Investment Consultants Market Investigation

Provisional Decision report

Notified: 18 July 2018

The Competition and Markets Authority has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. [Some numbers have been replaced by a range. These are shown in square brackets.] [Non-sensitive wording is also indicated in square brackets.]

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Investment consultancy and fiduciary management services influence the pension outcomes for millions of people. It is vital that competition within these markets works well.

Both investment consultancy and fiduciary management are useful services for many pension schemes, helping them to manage their investments well on behalf of scheme members.

We have provisionally found that there is an adverse effect on competition and that material customer detriment may be expected to result from it in both the investment consultancy and the fiduciary management markets. We have greater concerns about the fiduciary management market due to the features we have found.

In **investment consultancy**, there is a low level of engagement by some customers in choosing and monitoring their provider. It is also difficult for them to access and assess the information needed to evaluate the quality of their existing investment consultant and to identify if they would be better off using an alternative provider. This reduces their ability to drive competition and reduces providers' incentives to compete. In turn, this may be expected to result in material customer detriment in the investment consultancy market.

In **fiduciary management,** firms which provide both investment consultancy and fiduciary management have an incumbency advantage, deriving from low customer engagement at the point of first moving into the service, investment consultants steering their advisory customers towards their own fiduciary management service and the fact that prospective customers do not have access to comparable information on providers' historic performance, or clarity on their fees. This means that some customers remain with their investment consultant even if a better deal on fiduciary management is available elsewhere. This problem may be exacerbated by the relatively high costs of switching provider.

In addition, it is difficult for many customers to access and assess the information they need on the fees of their existing fiduciary manager and to identify if they would be better off using an alternative provider.

Overall, these features reduce customers' ability to drive competition between fiduciary managers and reduce providers' incentives to compete. In turn, this may be expected to result in material customer detriment in the fiduciary management market.

Our proposals aim to remedy these problems in an effective and proportionate way. They include the following:

- The introduction of mandatory tendering when pension trustees first purchase fiduciary management services and a requirement to run a competitive tender within five years if the existing fiduciary mandate was awarded without a competitive tender.
- Greater support for running tenders from The Pensions Regulator for investment consultancy and fiduciary management customers.
- A requirement on investment consultancy and fiduciary management firms to report investment performance to their customers using a set of common standards.
- A requirement on fiduciary management firms to disaggregate fees for prospective customers and provide greater clarity to existing customers on costs, including those relating to exiting the service.
- A requirement on pension trustees to set objectives when they hire an investment consultant, in order to be able to judge quality of the service.

In order to reinforce some of these remedies, we recommend that the government extend the FCA's regulatory perimeter to include the main activities of investment consultancy and fiduciary management providers.

Introduction

1. This is the provisional decision report of the Competition and Markets Authorities' (CMA's) market investigation into investment consultancy and fiduciary management services. The CMA is carrying out this investigation following a reference from the Financial Conduct Authority (FCA) in September 2017.

2. The purpose of a market investigation is to decide whether any feature or combination of features of a market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom; that is, whether there is an adverse effect on competition (AEC). Should we find any AEC, we will then

decide whether remedial action should be taken and if so identify effective and proportionate remedies.

The markets we are investigating

3. The FCA referred these markets for investigation at the conclusion of its Asset Management market study.

4. The FCA's assessment of the activities of investment consultants and fiduciary managers within this wider market study was necessarily less in-depth than a dedicated market study would have been. Overall, there has been very little previous work on the investment consultancy and fiduciary management markets, so we believe that this investigation plays an important role in shining a light on this very influential part of pension scheme investment.

5. This investigation covers two types of service: investment consultancy and fiduciary management:

   (a) **Investment consultancy** is the provision of advice to institutional investors on investment strategy, asset allocation and asset manager product selection. The scope of service varies by customer and may be time-limited or ongoing. The service has been provided to many pension schemes for over 20 years.

   (b) **Fiduciary management** may also include investment advice but also includes the legal delegation to the fiduciary manager of some or all investment decisions based on the strategy agreed by the pension trustees. The level of delegation may vary, with around 61% of fiduciary management mandates being for the full assets of a pension scheme. Fiduciary management is a more recent service than investment consultancy and has grown significantly in recent years.

6. Investment consultants and fiduciary managers influence pension scheme assets worth at least £1.6 trillion. These services therefore influence the retirement income of millions of people and, if they are high quality, they have the potential to add considerable value to pension scheme outcomes for their members.

7. The services are provided by a range of firms including some large, international firms and smaller, UK-only firms. We have identified 37 firms which offer investment consultancy services and 17 which offer fiduciary management to pension schemes in the UK.

8. Investment consultancy and fiduciary management services are provided to different types of institutional investor, including pension schemes, charities, insurance companies and endowment funds. We have found that pension schemes represent over 90% of investment consultants' revenues, and we have therefore focussed on these.

9. The main type of customer for investment consultants and fiduciary managers is trustees of the type of workplace pension known as a defined benefit (DB) scheme. Defined contribution (DC) pension schemes are also customers for these services and, while they represent a smaller source of revenue today, they are growing rapidly as a part of the overall UK pensions landscape and may become a more significant customer group for investment consultants and fiduciary managers in time.

10. Pension trustees must act on behalf of the members to ensure that the scheme is run properly and members' benefits are secure. Since 1995, both DB and DC pension scheme trustees have been legally bound to take and consider 'proper advice' before taking investment decisions and this is seen by many as a reason why they use an investment consultant. The trustees are fully accountable for the scheme and its investment.

11. Another driver of pension trustees' use of investment consultancy is the number and complexity of investment options they face and the challenge of closing the deficit gap which exists for many DB schemes between their liabilities and assets.

12. The duty to take proper advice on investment is just one of a wide range of legal and regulatory duties faced by pension trustees who are often unpaid lay people, rather than investment professionals (although the use of paid, professional trustees is growing). There is a complex legal and regulatory framework for pension investment. The Pensions Regulator (TPR) is the main regulator of trust-based pension schemes and the FCA regulates some activities carried out by investment consultants and fiduciary management firms.

Our assessment of competition in these markets

Introduction

13. Our provisional decision is based on a very large amount of evidence we have gathered from firms active in these markets including data, client documents and internal papers. We undertook a large-scale research survey of trustees of all types of pension schemes to give us an understanding of them, and we held round table discussions with pension trustees, pension

scheme in-house advisers and with asset managers. We have also examined any relevant information from secondary sources.

14. The provisional findings of our competition assessment are set out below.

Market structure

Competitive landscape

15. We have defined separate relevant markets for the supply of investment consultancy services to pension schemes in the UK (the investment consultancy market), and the supply of fiduciary management services to pension schemes in the UK (the fiduciary management market).

16. We have found that the investment consultancy market is not highly concentrated, that concentration is particularly low for smaller schemes, and that there are a large number of providers active in this market. We found:

- the largest firm has a market share of less than 20%;
- the three largest firms (Aon, Mercer and WTW) make up less than a 50% share of the market in total;
- the market is characterised by a number of well-established, mid-sized firms which in some customer segments enjoy a stronger position than the three leading firms.

17. The investment consultancy market has doubled in size over the past ten years and generated revenue of around £303 million in 2016. During this time, we have found that concentration in the investment consultancy market has fallen.

18. We have found that the fiduciary management market is expanding rapidly with revenues more than trebling over the last five years and reaching around £255 million in 2016.

19. We have found that the fiduciary management market is also not highly concentrated, and that customers have access to a sufficient number of suppliers. We found:

- the largest firm has a market share of less than 20%;
- there are five large firms in this market and several other notable players;

- there has been recent entry into the fiduciary management market by some large asset management firms.

20. The three largest investment consultancy providers have increased their share of the fiduciary management market rapidly in recent years to around 50%, and we consider that market concentration could increase in the future.

Barriers to entry and expansion

21. We have found that the barriers to market entry in investment consultancy and fiduciary management are not high. In the last ten years, firms have entered the markets by vertical and horizontal expansion and by entry from overseas. We note that firms can enter either market by focussing on a particular customer type or service.

22. We have found higher barriers to entry in fiduciary management as there are likely to be both higher costs and greater economies of scale than in investment consultancy.

23. The barriers to expanding in investment consultancy or fiduciary management may be higher than those relating to entry, and they may be higher in fiduciary management. The importance of reputation and, more specifically, the incumbency advantage enjoyed by firms that offer both investment consultancy and fiduciary management services and barriers to switching fiduciary managers that we describe below represent barriers to expansion.

Demand-side assessment

Information on fees and quality

24. We have assessed whether investment consultancy and fiduciary management customers are able to access and assess information about the services. In order to drive effective competition, it is important that customers have access to clear and comparable information on fees and quality, so that they can assess whether they are getting a good deal from their current provider and whether other providers would give them a better deal.

Investment consultancy

25. We have found that information on investment consultancy fees is generally clear for current customers. However, we have found that customers do not have sufficient information to judge the quality of their provider. In particular,

customers and investment consultants do not set objectives against which quality can be judged. In addition, it can be difficult for trustees to use investment performance information from investment consultants because it is often presented on a gross of fees basis which does not reflect the real outcome for the pension scheme.

26. We found there is limited information for prospective customers to compare investment consultants' fees and quality of service. The fee information in tenders is often limited, and it can therefore be difficult for customers to compare providers. It is also very difficult for prospective customers to assess in a meaningful way the quality of different providers. In particular, the different ways used by investment consultants to show performance of their recommended asset management products make this information difficult to compare.

Fiduciary management

27. We found that fiduciary managers' reporting of performance to current customers is mostly clear and detailed, with progress regularly shown against customers' strategic objectives. We are concerned however that performance is often reported on a gross of fees basis which does not reflect the real outcome for the pension scheme.

28. We have found that information on fees provided by fiduciary managers to current customers lacks sufficient clarity with fees for the fiduciary management service often bundled with the underlying asset management fees. This reduces customers' ability to assess the value for money of the fiduciary management service and of the underlying funds.

29. We have found that prospective fiduciary management customers find it difficult to compare quality across providers due to the nature and variety of the methods used by firms to calculate investment track records. As with investment consultants, the different methods used to show performance of recommended asset management products makes this information difficult to interpret and compare.

30. Comparing the fees of alternative providers can also be challenging. Although we saw examples of good practice in tenders, there is no consistent framework for reporting fees, there is wide variation in the reporting of asset management fees and the overall cost of service is often not indicated. Many customers do not see information on the costs of transitioning into and out of these services despite the fact that these can be considerable.

Trustee engagement

31. We have found substantial variation in the ability of pension trustees to monitor and assess their investment consultancy and fiduciary management providers. While many trustees are experienced and the majority hold a relevant qualification, TPR research shows that many lay trustees do not meet TPR's standards of required knowledge and understanding.

32. We have measured trustee engagement by considering the following four indicators:

    (a) switching;

    (b) tendering;

    (c) carrying out a formal review of fees and/or quality;

    (d) commissioning an external review of these.

33. We have found that levels of engagement, including switching, vary considerably across different types of pension schemes: small schemes and DC schemes are less engaged in this market based on a number of indicators. We do not consider that there are high barriers to switching investment consultant.

34. We have found it difficult to assess levels of ongoing customer engagement in fiduciary management. While the CMA survey indicates that formal levels of engagement are lower in fiduciary management than in investment consultancy (with a lower switching rate, for example), we do not draw a firm conclusion from this, as fiduciary management is a relatively new service. We set out below that we consider that engagement is low when customers first move into fiduciary management.

35. We have found that there are likely to be much higher costs and a greater time required to switch fiduciary management provider than investment consultancy provider, and that this may constitute a barrier to switching.

The sale of fiduciary management services by investment consultancy firms

36. We have considered whether there are competition problems arising from the sale of fiduciary management services by integrated investment consultancy and fiduciary management (IC-FM) firms.

37. Many trustees have concerns regarding this issue: our survey found that 30% have concerns about 'investment consultants using their position to steer clients into their own fiduciary management services' and think more

should be done to address this, while a further 30% think it is ‘a concern but is generally well managed’.

38. In our view, whether to buy fiduciary management and which provider to appoint are very important decisions for pension schemes as they are handing over significant control of their assets. These decisions also have long lasting consequences given the costs of switching provider or out of the service altogether.

Customer engagement when selecting a fiduciary manager

39. We have found a low level of engagement when pension schemes first buy fiduciary management as indicated by levels of formal market testing. Just 34% of customers buying fiduciary management carry out a formal tender. We found that tender rates were lower amongst customers who bought fiduciary management from their existing investment consultant: only 14% of these formally tendered. We also found that half of pension schemes using fiduciary management have appointed the firm that was already their investment consultant.

IC-FM firm behaviour

40. We have found that IC-FM firms have strategies and financial incentives to sell fiduciary management to their existing advisory clients.

41. These firms have significant interaction with existing advisory customers over the period in which they consider buying fiduciary management. We found that some of the ways IC-FM firms introduce and advise on fiduciary management has the effect of steering trustees towards the firm’s own service and makes it less likely that clients consider alternatives and get the best value for money.

42. We do not find any evidence that firms are seeking to introduce fiduciary management services that they believe to be against their clients’ interests.

Potential conflicts of interest

43. We considered some other potential conflicts of interest. These included:

- fiduciary management firms investing in their own asset management or investment products.

- business relationships that investment consultants have with asset managers that might affect the independence of the consultants’ manager ratings.

- the receipt of gifts and hospitality by investment consultants from asset managers that might affect the independence of the consultants' manager ratings.

44. We also considered submissions made to us that some other potential conflicts exist. For example, IC-FM firms said that investment consultants that do not offer fiduciary management face a conflict of interest as they would not wish to recommend this service to their customers in case it replaced their own service.

45. We did not find evidence that any of these potential conflicts gave rise to a competition problem.

Employee benefit consultants' provision of master trust pensions

46. Our terms of reference for this investigation also included the provision to employers of employee benefit consultancy in relation to the design and implementation of pension schemes by investment consultants. We considered whether there are competition problems arising from the sale of master trust pensions by investment consultants that also provide employee benefit consultancy services.

47. We have found that the potential conflict is unlikely to be leading to a competition problem at present, as we found that the master trusts of investment consultants that also act as employee benefit consultants currently have only limited take-up.

Market outcomes

48. Some market outcomes indicate that aspects of the investment consultancy and fiduciary management markets function well:

- Trustees are generally satisfied with the services they receive;
- Providers can achieve greater discounts from asset managers than schemes would be able to achieve themselves, particularly in fiduciary management;
- Their asset allocation advice appears to be tailored and has added value through the hedging of interest rates risks.

49. However, there is evidence that these markets do not function well in other ways, and that the issues of low customer engagement and difficulties in accessing information we identified in previous sections are resulting in worse outcomes for some customers. In particular:

- In fiduciary management, we found evidence that less engaged trustees pay significantly higher prices than those who are more engaged, when they buy fiduciary management from their existing investment consultant. There is some evidence that less engaged trustees pay more for investment consultancy too;
- Less engaged trustees are likely to get lower asset manager discounts negotiated by their investment consultant;
- Less engaged trustees in some cases receive a lower quality of service, for example a less experienced team;
- Investment consultancy providers with above average quality have persistently lower market shares.

