportunity to address these issues and we are hopeful that they will be addressed in the provisional findings report.

Findings of the Gains from Engagement working paper

We note that there is evidence that disengaged schemes pay more for FM services than engaged schemes, when they are converted from an IC to FM service.

We note that the equivalent findings in relation to IC services are much weaker than for FM and that there is only "limited evidence" that disengaged schemes pay any more for IC services than engaged schemes (paragraph 124).

Whilst the findings here are, in our view, not robust enough to identify an AEC, we believe that some of the potential remedies in the Trustee Engagement working paper could be adopted by the Pensions Regulator as best practice guidance to trustees when addressing the issues the working paper identifies.

We note that the effect on IC services fees from engagement that the analysis does identify is far less material than other costs to a UK pension scheme.

The total fee paid to ICs as a percentage of total UK pension scheme assets is approximately 0.02% (£280m total fees)[1]. This compares to a fee of around 0.48% paid to asset managers[2] (£5.7bn of total fees on the same asset base) and around 0.22%[3] fee paid to FM service providers (£237m total fees on the FM market's assets under management). The working paper states that fees are around 12% lower for engaged schemes – on average this is less than 0.003% fee difference expressed as a percentage of assets.

[1] Competitive Landscape working paper. CMA investigation into investment consultants. April 2018. Paragraphs 70 and 72. £280m total market size advising UK pension schemes with assets of £1.2trn.

[2] LCP calculation based on the FCA Asset Management Market Study Interim Report finding that the average fee on institutional investors is 0.63% for active products and 0.15% for passive, with 68% of assets managed actively. Total fees is based on the estimate total assets of pension schemes that ICs provide advice to of £1.2trn.

[3] Competitive Landscape working paper. CMA investigation into investment consultants. April 2018. Paragraph 114 and 115. Upper bound of market size of £237m, managing £110bn in assets.

With respect to IC services, the gains from engagement working paper focuses on the effect that engaging with the IC has on the fee paid to the IC (paragraph 57). It does not cover other key areas where customers of IC firms potentially could make gains from engagement. In paragraph 56, these are set out as:

- effort and success on the part of ICs in negotiating discounts for their schemes on Asset Management (AM) products in the context of their manager recommendations services;
- returns on their assets, leading to changes in the rate of growth of their funding levels for a given spend and level of risk, and
- quality of service on 'soft factors' such as personal relationship or clarity of advice.

Gains made in these areas may be substantially higher than the gain from any reduction in IC fee.