50. Our analysis of investment consultants' recommended asset manager products found that these appear to outperform benchmarks net of fees, but not to a statistically significant extent. Therefore, the evidence does not demonstrate, one way or the other, whether investment consultants collectively add value through this service, although some individual firms may do so.

51. Excess profitability can be an indicator of competition problems in a market but we did not have the evidence to assess economic profitability in these markets.

General conclusions of our competition assessment

52. We have found that both investment consultancy and fiduciary management are not highly concentrated markets and that barriers to entry and expansion are not high. We find that customers have access to a sufficient number of providers in both markets. Both markets are growing, although investment consultancy is already used by the vast majority of pension schemes, while fiduciary management is used by a fast-growing minority of them.

53. In both markets, we find there are weaknesses in the demand side based on a low level of engagement by some pension trustees with investment matters. In addition, for those who engage with the market, the information that trustees need in order to assess the value for money of these services is difficult to access. These two factors reduce the competitive pressure on investment consultants and fiduciary managers.

54. We have stronger concerns about competition in the fiduciary management market. In particular at the point at which pension schemes first purchase

fiduciary management, IC-FM firms have an incumbency advantage with respect to their advisory customers.

55. We have also found that fiduciary management has higher ongoing and switching costs and, while we consider the service to be of potential benefit to some pension schemes, it represents a significant change in how those schemes govern their investments which can have lasting consequences. The initial purchase of the service should therefore be made with great care.

56. There has been a notable increase in fiduciary management market share by the three largest IC-FM providers in recent years. In this context, our concern is that their incumbency advantage could contribute to further growth in their market share which would result in greater market concentration in the future. This could increase barriers to expansion for other fiduciary management providers, weakening competitive pressure and making it more difficult for all fiduciary management customers to get a good deal.

DC pension schemes

57. Our investigation into investment consultancy and fiduciary management has covered both DB and DC schemes as they both use these services.

58. One of the key dynamics in the pensions industry is a move by employers away from DB towards DC schemes. This has been accelerated by the government's auto-enrolment requirement, whereby most employers have had to enrol employees into a workplace scheme. We recognise that DC schemes represent the future shape of pensions in the UK.

59. A defining feature of DC schemes is that individual members bear the risk of poor investment outcomes, rather than employers. This makes it even more important that DC schemes take good investment decisions. However, there are some indicators that DC schemes spend less time on investment matters than DB schemes.

60. A potential indicator of this is that DC schemes' use of investment consultancy and fiduciary management is much lower at 38%, compared to an average of 82% for DB schemes; and, when they do use them, we found that they have lower levels of engagement as measured by switching (16% have switched in the past five years, compared to 27% of DB schemes).

61. We encourage policy makers to consider how best to address the lower level of engagement by DC schemes in investment matters.

Our provisional decision on competition

Investment consultancy

62. We have provisionally found that the following features, individually and in any combination, restrict or distort competition in connection with the supply and acquisition of investment consultancy services in the UK to and by pension schemes. Accordingly, there is an AEC in respect of investment consultancy services. Those features are as follows:

(a) Low levels of engagement by some customers;

(b) Lack of clear information for customers to assess the quality of their existing investment consultant;

(c) Lack of clear and comparable information for customers to assess the value for money of alternative investment consultants.

63. These features make it difficult for many customers to access and assess the information needed to evaluate the quality of their existing investment consultant and identify if they would be better off using an alternative provider. This in turn reduces the ability of customers to drive competition between investment consultants. It also reduces the incentives for investment consultants to compete for customers on the basis of fees and/or quality of service.

Fiduciary management

64. We have provisionally found that the following features, individually and in any combination, prevent, restrict or distort competition in connection with the supply and acquisition of fiduciary management services in the UK to and by pension schemes. Accordingly, there is an AEC in respect of fiduciary management services. Those features are as follows:

(a) IC-FM firms steering their advisory customers towards their own fiduciary management service;

(b) Low levels of customer engagement at the point of first moving into fiduciary management;

(c) Lack of clear and comparable information for customers to assess the value for money of alternative fiduciary managers;

(d) Lack of clear information for customers to assess the value for money of their existing fiduciary manager;

(e) Barriers to switching fiduciary manager.

65. Features (a) to (c) above result in an incumbency advantage for IC-FM firms and they prevent, restrict or distort competition at the point of customers first moving into fiduciary management. This means that some customers remain with their incumbent investment consultant even if a better deal on fiduciary management is available elsewhere. This reduces the ability of customers to drive competition between fiduciary managers. It also reduces the incumbent provider's incentives to compete for customers on the basis of fees and/or quality of service.

66. Features (c) to (e) set out above prevent, restrict or distort competition once customers have bought fiduciary management services. They make it difficult for many customers to access and assess the information they need to evaluate the fees of their existing fiduciary manager, to identify if they would be better off using an alternative provider and to act on this information by switching. This reduces their ability to drive competition between fiduciary managers. It also reduces the incentives for fiduciary managers to compete for customers on the basis of fees and/or quality of service.

Detriment

67. We consider that the AECs we have provisionally found may be expected to result in material customer detriment in both the investment consultancy and fiduciary management markets. This detriment may be expected to manifest itself in terms of customers paying higher prices for these services and receiving worse outcomes in terms of service quality.

68. In investment consultancy, the fact that customers face barriers in assessing the quality of their existing investment consultant and comparing it with alternative providers makes it difficult for them to select the best provider for their scheme. This in turn means there are weaker incentives for firms to compete vigorously, as they may be less likely to lose customers if they offer a worse deal, and less likely to gain them if they offer lower prices or a higher quality service.

69. In fiduciary management the risk of detriment will be even greater, as the features above are compounded by two more:

(a) First, the behaviour of the incumbent IC-FM firm can make it even less likely that customers properly shop around, which may further reduce firms' incentives to compete vigorously.

(b) Second, the greater switching costs in fiduciary management mean that customers may not be able to renegotiate or readily switch to a better alternative, so the detriment may persist for a longer period of time.

70. As a result of these competition problems, customers may be expected to pay higher prices for investment consultancy and fiduciary management than they otherwise would.

71. The problems we have identified may also be expected to result in customers receiving a lower quality service and the magnitude of this detriment is particularly difficult to estimate. However, lower quality advice or implementation would be likely to result in an ongoing shortfall in investment performance which would be much greater in magnitude than the impact on prices.

72. The following factors underlie our view that this detriment could be material:

(a) Investment consultants advise on, and fiduciary managers take decisions for, the investment of at least £1.6 trillion of pension scheme assets which affect millions of pension scheme members and their dependents;

(b) These investment decisions can have a major impact on pension scheme outcomes;

(c) Any negative impact on scheme outcomes may multiply over time, especially given the length of many investment consultant and fiduciary management appointments and the long time horizon over which pension scheme investment decisions are made.

73. We have not assessed whether any detriment arises from excess profits as we were not in a position to assess whether investment consultants and fiduciary management providers earn profits that are in excess of their cost of capital.

Our provisional decision on remedies

74. Having provisionally found an AEC in these markets, we must also consider whether and if so what remedial action the CMA should take or recommend others should take. We propose a package of remedies to address, in an effective and proportionate way, the AECs and the detrimental effect on customers which may result from them. As our competition concerns about fiduciary management are greatest, we describe remedies to address that market first.

75. The proposed package of remedies includes the following.

(a) In **fiduciary management**, we propose placing duties on pension trustees to carry out a competitive tender before awarding a fiduciary management mandate for the first time and carry out a competitive tender process if they already buy fiduciary management but did not carry out a competitive tender process before awarding the mandate (Remedy 1). We recommend that TPR provides more detailed guidance to pension schemes on running competitive tender processes for fiduciary management (Remedy 3).

(b) We also propose placing duties on fiduciary management firms to:

- only accept a first-time fiduciary management mandate when a competitive tender process has taken place; (Remedy 1);
- give warnings to customers on whether they are giving advice or marketing their fiduciary management service (Remedy 2);
- disaggregate fiduciary management fees to current customers, including enhanced disclosure of underlying investment fees (Remedy 4);
- be clearer about fiduciary management fees with prospective customers, including costs relating to transition or exit (Remedy 5);
- develop and use a standard approach to report their performance track record to prospective customers (Remedy 6).

(c) In **investment consultancy**, we propose that:

- pension schemes should set strategic objectives with their investment consultant and the consultant should report on progress in meeting these objectives periodically; including that reporting against any investment objectives should be to agreed standards (Remedy 7);
- report the performance of recommended asset management products and their own investment products to an agreed set of standards. (This will also apply to fiduciary managers) (Remedy 8).

76. To support these remedies, we propose making the following recommendations to government and regulators:

(a) Government should extend the FCA's regulatory perimeter to include the relevant services provided by investment consultancy and fiduciary management firms;

(b) TPR should develop guidance to support pension trustees in asking for and using the enhanced information they will now be able to access;

(c) The work of the FCA's Institutional Disclosure Working Group should be implemented and its use and effect monitored.

77. We have considered whether preventing investment consultants from offering fiduciary management would be an effective way to address the problems we have provisionally found.

78. This could be achieved by preventing firms from offering both services, or from offering both services to the same clients. While this remedy would be effective in preventing incumbent IC-FM firms from steering customers towards their own fiduciary management service, we consider that it would not be effective or proportionate in addressing the problems we have provisionally found for the following reasons:

- IC-FM providers would lose any economies of scale and scope from being active across both lines of business, for example by sharing the asset manager research function. Costs for providers, and prices for customers, could go up as a consequence;

- IC-FM firms might close, rather than divest, a line of business which would reduce choice for customers and increase market concentration;

- Pension schemes would no longer be able to buy fiduciary management services from a provider of investment consultancy services which already understands their scheme's needs.

Next steps

79. We now invite interested parties to submit reasons in writing as to why these provisional findings and remedies should not become final or why they should be varied. Responses should be sent to email: investmentconsultants@cma.gov.uk or write to:

Project Manager
Investment Consultancy Market Investigation
Competition and Markets Authority
Victoria House
Southampton Row

London
WC1B 4AD

by no later than **5:00pm on Friday 24 August 2018**.

80. We will have regard to responses received in making our final decision which must be published by 13 March 2019.

1. Our task

Introduction

1.1 On 14 September 2017 the Financial Conduct Authority (FCA), in exercise of its power under section 131 of the Enterprise Act 2002 (EA02),[1] made a reference for a market investigation into the supply and acquisition of investment consultancy services and fiduciary management services to and by institutional investors and employers in the UK.

1.2 On 19 September 2017, the CMA appointed from its panel a group of four independent members to lead the investigation.[2]

1.3 This report sets out the provisional findings of our investigation and our provisional decision on remedies. We are required to publish our final report by 13 March 2019.[3]

Our statutory duties

1.4 The CMA is required to decide whether 'any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom'.[4] If the CMA, decides that there are such features or combination of features, then there is an adverse effect on competition (AEC).[5] A 'feature' of the market refers to:

(a) the structure of the market concerned or any aspect of that structure;

(b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or

(c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.[6]

1.5 If the CMA finds that there is an AEC, it is required to decide:

[1] As provided for by the Financial Services and Markets Act 2000, section 234I.
[2] Details of the members of the Group are on our website.
[3] We are required to publish our final report within 18 months beginning with the date of the reference; and we may extend that period for special reasons only once and by no more than 6 months (EA02, section 137).
[4] EA02, section 134(1). For present purposes, 'relevant market' means a market in the United Kingdom for goods or services of a description specified in the reference made by the FCA (EA02, section 134(3)(b)).
[5] EA02, section 134(2).
[6] EA02, section 131(2).

(a) whether action should be taken by it, or whether it should recommend the taking of action by others, for the purpose of remedying, mitigating or preventing the AEC, or any detrimental effect on customers[7] so far as it has resulted from, or may be expected to result from, the AEC;

(b) and, if so, what action should be taken and what is to be remedied, mitigated or prevented.[8]

1.6 In deciding the above questions on remedies, the CMA must, in particular, have regard to 'the need to achieve as comprehensive a solution as is reasonable and practicable to the [AEC] and any detrimental effects on customers so far as resulting from the [AEC]';[9] and the CMA may, in particular, have regard to the effect of any action on any relevant customer benefits of the feature or features of the market(s) concerned.[10]

Background to the reference

1.7 Prior to making the reference, the FCA had undertaken a market study into asset management.[11] As part of this study, it identified potential competition concerns relating to investment consultants who play a significant role in the market for institutional asset management.

1.8 In November 2016, the FCA consulted on its provisional decision to make a market investigation reference in relation to investment consultancy and fiduciary management. In response to this, the three largest investment consultants offered undertakings in lieu of a reference (UIL). The FCA rejected the UIL for the reasons set out in its final decision to make a market investigation reference; in particular, the FCA stated that it could not be confident that the UIL package would achieve as comprehensive a solution as was reasonable and practicable to the potential adverse effects on competition it had identified.[12]

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[7] A detrimental effect on customers (including future customers) is defined in section 134(5) EA02 as a detriment taking the form of: (a) higher prices, lower quality or less choice of goods or services in any market in the United Kingdom (whether or not the market(s) to which the feature or features concerned relate); or (b) less innovation in relation to such goods or services.
[8] EA02, section 134(4).
[9] EA02, section 134(6).
[10] EA02, section 134(7).
[11] Asset managers manage investments on behalf of individual retail investors and institutional investors such as pension schemes – for more information see the FCA Asset Management Market Study launched in November 2015.
[12] FCA Reference Decision, paragraph 4.35.

1.9 The FCA concluded that a full investigation of the sector by the CMA would enable the identification of all the relevant issues and to allow for appropriate remedies to be put in place if the CMA were to find any AEC.[13]

Scope and focus of the investigation

Terms of reference

1.10 As set out in the FCA's terms of reference,[14] for the purposes of this reference:

(a) 'investment consultancy services' means the provision of a service to institutional investors where the provider advises the investor in relation to their investment strategy in the United Kingdom. This service may include, but is not limited to, advice on strategic asset allocation, fund/manager selection, advice on whether fiduciary management services are appropriate for the investor, and advice to employers in the United Kingdom; and

(b) 'fiduciary management services' means the provision of a service to institutional investors where the provider makes and executes decisions for the investor based on the investor's investment strategy in the United Kingdom. This service may include responsibility for all or some of the investor's assets and may include, but is not limited to, responsibility for asset allocation and fund/manager selection.

1.11 Under the terms of reference, the phrase 'institutional investors' means legal entities invested in funds or mandates, including pension schemes, charities, insurance companies, and endowment funds.

Focus of the investigation on pension schemes

1.12 Investment consultancy and fiduciary management services are provided to different types of institutional investors including charities, endowment funds, employers and insurance schemes. The core client base of providers of these services is occupational pension schemes.

1.13 We decided to focus on the provision of investment consultancy and fiduciary management services to pension schemes which represent 90% of

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[13] FCA Reference Decision, paragraph 4.35.
[14] FCA Terms of Reference.

combined investment consultancy and fiduciary management revenues and 92% of combined assets under advice/management.

Pension schemes represent 90% of investment consultants' and fiduciary managers' revenues.

1.14 The FCA's work on investment consultants as part of its broader market study had also focussed generally on pension schemes.

1.15 Use of these services amongst these other institutional investors is limited. These other types of client represent just 10% of combined investment consultancy and fiduciary management revenues and 8% of the assets on which they advise or manage. Use amongst in-house and third-party insurance investors appears to be even smaller than for charities.

1.16 Most parties supported our focus and did not raise any particular concerns that would warrant the CMA carrying out analysis on other types of institutional investors.[15]

1.17 We set out the basis on which we have defined the markets we are investigating in chapter 4.

Previous reviews and future developments

1.18 Pension scheme investment has been subject to several previous reviews by the UK government and other organisations.[16] While our investigation is focused on competition issues relating to investment consultancy and fiduciary management, these reviews have informed our work.

1.19 There has been relatively little previous work undertaken directly on investment consultancy and fiduciary management services. Therefore, one of the key functions of this investigation has been to 'shine a light' on these activities and their role within the wider pensions sector.

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[15] We consulted on our decision to focus on pension schemes in our progress update in February 2018.
[16] Including: HM Treasury (March 2001) – the Myners Review, *Institutional Investment in the UK: A Review*; OFT (September 2013, revised February 2014), *Defined contribution workplace pension market study*; The Law Commission (June 2014), *Fiduciary Duties of Investment Intermediaries*; The Law Commission (June 2017), *Pension Funds and Social Investment* (June 2017).

2. Our approach

Evidence gathering

2.1 In September 2017 we sent market and financial questionnaires to a wide range of firms who are active in the relevant markets and other key organisations. We made many further written requests and held telephone calls and/or meetings. This evidence helped us understand the relevant markets, suppliers and services, as well as providing much of the underlying data on which this provisional report is based.

2.2 We also commissioned a large survey of trustees of UK occupational pension schemes (the CMA survey), which was undertaken by IFF Research. The survey aimed to gather evidence on how pension scheme trustees use investment consultancy and fiduciary management services and how they view these markets. The results of this survey were published on our case page in March 2018. Our assessment draws from the CMA survey alongside other evidence we have gathered.

Consulting on our emerging analysis

2.3 On 21 September 2017 we set out the areas on which we intended the investigation would focus in an issues statement. We received 32 responses from a range of stakeholders and we published non-confidential versions of these on our case page.

2.4 Between March 2018 and May 2018, we published eight working papers presenting our analysis and emerging findings on a number of areas. We published non-confidential versions of the responses we received to these on our case page.

2.5 In March 2018, following publication of our working paper on asset management product recommendations,[17] we disclosed the underlying data by way of a confidentiality ring. The data was accessed by the external advisers of six firms.

[17] Working paper: Asset manager product recommendations, March 2018.

Engagement with stakeholders

2.6 We have engaged with many stakeholders during the investigation to seek their input and views on the issues.

2.7 We have liaised closely with relevant sector regulators, the FCA and The Pensions Regulator (TPR), and government departments, particularly the Department for Work and Pensions (DWP). The investigation has benefited from their knowledge of the sector and taken into account their ongoing work and policy developments.

> **We have liaised closely with the FCA, TPR and the DWP. The investigation has benefitted from their knowledge and taken into account their ongoing work.**

2.8 We made site visits to three large investment consultants and fiduciary managers: Aon Hewitt Limited (Aon), Mercer Limited (Mercer) and Willis Towers Watson Limited (WTW).

2.9 From November 2017 to January 2018, to assist us in our investigation, we held hearings with 25 parties to discuss issues and potential remedies in the event that we were to find any AECs. We also held four roundtables to seek views from asset managers, pension trustees and pension scheme chief investment officers. We have published summaries of these hearings and roundtables on our case page.

2.10 We also reached out more broadly to other organisations heavily involved in this sector including the Pensions and Lifetime Savings Association (the PLSA), the Society for Pension Professionals, the Investment Association (the IA), the Association of Member Nominated Trustees, the CFA Institute and CFA Society of the UK.

2.11 We would like to thank all those who have assisted in our investigation to date.

Approach to assessment and our theories of harm

2.12 In our issues statement we set out three high-level hypotheses (or 'theories of harm') to test in our investigation. These represented our early thinking about the issues to consider and test. These were:

- Difficulties in customers' ability to effectively assess, compare and switch investment consultants result in weak incentives for investment consultants to compete for customers;

- Conflicts of interest on the part of investment consultants reduce the quality and/or value for money of services provided to customers;
- Barriers to entry and expansion reduce competitive pressure on investment consultants which leads to worse outcomes for customers.

2.13 These theories of harm provided a useful framework for our evidence gathering and early analysis, but they have evolved as we have gathered more evidence and our work has progressed. The structure of this report therefore reflects our current approach to the assessment of competition in these markets.

Next steps in the investigation

2.14 This document, together with its appendices, constitutes our provisional decision on AECs and on remedies.

2.15 Following consideration of responses to this provisional decision report and further hearings with interested parties, as well as any further evidence that we may receive, we will publish our final report by 13 March 2019.

3. The industry

- Pension schemes are required by law to 'obtain and consider proper advice' before investing. This is often provided by investment consultants and fiduciary managers.
- Pension scheme trustees have significant assets to invest. Many schemes have a large funding gap; that is, their liabilities are greater than their assets.
- Investment consultancy and fiduciary management services provide advisory and investment services to help pension schemes manage their assets.

3.1 This chapter gives an overview of the industry we are investigating and its main customers – pension schemes. It explains what investment consultancy and fiduciary management services are, who supplies these services, how the pensions sector has developed over time and gives an overview of the legal and regulatory framework in which these services operate. This provides relevant context for the competition and remedies analysis we have undertaken.

The need for investment advice

3.2 Investment consultants and fiduciary managers provide advisory and investment services to institutional investors, in particular pension schemes, to help them manage and invest their funds.

3.3 Institutional investment plays a significant role in the UK's economy, with assets worth around £3.6 trillion at the end of 2016. Pension funds accounted for approximately £2.2 trillion (about 60%) of this total.[18]

3.4 The scale of assets affected by the advice and services provided by investment consultants and fiduciary managers is very large: we estimate that investment consultants potentially affect more than £1.6 trillion of assets[19] through their advice and that fiduciary managers have assets of

[18] Investment Association (September 2017), *Asset Management in the UK 2016-2017, The Investment Association Annual Survey*, p12. This excludes contract based pension schemes, individual personal pensions, assets in income drawdown and assets backing annuities.
[19] This calculation is merely indicative. We have assumed that investment consultancy providers advise on schemes' entire assets, and that schemes which purchase investment consultancy are on average no larger or smaller than schemes which do not. However, since the CMA survey shows that schemes which purchase investment consulting are likely to be larger than average, we consider that this is a lower bound.

around £110 billion under mandate (see chapter 4).[20] We estimate that over 73% of pension schemes use investment consultants and 13% use fiduciary managers.[21]

Investment consultants influence £1.6 trillion of UK pension scheme savings.

Fiduciary managers have £110 billion of UK pension scheme savings under management.

3.5 Therefore, although a relatively small sector in themselves with estimated revenues of £303 million for investment consultancy and £255 million[22] for fiduciary management, investment consultants and fiduciary managers can play a significant role within the wider institutional investment and asset management industry.

3.6 Investment consultancy services emerged in the 1980s with increasing demand by pension schemes and other investors for specialist advice, due to their growing awareness of the differences in returns across asset classes and between asset managers.

3.7 The Pensions Act 1995 (PA95) (following the Maxwell pension scandal) introduced various improvements to pension scheme governance and greater protection for pension scheme members; and these changes included a legal obligation for pension scheme trustees to obtain and consider ‘proper advice’ before making investment decisions.[23] This duty is often discharged by the use of investment consultants and fiduciary managers.

Pension schemes have a legal duty to seek ‘advice’, often from investment consultants and fiduciary managers.

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[20] We cannot apply the same methodology here because the prevalence of partial mandates means the assumptions that advice is taken across all assets will not be true for a very high proportion of schemes. We therefore summed the assets in data provided to us by providers. This could overstate the figure if schemes use more than one provider, or understate them if we did not receive data from all providers.
[21] CMA analysis of CMA survey; we have treated schemes responding to the survey with “don’t know” as not purchasing the relevant services. Further description of how we have analysed our survey is set out in Appendix 4.
[22] These figures are upper bound estimates. See chapter 4 for more information.
[23] PA95, section 36(3).

3.8 Since the early 1990s, pension scheme liabilities have grown relative to their assets, and this has resulted in large deficits. For UK defined benefit (DB) pension schemes,[24] the estimated aggregate funding level in 2017 (on a full buy out basis) was 68% which implies a deficit of £736 billion across all schemes.[25] There are a variety of reasons for this, including increased longevity of pension scheme members and a prolonged period of low interest rates which has held down returns from bonds. This deficit underlies the need for pension schemes to manage their investments well.

Customers of investment consultancy and fiduciary management: pension schemes

3.9 The main customers of investment consultancy and fiduciary management services are trust-based, workplace pension schemes. These are one of several different types of pension schemes which we outline below.

3.10 In trust-based occupational pension schemes, trustees have the task of ensuring that the scheme is run properly and members' benefits are secure. In these schemes, the trustee(s) is/are responsible for determining how the assets are invested. Generally, the trustee(s) are fully accountable for the scheme and its investment; however, they can take investment advice (and in some cases must do) and may also delegate investment decisions.[26] Trustees play an important role as they act on behalf of, and protect the interests of, the end consumer (that is, pension scheme members).

3.11 Investment has also become increasingly complex and there are different strategies pension schemes can take when investing their assets, and many hundreds of products they can invest in, including risk management products such as hedging. However, many trustees are not investment specialists, nor do they have professional experience or qualifications in investment. Therefore, they take advice in order to help them to invest and manage these assets. We consider the role of trustees and the dynamic between them and their advisors in chapter 6.

3.12 Many large pension schemes have in house staff who help them manage the scheme assets. They may also use investment consultants. The employer

[24] DB pension schemes are explained in more detail at paragraphs 2.3.1231 to 2.3.14
[25] Pension protection fund (PPF) *The purple book, DB pensions universe risk profile 2017*; p6. Figures as at the year to the end of March 2017.
[26] Where the power to make investment decisions is delegated, trustees may not be responsible for the default of a fund manager to whom powers have been delegated provided the trustees have taken reasonable steps to ensure that the adviser has appropriate knowledge and experience and is competently carrying out their role in accordance with relevant legislation. (PA95, section 34).

behind a workplace pension scheme will be responsible for the covenant[27] of a DB scheme and so may also use the services of investment consultants, although typically to a much smaller degree.

3.13 At present, occupational pensions arranged by an employer are typically of two main types, DB schemes and DC schemes:

- DB – schemes that provide a pre-determined retirement income to all members, accrued on the basis of length of service and the members' final or career-average salary. Typically, both the employer and member will make contributions to the scheme. The employer acts as scheme sponsor and is responsible for ensuring that liabilities are funded through a covenant. Therefore, ultimately the benefit that a member receives does not depend on the performance of investments.

- DC – schemes where members (and employers) contribute an amount to be invested but there is no pre-determined benefit. The investment risks which determine the scheme benefit are borne by the scheme member rather than the employer. DC schemes give no certainty about the benefit the member will receive on retirement. DC pension schemes can be either contract-based or trust-based.[28]

3.14 In addition to these two main types there are also a variety of different pension schemes which typically offer a combination of DB and DC elements, which are known as 'hybrid' schemes. There are different variants of hybrid schemes but for example these can include schemes which are DB but have a DC top-up, DC schemes which also have a contracted-out DB element and separate DB and DC parts under one pension scheme trust.

3.15 The demand for investment consultancy and fiduciary management services is strongest amongst DB and Hybrid pension schemes which have financial liabilities. DB and Hybrid schemes make up about 90% of investment consultancy revenues derived from pension schemes, and a large majority of fiduciary managers' revenues. DC schemes also use these services but currently much less than DB schemes despite the fact that their membership has grown quickly.

3.16 In trust-based pension schemes, a pension trustee is a person or company, acting separately from the employer, who holds assets on trust for the

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[27] The covenant is the employer's legal obligation and financial ability to support their defined benefit scheme now and in the future.
[28] Contract-based: Group Personal Pensions are arranged by employers. However, the employer has no ongoing legal responsibility for monitoring the performance of the scheme once it is in place. Whereas in trust-based schemes these are set up by the employer and the responsibility for governing the scheme lies with a board of trustees.

beneficiaries of the scheme. Most trustee boards include different types of trustees, such as: member nominated trustees, employer nominated trustees or directors, professional trustees (who may work on a paid basis across several pension schemes) and corporate trustees.

Recent trends in pensions

3.17 There are some recent trends in workplace pensions which have some impact on the markets we are investigating. These include the growth in workplace pensions arising from auto-enrolment and the growth of DC pensions and master trusts; alongside the continued significance of DB pensions.

3.18 The membership and value of assets of occupational pension schemes have been growing rapidly within the UK due to recent legislative changes which have created new pension duties for employers. There has been particularly rapid growth in membership of DC schemes since the introduction of auto enrolment: from October 2012, UK employers have had a duty to enrol eligible employees automatically into a qualifying pension scheme.[29]

3.19 Membership of DC pension schemes has grown while the number of open DB schemes has fallen. Employers are now much more likely to offer a DC scheme than a DB scheme. The majority of DB schemes are now closed to new members. However, with around £1.5 trillion of assets and around 10.5 million scheme members,[30] they remain important to many working people and retirees.

Defined benefit pension schemes have around £1.5 trillion of assets and 10.5 million UK members.

3.20 In recent years, master trust DC pension schemes have emerged as a way for employers to fulfil their auto-enrolment duties without having to set up their own bespoke scheme. A master trust is a form of multi-employer pension scheme, established under trust and intended for employers that are not connected with each other. Employers are able to select a master trust for their staff rather than needing to set up their own trust-based pension scheme or choose another arrangement.

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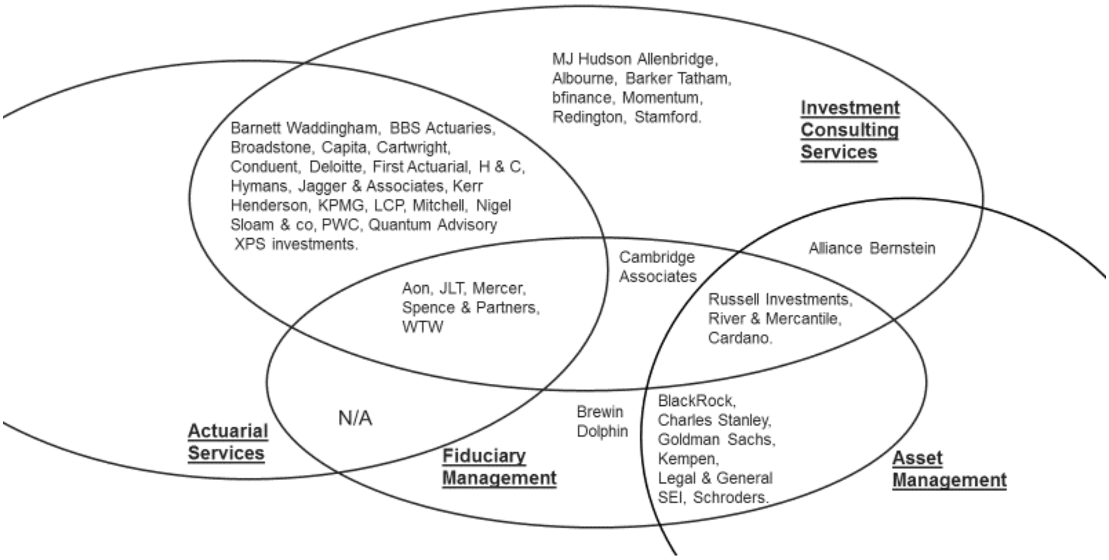
[29] Pensions Act 2008, (PA08), section 3.
[30] Source: Department of Work and Pensions, March 2018 White Paper '*Protecting Defined Benefit Pension Schemes*'.

Suppliers of investment consultancy and fiduciary management services

3.21 Figure 1 shows the main firms which offer investment consultancy and/or fiduciary management services. The diagram also shows which of these firms offer actuarial services and/or asset management services, although these are outside the scope of our investigation.

Figure 1: Provision of key services to pension schemes by firm



Source: Parties' responses[31]

3.22 Figure 1 shows that there is a large group of firms which offer investment consultancy services to pension schemes (37 firms), and a moderate number which offer fiduciary management services to pension schemes (17).

> **We have identified 37 firms which offer investment consultancy and 17 firms which offer fiduciary management in the UK.**

3.23 A subset of each of these groups of firms also offer either actuarial services or asset management services, but none appear to offer both services in addition to investment consultancy or fiduciary management services.

[31] Based on revenue data received by the CMA and parties' responses. For our purposes we have treated Fiduciary Management activities as distinct from Asset Management activities (although we are aware some firms do not make this distinction). The chart above shows merely whether the services are offered, some firms may offer very little of particular named services.

3.24 Several of the investment consultancy and fiduciary management firms are part of significant global companies offering a range of pension, professional or financial related services. For example, the investment consultancy firms, WTW, Aon and Mercer, are global companies that offer a range of other consulting, risk management, insurance brokerage, actuarial and pension services.

3.25 There are also a number of smaller but still significant players in investment consultancy. Some of these firms are part of large multinational professional services firms and audit firms such as Capita and KPMG. There are also a number of investment consultants that are UK actuarial and consulting firms such as LCP, Hymans, JLT and Barnett Waddingham. There is a further range of smaller investment consultancy firms, many of which also offer other pension related services. Very few firms only offer investment consultancy.

3.26 We have identified nine firms which offer both investment consultancy and fiduciary management services to pensions schemes. A number of investment consultants told us that they had specifically chosen not to offer fiduciary management.

3.27 There are also a number of asset management firms which provide fiduciary management services. Some of these are significant global asset managers in their own right, such as Blackrock, Goldman Sachs and Schroders.

3.28 We consider market definition, market shares of different firms and concentration in chapter 4.

3.29 There has been a variety of new firms offering investment consultancy and fiduciary management services over the last ten years; including for example Momentum, Redington and Cardano. These firms have taken different routes to enter and grow their businesses, which we explore further in chapter 9.

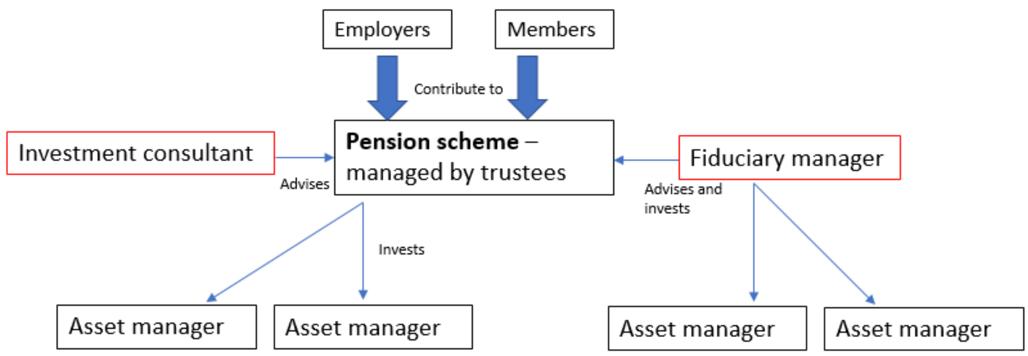
Investment consultancy and fiduciary management services

3.30 This section describes the services that are provided as part of investment consultancy and fiduciary management.

3.31 We note that, for both investment consultancy and fiduciary management services, there are no legal or regulatory definitions. There is also no standard use of the term ‘fiduciary management’ in the industry: it can also be referred to as discretionary management, implemented consulting or delegated solutions/consulting.

3.32 Figure 2 shows how pension schemes use investment consultancy and fiduciary management.

Figure 2: How pension trustees use investment consultancy and fiduciary management



Source: CMA

Investment consultancy services

3.33 Investment consultancy services are advisory in nature and primarily involve:

(a) The provision of advice in relation to matters such as investment strategy;

(b) Advice on strategic asset allocation – which includes advice on the different types of investments and the mix and proportion of different asset classes to invest in; and

(c) Advice on asset manager selection – which involves researching, rating and recommending asset management products or investment strategies.

3.34 Although investment consultants provide advice, decisions on these matters are ultimately taken by pension scheme trustees. The scope of investment consultancy will vary according to the needs of the investor. An investment consultant can be retained to provide ongoing advice, or may be hired for a specific, time-limited project. Some schemes use more than one investment consultant at the same time. Whatever the scope of services provided by investment consultants, the pension scheme trustees retain full accountability for the investment strategy and its outcomes.

Fiduciary management services

3.35 Institutional investment has become increasingly complex while the duties placed on trustees have increased. There has been a desire amongst pension schemes to find new ways to manage their investments. One way is to use fiduciary management services.

3.36 Fiduciary management has grown quickly: our analysis shows that the market size of fiduciary management was over three times greater in 2016 than five years earlier (in nominal revenue terms). This strong growth is consistent with evidence from other sources. KPMG's fiduciary management survey found that there were 61 fiduciary management mandates with £12 billion of assets under management in 2007 and 805 fiduciary management mandates with £135 billion of assets under management by 2017.[32]

3.37 Fiduciary management involves the legal delegation by the investor to the fiduciary manager of some investment powers and decisions (unlike investment consultancy which is advisory in nature).

3.38 A fiduciary manager makes and implements investment decisions for the investor based on the investor's investment strategy, typically taking responsibility for the asset allocation, investment in particular products and the ongoing management and allocation of assets.

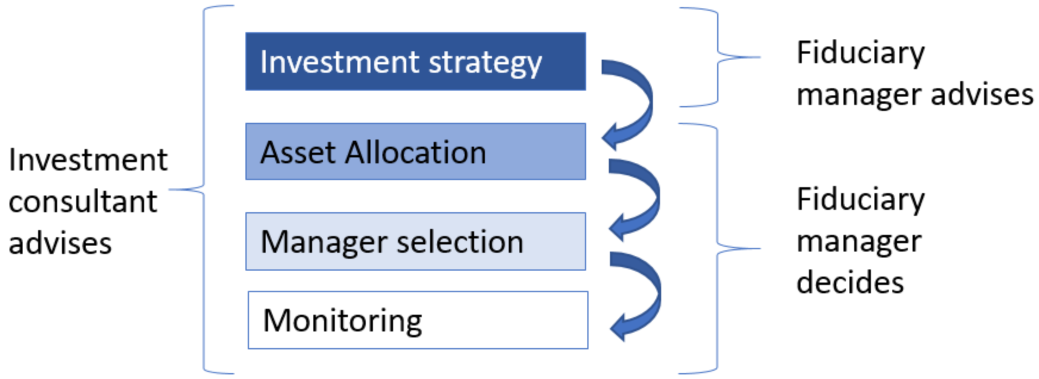
3.39 The level of delegation and discretion given to the fiduciary manager varies depending on the client's needs. Some schemes delegate the portfolio construction and management of all assets to the fiduciary manager, whereas others delegate the investment of some assets or asset classes only. Where only a proportion of assets are delegated, this is usually termed 'partial' rather than 'full' fiduciary management.

3.40 Fiduciary management also involves similar services to investment consultancy such as providing advice on investment strategy.

3.41 As with investment consultancy, when using fiduciary management services, the trustees remain responsible and accountable for the stewardship and outcomes of the scheme, including setting the overall investment strategy.

[32] KPMG publication: *UK Fiduciary Management Survey* (2017).

Figure 3: Overview of investment consultancy and fiduciary management services



Source: CMA

Related services

3.42 Investment consultants and fiduciary managers may also provide a range of other services to pension schemes. This can include their own investment products. They may also provide other investment services including investment governance reviews and performance monitoring.

3.43 Investment consultancy firms may also provide pensions advisory services to employers known as employee benefit consultancy services, assisting in the design and set up of the pension schemes and other employee benefits. Some investment consultants also offer their own DC pension products and some now provide master trust pension schemes.

3.44 Some firms also advise on the selection of a fiduciary manager, acting as a third-party evaluator (TPE).

3.45 DB pension schemes are required to appoint a scheme actuary to provide advice on all aspects of the funding of the scheme.[33] Pension schemes also often employ a firm to administer the pension scheme for members. A number of investment consultants and fiduciary managers are also providers of actuarial services and scheme administration services in the UK. Pension schemes may obtain some or all of these services from the same firm (see Figure 2).

3.46 Asset management, scheme actuarial and administration services are not in scope of this investigation.

[33] PA95, section 47(1)(b).

The legal and regulatory framework for these markets

The regulation of investment consultancy and fiduciary management services

3.47 This section provides a high-level summary of how financial services regulation[34] maps on to the key investment consultancy and fiduciary management services.

3.48 The FCA regulates some, but not all, investment consultancy and fiduciary management activities. The current regulatory perimeter does not align perfectly with the mix of services offered by these firms. For example, in summary:

(a) Investment consultants provide a range of advice to their customers. Advice on particular investments may be regulated.[35] However, the provision of strategic advice (such as on strategic asset allocation) is unlikely to fall within the regulatory perimeter.[36] We have found that firms often provide to customers both regulated and unregulated advice.

(b) Similarly, advice on the suitability of a fiduciary management service or provider is generally not regulated, in so far as the fiduciary management service in question does not in itself constitute a specified investment to which the regulated activity of 'advising on investments' applies.

(c) For fiduciary management services, the most directly relevant regulated activity is 'managing investments' which covers the exercise of discretion in managing assets belonging to another person.[37] Fiduciary managers may also provide other services which are not a regulated activity.

3.49 We note also that whereas many investment consultants and fiduciary management firms are authorised and regulated by the FCA for some of their activities, others are not, because they are subject to the regulatory

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[34] We focus on the regulatory regime established under the Financial Services and Markets Act 2000 and the EU MiFID II legislation.

[35] The regulated activity of 'advising on investments' covers personal recommendations made by an investment consultant in respect of specified investments. This is a highly simplified summary of Article 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/516, as amended (the RAO). See also the related EU provisions on 'investment advice' in respect of financial instruments covered by MiFID II (Article 4(2), (4) and (15) and Annex I of MiFID II Directive and Article 9 of MiFID II Delegated Regulation).

[36] However, it could be covered by FCA regulation if, for example, it forms an integral part of another regulated activity (see, for example, the FCA's Perimeter Guidance Manual (PERG) 13.3 Investment Services and Activities, Q21).

[37] FCA Glossary and Article 37 of the RAO). See also the related EU provisions on 'portfolio management' in respect of financial instruments covered by MiFID II (Article 4(2), (8) and (15) and Annex I of MiFID II Directive). Other regulated activities that cover aspects of fiduciary management services include: 'dealing in investments as agent' (FCA Glossary and Article 21 RAO); 'dealing in investments as principal' (FCA Glossary and Article 14 RAO); 'arranging (bringing about) deals in investments' (FCA Glossary and Article 25(1) RAO).

regime applied by a designated professional body of which they are members.[38] For investment consultancy, one of the main relevant bodies which is recognised in this way is the Institute and Faculty of Actuaries.

The regulation of pension schemes

3.50 Trustees and managers of occupational pension schemes are subject to a wide range of legal duties and regulation. Broadly, occupational pension schemes and master trusts (schemes in scope of our investigation) are regulated by TPR. The FCA regulates the providers of personal and stakeholder pension schemes which are generally contract-based.

The Pensions Regulator

3.51 TPR was created to protect workplace pensions in the UK. It has statutory objectives including to protect member benefits under pension schemes and to promote and to improve understanding of the good administration of workplace pension schemes. Both contract and trust-based workplace schemes must register with TPR, whose powers include situations where employers' contributions are unpaid.[39]

3.52 TPR has issued codes of practice[40] which provide practical guidance to trustees on how to comply with the requirements of pensions legislation. These include sections on investment governance and considerations for investment strategy.

The Pension Protection Fund (PPF)

3.53 In broad terms, the PPF is designed to protect members of eligible DB schemes if their employer becomes insolvent, and there are insufficient assets in the scheme to fulfil obligations to members.[41] DB pension schemes pay a levy to the PPF which provides some of the funding for such

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[38] The MiFID II regime has various exemptions. For example, firms are exempt where they provide investment services in an incidental manner in the course of their main professional activity which is regulated by legal or regulatory provisions or a code of ethics which do not exclude the provision of investment services (Article 2(1)(c) MiFID II Directive, Article 4 MiFID II Delegated Regulation and PERG 13.5 'Exemptions from MiFID', Q39; see also the Financial Services and Markets Act 2000, Part XX in respect of designated professional bodies). Member States are also permitted not to apply the MiFID II Directive to persons where (among other matters) the activities of those persons are authorised and regulated at the national level, the persons meet a number of strict additional criteria and they are subject to requirements that are at least analogous to various requirements under the MiFID II Directive (Article 3 MiFID II Directive on 'optional exemptions').

[39] See Pension Schemes Act 1993, section 111A and the Personal Pension Schemes (Payments by Employers) Regulations 2000 (SI 2000/2692), PA95, section 49 and 88 and PA04, section 228.

[40] Pensions Act 2004, section 90 – in particular section 90(3) contains a duty to issue codes dealing with certain specified matters.

[41] Where a qualifying insolvency event has occurred in relation to the employer in relation to an eligible scheme, the Board of the PPF must assume responsibility for the scheme in accordance with chapter 3 of the PA04

protection. There is no similar protection for DC schemes as members' benefits are not defined.

Trustee obligations

3.54 Trustees are subject to a range of legal requirements which, amongst other things, aim to ensure in broad terms that they fulfil their duties to the scheme members and act in their best interests.

3.55 In DB schemes, the trustees seek to ensure the scheme can meet its projected liabilities as they fall due. Trustees are required to carry out actuarial valuations / reports at regular intervals in order to receive information on funding levels, prepare and maintain a Statement of Investment Principles (SIP),[42] and manage the scheme's investments. Trustees of DB occupational pension schemes (unless exempted) are subject to a statutory funding objective which requires it to hold 'sufficient and appropriate assets' to meet the scheme's liabilities.[43]

3.56 As noted previously a particularly significant legal obligation for all trustees of trust based occupational pension schemes is to obtain and consider 'proper advice' in writing for certain types of investment decisions.[44]

3.57 Further information on these obligations and the role of trustees is set out in chapter 6.

[42] PA04, section 224 and PA95 section 35(1)(a). A SIP is a written statement outlining the principles and policies governing determinations about investments made by or on behalf of trustees in the management of the scheme's assets.
[43] PA04, section 222(1).
[44] PA95, section 36.

4. Competitive Landscape

Our main findings

- There are separate relevant markets for the supply of investment consultancy services to pension schemes in the UK (the investment consultancy market), and the supply of fiduciary management services to pension schemes in the UK (the fiduciary management market).
- The investment consultancy market is not highly concentrated, concentration is particularly low for smaller schemes and there are a large number of providers active in this market.
- The fiduciary management market is more concentrated than the investment consultancy market. However, the fiduciary management market does not appear to be highly concentrated and customers appear at present to have access to a sufficient number of suppliers.
- There has been a trend of increasing shares in the fiduciary management market for the three largest investment consultants, and concentration could increase in the future.

Introduction

4.1 Our guidelines for market investigations set out that any assessment of the working of competition usually begins with an overview of market structure.[45] In this section we set out our analysis of market definition, before then considering market structure; including our analysis of size and firms' shares, concentration levels and trends.

4.2 In Appendix 1, we provide supplementary analysis covering concentration within segments of these markets, and analysis in relation to customers who purchase these services jointly with actuarial and/or administration services.

Market Definition

4.3 Market definition is the process by which the CMA identifies the boundaries within which competition occurs for particular services, such as which firms compete for which customers' business.

[45] CC3 revised, paragraph 99

4.4 Our market investigation guidelines state that defining the market helps the CMA to focus on the sources of any market power and provides a framework for the assessment of the effects on competition of features of a market.[46]

4.5 The guidelines also state that market definition is a useful tool, but not an end in itself, and that identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of our competitive assessment of a market in any mechanistic way. The competitive assessment takes into account any relevant constraints from outside the market, segmentation within it, or other ways in which some constraints are more important than others.[47]

4.6 Our starting point for assessing market definition was the terms of reference for this investigation, which are 'the supply and acquisition of investment consultancy services and fiduciary management services to and by institutional investors and employers in the UK'.[48]

4.7 We considered three possible dimensions of the definition of the market:

(a) the product market;

(b) the geographic market, and

(c) customer segments.

4.8 We address each of these in turn below.

Product market

4.9 We have examined whether

(a) Investment consultancy and fiduciary management services should be treated as part of the same or different product markets;

(b) whether advice from other professional advisors should be included in the markets, and

(c) whether advice from in-house advisors should be included in the markets.

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[46] CC3 revised, paragraph 132.
[47] CC3 revised, paragraph 133.
[48] FCA Terms of reference, 14 September 2017

Investment consultancy and fiduciary management services

4.10 There are some similarities between investment consultancy and fiduciary management services. Investment consultancy services are predominantly advisory: firms advise their clients as regards investment decisions such as strategic asset allocation and manager selection. Investment advice is also a component of fiduciary management services. Because this component is common to both services, there will be a degree of substitutability between them for some schemes.[49]

4.11 However, there are also significant differences between them which are relevant for our assessment of market definition. These differences reduce the extent to which the two services will be seen as sufficiently strong substitutes to each other. In turn, these mean that fiduciary management providers may not pose a sufficiently strong constraint on investment consultancy providers' prices to place them in the same market, and conversely investment consultancy providers are not likely to pose a sufficiently strong constraint on fiduciary management prices. We discuss each of these in turn.

4.12 First, as regards the constraint fiduciary management providers place on investment consultancy providers, fiduciary management is an implemented service whereby providers put into action their advice and make decisions on each client's behalf. It will not therefore be perceived as an attractive option for trustees who wish to have greater direct control over their schemes' assets. In addition, the implementation aspect of fiduciary management services, which is not present in investment consultancy services, implies higher costs to providers. Therefore, a move to fiduciary management would have significant implications on fees.

4.13 In recent years there has been both a substantial movement of customers from investment consultancy to fiduciary management, and a significant number of customers who have begun purchasing fiduciary management for some asset classes alongside wider investment consultancy services.[50] However, this appears to be part of the emergence of fiduciary management as a service model, rather than customers switching in response to a small change in the competitiveness of investment consultancy services.

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[49] Investment consultancy and fiduciary management services include a range of distinct elements such as manager recommendations and strategic asset allocation advice. We consider that these elements are not likely to constitute separate economic markets in themselves and we cover these further in Appendix 1.
[50] CMA Analysis; Parties' Data. Consistent with this, the KPMG UK Fiduciary Management 2017 survey indicates that there were 61 fiduciary management mandates (£12 billion of assets under management) in 2007 and 805 fiduciary management mandates (£135 billion of assets under management) by 2017. Source: *UK Fiduciary Management Survey* (2017).

4.14 Indeed, as set out in chapter 7, about half of customers who have moved to fiduciary management with a provider offering both investment consultancy and fiduciary management services were originally investment consultancy clients of that firm. This implies that firms are losing only a limited number of investment consultancy customers through switching to a fiduciary management service provided by rivals.

4.15 Second, as regards the constraint investment consultancy providers place on fiduciary management providers, we consider that many trustees using fiduciary management are unlikely to regard the investment consultancy model, in which they make decisions and implement the investment strategy themselves, as an effective substitute. In particular, this may be the case for trustees who do not consider themselves to have sufficient availability or practical expertise to move to the investment consultancy model. In practice, we have observed minimal switching from fiduciary management to investment consultancy in recent years.

4.16 It is therefore not clear that either are a sufficiently effective substitute for the other, for us to treat the two services as part of the same market.

4.17 Several parties supported our view that there were separate markets for investment consultancy and fiduciary management. For example, LCP said 'We welcome and agree with the finding of the working paper that there is a clear distinction between [investment consultancy] services and [fiduciary management] services'.[51]

4.18 However, some parties told us that there were not clear distinctions between these services. For example, Redington said 'We do not see the [investment consultant] and [fiduciary management] markets as separate from each other, rather that there is overlap where such services may replace each other'.[52]

4.19 Hymans acknowledged that there are some distinct differences between these services, but in a similar vein told us that '[by] default, providers of [fiduciary management] will incorporate a material proportion of what would otherwise be considered investment advice within their proposition; thus they are competing directly with [investment consultancy] advisers'.[53]

4.20 We acknowledge above that the common advisory component of investment consultancy and fiduciary management means that there will be a certain degree of substitutability between these service types for some customers.

[51] LCP's response to the Competitive Landscape Working Paper, Page 5.
[52] Redington's response to the Competitive Landscape Working Paper, Page 1.
[53] Hymans' response to the Competitive Landscape Working Paper, Page 1.

Therefore, fiduciary management providers will exert some degree of competitive constraint on investment consultancy providers, and vice versa.

4.21 Nevertheless, we consider that the factors we have discussed and clarified above imply that the services are not effective substitutes. Further, as set out above the boundaries of the market do not determine the outcome of our competitive assessment of a market in any mechanistic way.[54]

4.22 Our provisional view is therefore that the provision of investment consultancy and fiduciary management services should be treated as separate markets for the purposes of this investigation, although providers of one service type may exert a degree of constraint on the other for some scheme types.[55]

Investment consultancy and fiduciary management should be treated as separate markets.

Other professional advisors

4.23 In response to the CMA survey, up to 15% of pension schemes reported that they do not purchase investment consultancy or fiduciary management services.[56] However, because trustees are required under the Pensions Act 1995 (the PA95) to obtain 'proper advice', they must be receiving this advice from other sources.

4.24 The PA95 makes clear that this advice can be provided by anyone 'who is reasonably believed by the trustees to be qualified by his ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of the investments of trust schemes.'[57] It is therefore not limited to advice from investment consultancy or fiduciary management providers.

4.25 The CMA survey shows that the schemes that were not purchasing investment consultancy or fiduciary management services were overwhelmingly small schemes.[58] These schemes rely on a range of other

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[54] This is consistent with the approach set out in our guidelines, CC3 revised, paragraph 133.
[55] We have taken this into account in our analysis of competitive conditions for these services, and our consideration of remedies.
[56] CMA Survey. We have dropped schemes which don't know whether they purchase investment consulting or fiduciary management.
[57] PA95, Section 36(6).
[58] IFF Research Report on the CMA survey, published 29 March 2018, page 10. Whilst around nine in ten large schemes purchase investment consultancy services, only around five in ten small schemes do so. Further, only about two in ten small schemes purchase fiduciary management services, some of whom also purchase investment consultancy services.

professional advisors such as wealth managers, independent financial advisors and actuaries.

4.26 We considered whether these other professional advisors should be included within the relevant markets. However, these advisors have different areas of expertise, and are not focussed on the provision of investment consultancy or fiduciary management services to pensions schemes, which require specialist expertise in investing with respect to a scheme's liability profile and cash flow requirements.

4.27 As a result, the fact that some very small pension schemes, which are more likely to have simple investment requirements, are able to use these non-specialist advisors, does not mean that these would be an effective competitive alternative for the large majority of pension schemes.

4.28 Our provisional view is therefore, that these other professional advisors should be treated as lying outside the relevant markets for the purposes of this investigation. However, where relevant, we have taken into account the fact they these may provide some competitive constraint for the very smallest schemes.

In-house advisors

4.29 Some pension schemes satisfy their duty to obtain proper advice by employing in-house advisors, often investment professionals with similar expertise to those working for investment consultants. We understand that some in-house investment teams (typically for the very largest pension schemes) effectively have a fiduciary management role. We therefore considered whether these should form part of the relevant markets.

4.30 Only the very largest pension schemes typically employ in-house advisors, usually when they have scheme assets of at least £1 billion, and this is even more common for schemes with assets over £5 billion. Regarding the investment consultancy market in particular, even these large schemes typically still employ outside investment consultants because their in-house advisors are not able to replicate the entirety of their services, such as their very broad research into asset management products.

4.31 Our provisional view is therefore that in-house advisors lie outside the relevant markets. However, in-house advisors are likely to play an important role in shaping competition between investment consultants to supply investment consultancy services to the largest pension schemes. They make it easier for these schemes to evaluate the quality of advice they are receiving, and mean that schemes purchase less advice by doing more in-house. Stakeholders told us that these in-house advisors often use a number of consultants simultaneously for different pieces of project work, and are well placed to switch between them. Similar considerations may apply to the purchase of fiduciary management services for such schemes. We therefore consider these advisors an important part of our competitive assessment of larger schemes' purchasing behaviour.

Asset management and fiduciary management

4.32 Chapter 3 set out that we have treated asset management as a distinct service from fiduciary management.

4.33 Several parties have provided submissions which imply clear divisions between investment consultancy and asset management. For example, WTW has told us that 'The fiduciary management service … is not a (vertical) replacement for asset management'.[59]

4.34 In contrast, LCP told us that 'there is no clear distinction between fiduciary management services and asset management services', and that in particular, 'provision of [partial-fiduciary management] services – management of a sub-set of the assets of a pension scheme – is virtually indistinguishable from a fund-of-funds service offered by an asset manager'.[60]

4.35 Whilst some asset management offerings may contain advice on investment strategy and/or implementation of investment decisions regarding underlying products not offered by the asset manager, we understand that this is not the norm. By contrast, both are a key part of many fiduciary management offerings, including partial fiduciary management. A clear example is cases where the fiduciary management provider selects asset management products in which to invest their client assets; there is no such process involved in asset management.

4.36 As a result, trustees do not generally substitute fiduciary management for typical asset management offerings. Although some trustees who are prepared to 'unbundle' their purchasing decisions may be able to do so, and some asset management offerings may include these components and therefore be more substitutable.

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[59] WTW's response to the Issues Statement, paragraph 14
[60] LCP's response to the Competitive Landscape Working Paper, page 2.

4.37 For the purposes of our competitive assessment, we therefore provisionally consider that it is appropriate to treat fiduciary management as a separate market from asset management.

Geographic market

4.38 As noted above, our terms of reference concern the supply and acquisition of the services in question within the UK.[61]

4.39 In addition, the supply and acquisition of investment consultancy and fiduciary management services is heavily shaped by the UK-specific regulatory and legal framework, such as the requirement under the PA95[62] for trustees to obtain proper advice.

4.40 Therefore, for the purposes of this investigation, we are taking the geographic market as the UK.

Customer segments

4.41 We considered whether the market should be subdivided:

(a) between pension schemes and other institutional investors, and

(b) between different types of pension schemes based on their characteristics.

Pension schemes and other institutional investors

4.42 Pension schemes appear to have different requirements for financial advice compared to other institutional investors. For example, DB scheme advisors need to work closely with actuaries to invest according to schemes' liabilities to help them reach their funding requirements, considering other scheme-specific factors such as trustees' investment preferences and the strength of the employer covenant. Moreover, this all takes place within the pensions regulatory and legal framework.

4.43 Other institutional investors also appear to have different requirements from pension schemes. In some ways, advice provided to them may be more complex: for example, we have been told that charities have specific tax treatment that leads them to take particular approaches in their investment

[61] Sections 131(1) and 134(3) of the EA02 provide that the market for the goods or services described in the reference is the market in the UK for those goods or services.
[62] PA95, section 36 and corresponding provision for Northern Ireland

strategies. In other ways however, advice may be simpler: we understand that complex liability modelling may not be required.[63]

4.44 The differences set out above mean that it may be challenging for firms supplying investment consultancy or fiduciary management services to other institutional investors to expand to supply pension schemes within a short period of time. Further, although a majority of firms providing services to pension schemes also supply at least one category of other institutional investors (as set out in chapter 3 in Figure 1), many of these supply only a very small number of such customers.

4.45 Our provisional view is therefore that UK pension schemes comprise a separate relevant market that does not include other institutional investors.

4.46 As set out in chapter 1 we have focussed on pension schemes as the main customer group for investment consultants and fiduciary managers. As such, we have not undertaken analysis to define the market in which other types of institutional investors purchase these services.

Pension scheme characteristics

4.47 There is substantial variation in the specific characteristics of individual pension schemes. Most obviously, this can be in terms of scheme type (DB, DC or hybrid) and scheme size, which can have assets ranging from the tens of millions to several billion pounds in value.

4.48 These characteristics can translate into differences in the advice that these schemes are looking to purchase: for example, larger schemes may seek more detailed and potentially complex advice. DC schemes may be more limited in the advice they seek, in part due to tighter financial constraints on spending linked to the DC charge cap.

4.49 However, each pension scheme has its own specific combination of characteristics, and many of these lie along a continuous spectrum. This means that no straightforward bright line can be drawn between different groups of customers.

4.50 Further, commonalities in the nature of advice across different pension schemes means that firms providing advice to schemes in one segment

[63] We have also been told that charities may have specific environmental, social and governance requirements. Insurers appear to have greater in-house expertise than almost all pension schemes, and different criteria for investing given their specific regulatory environment. Investment consultancy services to employers appear rarely to operate on a retained basis and to be focussed on particular questions, such as supporting the triennial actuarial valuation of the scheme, whilst services for wealth managers appear to be highly bespoke and often step beyond the tasks required for pension schemes.

could expand into other segments quickly. In addition, a significant number of investment consultants and fiduciary managers offer services to (i) large, medium and small clients, and (ii) both DC and DB schemes, such that schemes of different sizes and types have many of the same options.

4.51 Our provisional view is that all pension schemes purchasing investment consultancy services should be treated as part of the investment consultancy services market, and all schemes purchasing fiduciary management services should be treated as part of the fiduciary management services market.

4.52 Nevertheless, where necessary, we supplement our market-wide assessment with analysis of the various customer segments introduced above. We treat the segmentation as indicative only, and conduct this exercise to understand how competition might vary within the same market.

Provisional conclusions on market definition

4.53 Based on the assessment set out above, our provisional conclusion is that there are separate relevant markets for:

(a) the supply of investment consultancy services to pension schemes in the UK (**the investment consultancy market**), and

(b) the supply of fiduciary management services to pension schemes in the UK (**the fiduciary management market**).

4.54 However, in our assessment we have had regard to differences in competitive conditions within the same market, and potential constraints from services that we have treated as part of separate markets.

Analysis of market structure and concentration

4.55 Market concentration measures can provide background data for the assessment of the levels of firms' market power and may be relevant for the assessment of other sources of potential competitive harm.[64] Subject to the availability of data, the CMA normally calculates market shares for all firms currently producing products in the relevant market or in any market the CMA considers relevant to its investigation.[65]

[64] CC3 revised, paragraph 101.
[65] CC3 revised, ANNEX A: Market Characteristics and Outcomes, paragraph 1. Note that the 'relevant market' is defined in EA02 to mean the market in the UK for the goods or services described in the terms of reference given to the CMA for investigation (EA02, section 134(3).) The market definition(s) used by the CMA are in respect of the economic market(s) and need not always correspond with the relevant market(s) as used in the EA02 (CC3 revised, paragraph 26 and footnote 18).

4.56 Concentration measures can form a useful starting point for the assessment of the market as a whole. Although high concentration does not necessarily imply that competition is working poorly (or where there are low market shares, that it is functioning well).

4.57 Our guidelines set out that concentration is only one determinant of market outcomes, and that market shares must be interpreted alongside a range of other factors. For example, other factors include the stability of market shares, capacity constraints, product differentiation, demand and supply side factors.

4.58 We consider the stability of market shares and product differentiation in this section, and the factors relevant to the demand and supply side in the following sections.[66] As such, even in a market which is not highly concentrated, it is possible for a small number of suppliers to have market power. We have taken these other factors into account throughout our assessment.

4.59 We have undertaken analysis to calculate market shares for each of the markets defined above. We have also calculated shares for relevant segments of these markets which is set out in Appendix 1.[67]

4.60 Our primary metric for market shares is revenue. We have used revenue because we consider that it is the best proxy for the amount of advice or fiduciary management undertaken by firms. It also has the advantage of being a very standard metric.

4.61 Consistent with the practice set out in our guidance, we have also constructed other indicative measures to understand fully how the relevant markets are operating.[68] In particular, we have analysed market shares in terms of number of clients and assets under advice (AUA) / assets under management (AUM). However, in our view both measures have significant

[66] CC3 revised, paragraphs 170 and 185. We have not undertaken an analysis of capacity constraints. We recognise the views of some parties that the best ideas of investment consultancy and fiduciary management firms might be available to a limited number of clients if Asset Management firms they recommend accept limited volumes of AUM in their products, or increase effective prices for later adopters of their products. This could imply diseconomies of scale, although even if this is the case we consider that the way in which our assessment of market structure is conducted would not be different.
[67] We note that our figures differ from those published in the FCA's Asset Management Market Study and used in that context. Our figures include data from more firms, fiduciary management firms which do not offer investment consultancy, use more recent data, include a set of breakdowns relevant to our market investigation (such as for fiduciary management alone), and a longer timeseries.
[68] CC3 revised, ANNEX A: Market Characteristics and Outcomes, paragraphs 1 and 2.

limitations, and as a consequence we have not relied on them for our analysis.[69]

4.62 We also use revenue market shares to assess concentration, calculating concentration ratios and the Herfindahl-Hirschman Index (HHI). The HHI is a common reference point in competition assessments. It is useful because it summarises all market shares in one single number. It is often more useful than the simple count of firms in the market, because it assigns less weight to firms which are very small and greater weight to firms which are larger.

4.63 The HHI is calculated as the sum of the squared market shares, and takes a value between 0 and 10,000 points. A value of 0 can be thought of as a market in which an extremely large number of firms are active, and a value of 10,000 would indicate a complete monopoly.[70]

4.64 Our guidelines for market investigations state that the CMA is likely to consider any market with a HHI in excess of 2,000 as highly concentrated, and any market with an HHI in excess of 1,000 as concentrated.[71] The HHI is therefore a useful benchmark for assessment of concentration.

4.65 In order to construct these concentration measures we collected data from over 45 industry participants. We collected a snapshot of revenues, AUM and AUA, and number of clients for 2016. This was the most recent full year of data at the time our investigation began.

4.66 We split the snapshot by client type (eg pension or charity), as well as by client size (small, medium and large clients, respectively with under £100 million, £100 million to £1 billion and over £1 billion in assets under advice/management). We also collected historic revenue data running back to 2007.

4.67 Despite the very large-scale nature of our data collection exercise, we have not obtained data from every conceivable supplier of investment consultancy and fiduciary management services. Our analysis of the CMA Survey indicates that we have covered approximately 85% of the market for investment consultancy services[72] and approximately 78% of the market for

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[69] These measures have the advantage that each firm's share is not (directly) a function of the price it is charging, price itself being a measure of market outcomes rather than market structure. However, they are much more sensitive to the inclusion of particular types of clients. AUM/AUA based measures will be very sensitive to the distribution of a few very large clients, whilst number of clients bases metrics assign as much weight to clients which contribute large amounts of business to the firms as those which contribute very little business.
[70] Values ranging between these two extremes represent a spectrum of concentration: for example, an HHI of 2,000 would imply a market structure equivalent to a market with five equal sized firms, and a HHI of 1,000 would imply a market structure equivalent to a market with ten equal sized firms.
[71] CC3 revised, ANNEX A, paragraph 7.
[72] CMA analysis of CMA survey. This is the proportion of respondents who said they purchased investment consultancy services from a provider we have confirmed as offering investment consultancy services.

fiduciary management services.[73] These relatively large percentages give us confidence that the shares below do not omit any large providers.

4.68 We have adjusted our market shares downwards by the proportion of respondents to the CMA survey who said they use an investment consultancy or fiduciary management provider outside of those who we have confirmed provide these services.

4.69 In our view, this adjustment is likely to overstate the significance of these providers, given that they are likely to be small and our data on small providers shows that they tend to have clients with disproportionately small revenue. As such, we treat these adjusted figures as upper bounds, whilst we treat the unadjusted figures as lower bounds. We find these bounds are quite close together, and so using one rather than the other would not change our conclusions.

Investment consultancy market structure

4.70 In this section, we consider the market for investment consultancy services to pension schemes in the UK. We first set out statistics regarding the market as a whole, before considering breakdowns by scheme size, scheme type, and the level of individual services. We then present information on how the market has evolved through time, and likely future trends.

The market in aggregate

The investment consultancy market is worth up to £303 million in terms of revenues.

4.71 Our analysis indicates that the market size has a lower bound of £257 million per year in revenue terms.[74] Adjusting for our estimate of the percentage of

[73] CMA analysis of CMA survey. We understand that there are a number of asset management services which can fulfil a similar role (in some respects) to fiduciary management itself. As a consequence, schemes which purchase services outside the definition for fiduciary management may nevertheless consider themselves to be *in effect* purchasing such services. Consistent with this fact, the fiduciary management providers from which we have collected data are used by only about half of the schemes in the CMA survey. However, several of the remaining providers have confirmed to us that they don't provide fiduciary management services. Excluding these firms, our initial results are that our shares cover firms used by 78% of remaining respondents.
[74] This figure is calculated by summing all the revenues for investment consultancy suppliers from which we collected data.

the market we have not covered gives an upper bound to the market size of around £303 million per year.[75]

4.72 Our data gathering exercise revealed over 4,300 pension scheme-investment consultant relationships.[76] Because we collected data from investment consultants rather than schemes, this may understate the true number of relationships. Some pension schemes do not purchase investment consultancy services, and some purchase fiduciary management services as an alternative to investment consultancy services.

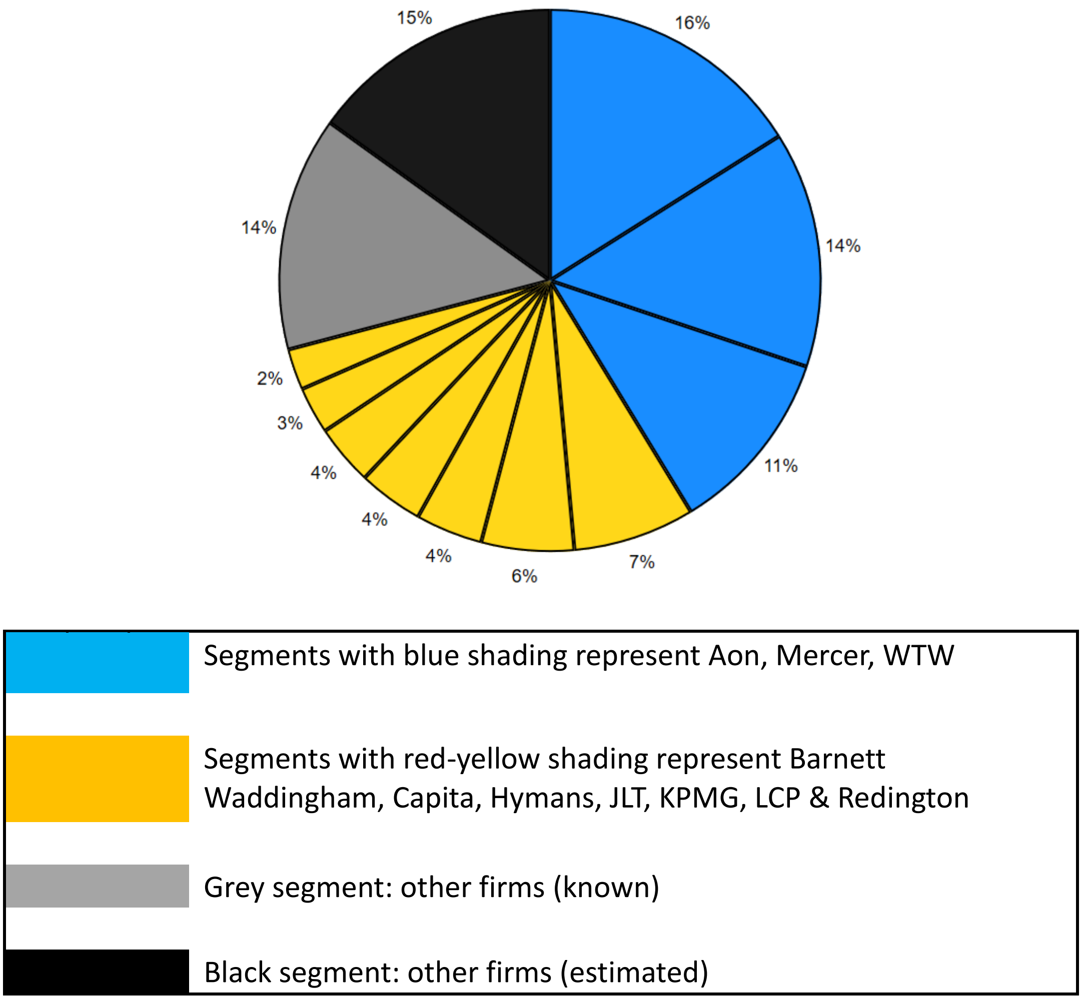
4.73 We noted in chapter 2 that figures collected by the Investment Association together with the CMA survey showed that investment consultants are likely to advise on over £1.6 trillion in assets.[77]

4.74 Market shares by revenue are set out in Figure 4 below. This is a pie chart showing the shares of the largest three firms in the investment consultancy market in blue, and the shares of a set of other notable firms in yellow. We have split the market in this way because whilst the shares of the fourth largest firm and others are significant, we consider that they are of a different order to the largest three firms.[78]

4.75 The chart also shows the aggregate share of all other firms we have received data from, and our estimate of the share of all firms from which we have not received data.

[75] From the suppliers we have collected data from, our initial results are that investment consultant revenues were in excess of £290 million in 2016 for all client types (not just pension schemes).
[76] Some schemes have a relationship between more than one investment consultant, but we are not able to identify duplicate pension schemes across firms in most cases. This figure is likely to be a lower bound because we have not adjusted it for the proportion of the market not covered in our data collection exercise from investment consultants.
[77] The Pension Protection Fund (PPF) found the total value of assets for schemes in the PPF 7800 index is around £1.6 trillion. PPF, *PPF 7800 Index*, March 2018 Update.
[78] The share of the fourth largest provider is less than two-thirds of the magnitude of the share of the third largest provider; by contrast the share of the third largest provider is more than three-quarters of the magnitude of the second largest provider. This represents a notable discontinuity in the shares and reasonable grounds to distinguish the very largest from other providers in the market.

Figure 4: 2016 shares by firm of the investment consultancy market (by revenue)



Source: CMA Analysis, Parties' Data.[79] Parties listed alphabetically within groups.

4.76 Figure 4 shows that Aon, Mercer and WTW make up between 41% and 49% of the market in revenue terms for the supply of investment consultancy services to pension schemes in the UK.[80]

4.77 There are also several comparatively smaller, but nevertheless significant, players in the investment consultancy market. In particular, two further firms have over 5% of the market, three more have around 4% of the market, and others have a noteworthy share.[81] The ten largest players in combination constitute between 71% and 83% of the market, and there at least a further 27 suppliers who are active to some degree.

[79] This chart shows individual market shares and identifies particular firms as belonging to two groups: those in the largest three firms, and others who have shares ranging between 3% and 8%. Individual firms are not matched to individual segments. We list firms alphabetically rather than in size order.

[80] Discrepancy between the lower bound figure and the sum of each firm's shares in the chart is due to rounding.

[81] Using 'lower bound' figures.

4.78 Drawing together the market shares in one summary measure of concentration indicates that the market for investment consultancy services to pension schemes has an HHI of up to 1,023 points.[82] As noted above our guidelines state that the CMA is likely to consider any market in excess of 2,000 as highly concentrated.

4.79 This picture is not dissimilar when we consider metrics other than revenue and these shares appear to be relatively consistent with those used internally by the parties. For example:

(a) A 2017 Mercer internal document states that they have a '[✂]% market share[83] ([✂]) in their target market', and

(b) A 2017 WTW Board minute states that they have a [✂] share of the UK DB advisory market.[84]

4.80 When taken together, the overall picture is one of a large number of noteworthy suppliers where the largest firms have market shares that are significant but not suggestive that, in itself, concentration is likely to inhibit the functioning of competition.

The investment consultancy market is not highly concentrated.

Segmentation within the market

4.81 Appendix 1 sets our analysis of the sizes of and concentration within various segments of the market. In particular, we have considered how market structure breaks down across schemes of different sizes and types.

4.82 Our analysis shows that a few very large schemes comprise a high percentage of the market by revenue and AUM terms. It also shows that whilst the supply of investment consultancy services to smaller pension schemes is particularly unconcentrated, concentration is higher for the largest pension schemes.

4.83 However, larger schemes often employ in-house advisors, use external consultants for more limited pieces of project work, and sometimes employ

[82] Given that we cannot estimate the market shares of each individual investment consultant firm which potentially exist in the market but from which we have not received data, and on a cautious basis, we have used the 'upper bound' market share figures to calculate this HHI.
[83] Mercer internal document. Mercer define their target market as [✂]. It is not clear whether these figures are common across advisory and fiduciary management.
[84] WTW Internal Document. Measured by AUM. The largest three IC-FM providers (Aon, Mercer and WTW), together with Hymans are stated to have a [✂]% market share,

multiple consultants simultaneously.[85] This will mitigate the impact of the greater concentration faced by these customers.

4.84 Our analysis also showed that the DC segment of the market is smaller and faces lower levels of concentration than the DB segment. Whilst there can be differences between the exact mix of services purchased within the investment consultancy market, there does not appear to be significantly higher concentration arising from differences in firms' exact offerings.

Historical evolution

4.85 We collected revenue data from each party through time. This allowed us to understand how both the size of and concentration in the market have evolved over the last ten years.

> **The investment consultancy market has doubled in size in the past ten years.**

4.86 As regards the size of the investment consultancy market, we show in Appendix 1 that the total size of the market approximately doubled (in nominal revenue terms) over these ten years.[86] DC revenues have grown significantly more than DB revenues, particularly within the last few years.

4.87 We analysed individually the market shares of the five largest investment consultant firms over the ten-year period. Our analysis showed that the shares of [✂] and [✂] have remained relatively stable through time, and the same is true for [✂] and [✂] as the fourth and fifth largest players. The share of [✂] has however decreased markedly over this period of time.[87]

4.88 Amongst other reasons, [✂] put this down to '[✂]'.[88] We note however that the decrease in share has occurred whilst many of its investment consulting clients have moved into fiduciary management; therefore, a proportion of its apparent reduction in investment consultant client revenues in fact represents the conversion of investment consultancy clients to its own fiduciary management offering, rather than loss of clients to competitors.

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[85] As set out in Appendix 1, this matches the views expressed by participants of pensions schemes' investment staff at our roundtable.
[86] 'Real' growth, that is growth adjusted for the general increase in prices over this period for all services, will be slightly lower.
[87] In combination, the share of the three largest investment consultant providers fell slightly through time, with this fall attributable to [✂] decrease in share.
[88] [✂] response to the issues statement.

4.89 We also assessed the evolution of the HHI through time. Our analysis showed that the HHI in 2007 was around 2000 points, and had fallen to just over 1000 points by 2016. This represents a decline in this particular concentration measure, of which the decline in share of [✂] is likely to be a major cause.

4.90 In paragraph 4.63 above, we noted that our guidelines for market investigations state that the CMA is likely to consider any market with a HHI in excess of 2,000 as highly concentrated. Our analysis shows that the HHI has been clearly below this threshold since 2009.

Concentration in the investment consultancy market has fallen over the past ten years.

Future trends

4.91 Parties' internal documents generally note a projected long-term decline in DB advisory revenues, and a growth in DC advisory revenues. This is consistent with views we have heard from the parties. It is also consistent with third party analysis showing the growth in DC. For example, in 2016 Spence Johnson analysis found that DC AUM will triple in size by 2025.[89]

4.92 The future size of the investment consultancy market as a whole will likely depend on the extent to which contract-based DC pension schemes expand, as these are generally associated with reduced purchasing of investment consultancy services. It will also depend on the extent to which the market for fiduciary management services to pension schemes increases in size at the expense of the investment consultancy market. We cover this further below.

Parties' views on investment consultancy market structure

4.93 Parties broadly agreed that the investment consultancy market was not highly concentrated. For example, Aon said that 'Aon agrees with the CMA's emerging finding that the [investment consultant] segment is not highly concentrated.'[90] Similarly, Russell Investments said that 'we agree with the CMA's account of … market concentration in the supply of investment consultancy services…'.[91]

[89] Spence Johnson, Market Intelligence 2016, p104.
[90] Aon's response to the Competitive Landscape Working Paper, paragraph 1.1
[91] Russell Investments' response to the Competitive Landscape Working Paper, paragraph 1.2

4.94 Mercer, however, told us that the investment consultancy market ‘cannot be considered to be concentrated’.[92]

Provisional conclusions

4.95 There appear to be a large number of noteworthy suppliers in the investment consultancy market. Concentration levels are significantly below those at which our guidelines state we would typically consider the market highly concentrated, and our analysis shows that this has been the case for several years.

4.96 Taking this evidence together with the fact that the largest firm has a market share of less than 20%; the three largest investment consultancy firms make up less than a 50% share of the market in total; the market is characterised by a number of well-established mid-sized firms; and overall, ten firms make up around 80% of the market, our provisional finding is that the investment consultancy market is not highly concentrated.

4.97 As such, current levels of concentration are not in themselves sufficient to lead to competition concerns.

Fiduciary management market structure

4.98 We have also undertaken analysis of the market for fiduciary management services to pension schemes in the UK. As for the investment consultancy market, we first assess the size of the market, before considering market shares. We then set out how market size and shares vary by customer segment, and present analysis of trends through time.

[92] Mercer pointed in particular to the closeness of the HHI figure to the threshold at which the CMA is likely to consider a market as concentrated; the decrease in concentration in this market over time; and Mercer’s expectation that the downward trend in concentration will continue. Mercer’s response to the Competitive Landscape Working Paper, p2.

The market in aggregate

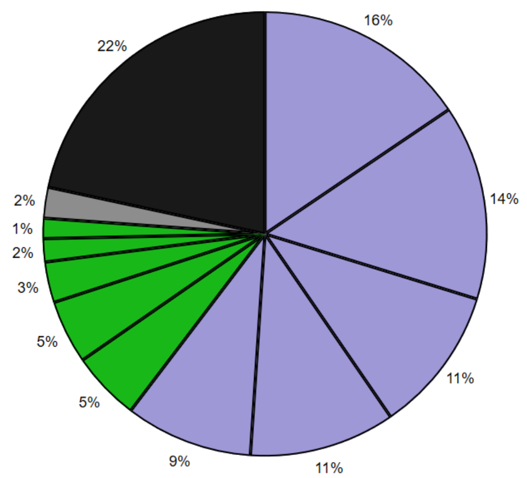
The fiduciary management market is worth up to £255 million in terms of revenues.

4.99 For the suppliers from whom we have collected data, our results show a lower bound on the market size (in revenue terms) of £200 million per year. Adjusting for our estimate of the percentage of the market we have not covered gives an upper bound to the market size of £255 million.[93]

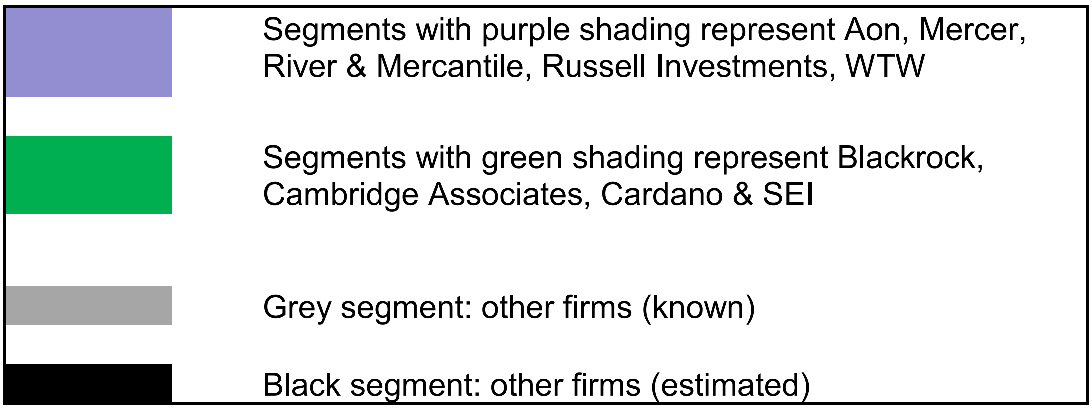
4.100 Providers we have confirmed as offering fiduciary management services manage at least £110 billion in assets,[94] and have 741 clients.[95]

4.101 We have calculated the share of revenue for each firm within the fiduciary management market based on 2016 data. We show these shares in Figure 5 below. We group together the largest five firms in the market, who have comparable shares, and the next largest four firms in the market who also have notable shares.

Figure 5: Shares by firm of the fiduciary management market



[93] Total fiduciary management revenues for all institutional investors in our data were over £218 million.
[94] We have summed together the value of all assets in the data provided to us to give a total of £117 billion. We consider this has indicative value here but not in investment consultancy because few schemes have more than one fiduciary manager (whilst this is more common in investment consultancy). Therefore, we do not think there are such significant concerns about double counting scheme assets (as there would be for investment consultancy). This figure does not take into account the percentage of the market which may use a fiduciary manager from which we did not collect data.
[95] We have not presented figures at market level. To do this, we would need to adjust these figures (i) upwards to account for our estimate of the percentage of the market we have not covered, and (ii) downwards to account for some investment consultants purchasing from multiple investment consultants (or if they switched, being present in two investment consultants' data for the year they switched).



Source: CMA Analysis, Parties' Data. Parties listed alphabetically within groups.

4.102 Figure 5 shows that the three largest investment consulting firms have combined fiduciary management market shares of between 40% and 52% in revenue terms. This is very similar to their share of the investment consultancy market set out in paragraph 4.76. The share of the largest ten providers is slightly higher but comparable (in fiduciary management it is 76 - 97%, whereas in investment consultancy it is 71 - 83%).

4.103 In the fiduciary management market there are two other suppliers of comparable size: River and Mercantile (operating under the name P-solve) and Russell Investments. This means that the five-firm concentration ratio is higher (at least 60% as compared with 54% in the investment consultancy market).

4.104 As with the investment consultancy market, there are also a number of players outside of the largest five, although in comparative terms these players have a smaller share of revenues. Therefore, we consider they are not sufficiently large to include in our summary concentration ratio above, but still represent significant players in their own right. These include BlackRock, Cambridge Associates, Cardano and SEI Investments. However, in comparison to the investment consultancy market, these mid-size fiduciary management suppliers have a smaller share of the market relative to the largest firms in the market.

4.105 We have also calculated the HHI for the fiduciary management market as a whole. Our initial results show a value of 1,324. This figure is higher than that for the investment consultancy market as whole (1,023), however it does not meet the threshold set out in our guidance at which we would be likely to consider the market 'highly concentrated'.[96]

[96] CC3 revised, ANNEX A, paragraph 7.

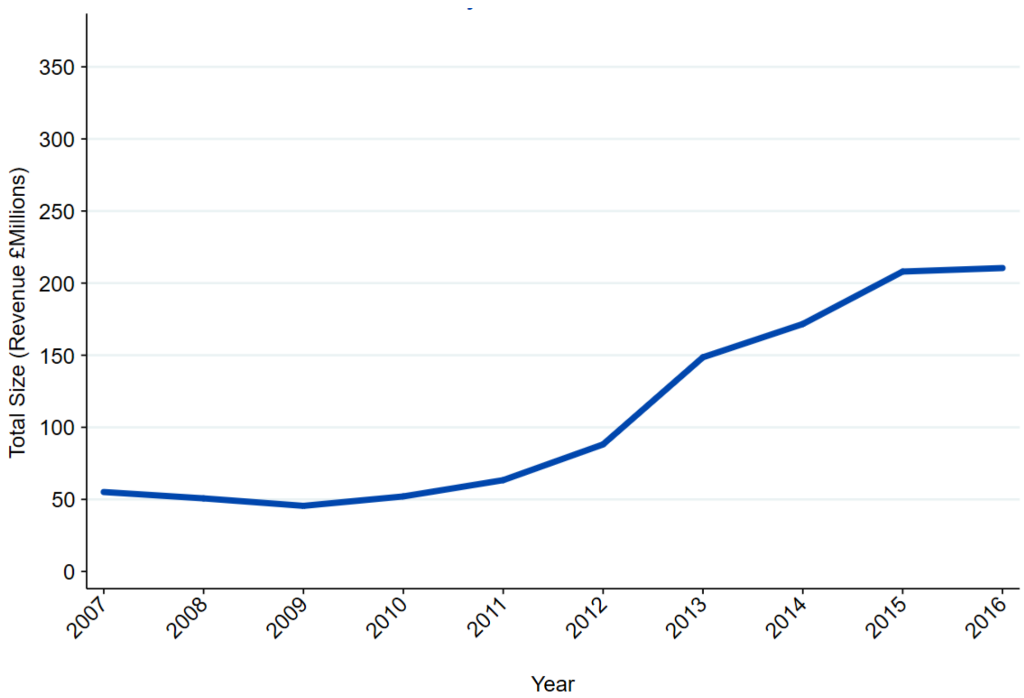
4.106 The HHI is just one element of our assessment of concentration; we also place significant weight in particular on the individual market shares and the number of suppliers in the market. In our view, customers currently appear to have a sufficient degree of choice.

The fiduciary management market is not highly concentrated.

Historical evolution

4.107 As with the investment consultancy market, we collected revenue data from each party through time. This allowed us to understand how both the size of and concentration in the market have evolved over the last ten years. We show the total size of the market (in nominal revenue terms) over these ten years in Figure 6 below.

Figure 6: Total size of the market for fiduciary management services to pension schemes through time in revenue terms



Source: CMA Analysis, Parties' Data

4.108 Figure 6 shows that the size of the fiduciary management market has increased substantially in recent years. In particular, total revenue increased from around £50 million in 2009 to around £210 million in 2016.[97] It more

[97] These figures are lower bounds. Whilst in the snapshot it is possible to apply an estimate to the percentage of the market we have not covered to calculate an upper bound, it is not possible to do this in the timeseries as we do not have the data to do so.

than trebled in size in the period following 2011. This significant growth is consistent with other sources of information, such as the KPMG fiduciary management survey, which analyses this growth in terms of the number of mandates and growth in assets under management.[98]

The fiduciary management market has trebled in size since 2011.

4.109 We also analysed changes in individual firms' market shares through time. We focussed on the largest five firms in this market (as of 2016). These results are shown in Figure 7 below.

Figure 7: Market Shares through time for the largest 5 fiduciary management providers

[✄]

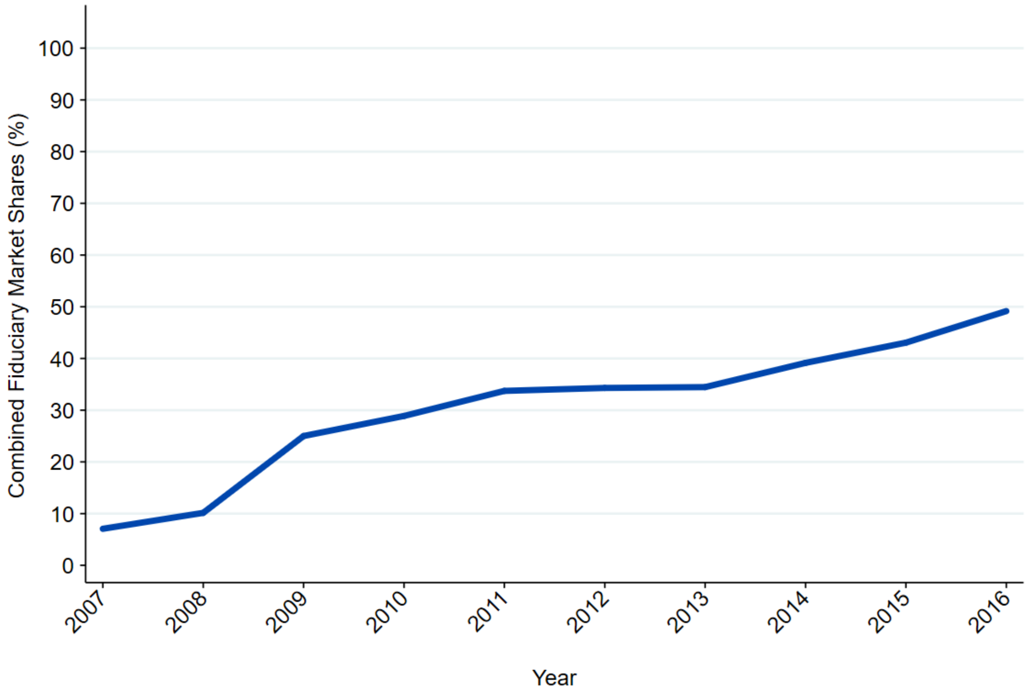
Source: CMA Analysis, Parties' Data.

4.110 Figure 7 shows that the largest three providers of investment consultancy services have increased their shares of the fiduciary management market from relatively low levels in 2007 to become large market players in 2016. The remaining two providers in the chart, River & Mercantile and Russell Investments, have not seen such large comparative increases in fiduciary management market shares.

4.111 We therefore considered the evolution of the combined shares in the fiduciary management market for the largest investment consultancy providers through time. This consideration is particularly relevant given our assessment in chapter 7. This analysis is represented in Figure 8 below.

[98] KPMG, *KPMG Fiduciary Management Survey*, 2017, Page 2.

Figure 8: Combined share of the market for fiduciary management services to pension schemes for the three largest investment consultancy firms through time



Source: CMA Analysis, Parties' Data

The three largest investment consultancy firms have increased their share of the fiduciary management market by 40 percentage points since 2007.

4.112 Figure 8 shows that the largest three investment consultancy providers have increased their combined share of the fiduciary management market from around 10% in 2007 to up to (at most) 50% in 2016.[99,100] This is a considerable upward trend, and informs our assessment in subsequent chapters.

Future trends

4.113 Most evidence points to continued growth in the fiduciary management services market as time goes on. This is consistent with the growth in

[99] We note that these shares and concentration measures are likely to represent upper bounds because we cannot account for the estimate of the percentage of the market not covered through time. The three largest investment consultancy providers' shares and overall concentration are both in practice likely to be slightly lower. The figures differ slightly from those implied by our static revenue data due to differences in firms' returns. The key change appears to be due to the reconciliation between calendar and financial years. We consider that our static analysis represents the best picture for 2016, but the timeseries data remains useful to assess trends.
[100] Because our data indicates that Russell Investments and River & Mercantile were previously the only two large providers of services in 2007, the entry and subsequent rapid growth of the three largest investment consultant providers actually resulted in a reduction in the HHI over this period from over 4300 in 2007 to 1353 in 2016.

fiduciary management services revenues we observe in our own data in recent years, survey evidence, and the parties' forecasts.

(a) Aon's 2017 fiduciary management survey shows that 16% of those schemes who do not currently use fiduciary management plan to explore or are currently exploring it. A further 35% of those who do not currently use fiduciary management have decided against it for now, but say they may reconsider later.[101]

(b) A 2017 WTW document states that the UK fiduciary management market seems 'to be approaching the tipping point … where we move from early adopters to early majority and volumes increase sharply'.[102]

(c) A 2015 [✂] strategy document forecasts annualised AUM growth over the period 2014-2019. The 2017-2019 projected annualised growth rate is in the region of 12%.[103]

(d) Spence Johnson analysis forecasts continued fiduciary management growth until at least 2024.[104] Over the period 2017-2020, the projected annualised AUM growth rate is in the region of 11%. As the fiduciary management market increases in size beyond this, the forecast annualised growth rate falls.

4.114 In the context of the recent substantial growth in combined shares of the three largest investment consultancy providers in fiduciary management services, we have considered whether there is evidence that this trend will continue.

4.115 We reviewed some internal documents from the five largest fiduciary management providers in 2016. Whilst we can only place limited weight on these documents due to their aspirational nature, these generally show that each of these five large firms aim to achieve strong growth rates in their own fiduciary management offerings.[105]

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[101] Aon Fiduciary Management Survey 2017, p9.
[102] WTW internal document, p9.
[103] [✂].
[104] Spence Johnson Institutional Insights, 'Fiduciary Management: Surging forward', 2016. Page 24.
[105] There are challenges in comparing and interpreting these as a set because the projections are not always comparable. For example (a) Achieving high growth rates in fiduciary management was easier when the fiduciary management market was smaller in 2015: as the fiduciary management market has grown, achieving the same growth rate requires winning more business. Figures forecast over different periods will therefore contain different annualised growth rates, (b) Several figures were presented at the global rather than the UK level and (c) Differences in rates of growth may be as much to do with differences about expected market growth as they are about expected ability to win business from others. Assumptions on market growth rates are usually not stated in these documents.

(a) A 2017 WTW strategy document states a global 5-year growth target of 20% per annum for their global fiduciary management revenue, relative to their 2016 levels.[106]

(b) A 2015 Aon strategy document states that Aon sought to increase its AUM in corporate pensions delegated solutions (globally) at a faster rate than market growth ([✂]).[107]

(c) A 2015 River and Mercantile board strategy day document set out targeted growth of 15% p.a. in fiduciary management up until 2020.[108]

(d) A 2015 3-year strategy document from Russell Investments stated targeted revenue increases totalling $7.8 million across 2016, 2017 and 2018. This implies an annualised growth rate of around 11%.[109]

(e) A 2017 Mercer strategy document states that they will '[✂].[110]

4.116 We received some evidence that forecasts that the market shares of the IC-FM firms could fall over the next few years due to factors such as market entry from asset management firms and an increased use of open tenders. In particular, Spence Johnson analysis forecasts reduced market shares for IC-FM firms. They found market shares of 74% for this group in 2014, but forecast this to fall to around 50% by 2024. They note the basis for this as more asset managers entering the market, and 'clients putting their fiduciary management mandates to open tender, having already experienced the fiduciary management solution at the hands of their consultant'.[111]

4.117 Future concentration in the market for fiduciary management services to pension schemes of course depends on the prospect for future entry and expansion. We discuss this issue further in chapter 9.

Parties' views on fiduciary management market structure

4.118 Several parties supported our view that the fiduciary management market was more concentrated than the investment consultancy market and said that concentration in the fiduciary management market could further increase in the next few years.

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[106] WTW internal document.
[107] Aon internal document.
[108] River & Mercantile internal document.
[109] Russell Investment internal document. Figure uses 2016 revenue provided to the CMA as a base, and 2016 USD/GBP conversion rates. The calculation is only approximate.
[110] Mercer UK internal document.
[111] [✂].

(a) LCP told us that ‘We agree that the CMA should have concerns that the concentration in the fiduciary management services market could further increase. In particular, given the way in which the market is currently structured, the combined IC-FM firms can be expected to grow and increase market share’.[112]

(b) Hymans said that ’there is a genuine concern that [the fiduciary management market] becomes more concentrated over time rather than more competitive’.[113]

(c) Russell Investments emphasised the trend in growth for the three largest fiduciary management providers and, acknowledging the difficulty in predicting whether it will continue, said that it is a reasonable cause for concern given … there is reason to suggest that the observed gains in these providers’ market share have been largely driven by conversion of investment consultant mandates to fiduciary management.[114]

4.119 However, the largest three investment consultancy providers challenged the evidence and inference underlying this view on a number of grounds. In particular:

(a) Aon and Mercer noted that any potential growth in combined shares was not certain and is difficult to predict.[115]

(b) Aon, Mercer and WTW submitted that ambitious growth plans demonstrated future vigorous competition, that such plans did not necessarily represent achievable plans for all firms and did not demonstrate that such growth would be realised in the future given the plans were aspirational. They also submitted that, if we had considered growth plans of firms outside the largest five fiduciary management players, similar ambitions would have been observed.[116]

(c) Aon, Mercer and WTW submitted that future entry and expansion (including that from established asset managers seeking to expand

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[112] LCP’s response to the Competitive Landscape Working Paper, page 3.
[113] Hymans’ response to the Competitive Landscape Working Paper, page 1.
[114] Russell Investments’ response to the Competitive Landscape Working Paper, page 1.
[115] Aon’s response to the Competitive Landscape Working Paper, paragraph 2.2.
Mercer’s response to the Competitive Landscape Working Paper, paragraph 2.13.
[116] Aon’s response to the Competitive Landscape Working Paper, paragraph 2.3.
Mercer’s response to the Competitive Landscape Working Paper, paragraphs 2.11 and 2.12.
WTW’s response to the Competitive Landscape Working Paper, paragraph 1.11.

their offering) would likely prevent increases in concentration in the fiduciary management market.[117]

(d) Aon and Mercer told us that even if concentration were to increase, the CMA had not provided any evidence as to why this would in itself lead to an AEC.[118]

4.120 We acknowledge the challenges in predicting future growth in shares. We also recognise that high rates of growth, and ambitious growth plans, could be competitive if reflecting a highly competitive service offering.

4.121 Nevertheless, we consider that an alternative hypothesis explaining at least part of this historical and planned growth, is that certain features of the investment consultancy and fiduciary management markets have favoured the growth of certain IC-FM firms. We discuss this more in chapter 7. This historical increase in share may in part be symptomatic of these features, and could cause the observed historical trend to continue. Our analysis here is not intended to imply that future increases in concentration in the fiduciary management market would necessarily be considered problematic in themselves.[119]

Provisional conclusions

4.122 Our analysis shows that concentration levels for the fiduciary management market are higher than that for the investment consultancy market as whole (1,324 compared to 1,023). However, it does not meet the threshold set out in our guidance at which we would be likely to consider the market 'highly concentrated'. We also found that:

(a) no firms have market shares above 20%;

(b) there are five large firms in this market and several other notable players, and

(c) there has been recent entry into the fiduciary management market by a number of large asset management firms.

[117] Aon's response to the Competitive Landscape Working Paper, paragraphs 2.4 and 2.5.
Mercer's response to the Competitive Landscape Working Paper, paragraph 2.11.
WTW's response to the Competitive Landscape Working Paper, paragraph 1.16.
[118] Aon's response to the Competitive Landscape Working Paper, paragraph 2.
Mercer's response to the Competitive Landscape Working Paper, paragraph 2.10.
[119] We are not expressing a theory of harm around future concentration. We have considered the parties' views that entry and expansion are able to offset any increases in concentration separately, see chapter 9

4.123 Our provisional finding is that the fiduciary management market is not highly concentrated, and customers appear at present to have access to a sufficient number of suppliers.

4.124 As such, current levels of concentration are not in themselves sufficient to lead to competition concerns.

4.125 However, our analysis shows that the combined position of the three largest investment consultancy firms (Aon, Mercer and WTW) has grown substantially, having increased by around 40 percentage points in the last ten years. This represents a significant upwards trend.

4.126 While it is difficult to predict whether this trend will continue, we see that these firms have ambitious growth plans in the fiduciary management market. There is also some evidence that barriers to expansion may be greater in fiduciary management than investment consultancy (see chapter 9).

4.127 Therefore, we provisionally conclude that there has been a trend of increasing shares for the three largest investment consultancy providers in fiduciary management, and that concentration in fiduciary management could increase in the future.

Fiduciary management could become more concentrated in the future.

Provisional conclusions

4.128 We have provisionally found that there are separate relevant markets for the supply of investment consultancy services to pension schemes in the UK, and the supply of fiduciary management services to pension schemes in the United Kingdom.

4.129 The investment consultancy market is not highly concentrated, concentration is particularly low for smaller schemes and there are a large number of providers active in this market.

4.130 The fiduciary management market is more concentrated than the investment consultancy market. However, it does not appear to be highly concentrated and customers appear at present have access to a sufficient number of suppliers.

4.131 We have also provisionally identified that there has been a trend of increasing shares for the three largest investment consultancy providers in fiduciary management, and that concentration in the fiduciary management market could increase in the future.

5. Information on fees and quality

Our main findings

Investment consultancy

- Fee information for current clients is generally clear, with trustees receiving simple regular invoices. Comparing the fees of alternative providers (eg at tendering) can be challenging however; information is often limited, and rival bids are not directly comparable.

- Trustees receive regular and generally clear information on the performance of their scheme. However, we are concerned about certain practices such as the reporting of performance on a gross of fees basis.

- Very few performance reports demonstrate progress against the trustees' strategic objectives, which would help trustees to assess the quality of their provider's investment advice.

- For prospective clients, there is limited information to assess providers' investment abilities and performance information on their recommended asset management products and funds is not directly comparable.

Fiduciary management

- Many fee reporting practices for current clients (such as the 'bundling' of fiduciary management and asset management fees) prevent them from being able to fully assess the value for money of their service.

- Comparing the fees of alternative providers in tenders can also be challenging and there is wide variation in the reporting of asset management fees; the overall cost of service is often not indicated.

- Many tenders also include no information on the costs of transitioning into and out of these services, which can be considerable.

- Performance reporting for current clients is mostly clear and detailed. Progress is regularly shown against the trustees' strategic objectives.

- We are concerned however that performance is often reported on a gross of fees basis.

Introduction

5.1 This chapter, together with the following chapter on trustee engagement, considers demand side and information issues. Our issues statement summarises the potential concern in this area as follows:

> Difficulties in customers' ability to effectively assess, compare and switch investment consultants result in weak incentives for investment consultants to compete for customers.

5.2 In considering the extent to which customers face difficulties in assessing, comparing and switching investment consultants, we broadly follow the conceptual framework outlined in our market investigation guidelines ('the Guidelines').[120] The Guidelines state that customers may face difficulties in each of the following areas:

(a) Accessing information (access).

(b) Identifying the best value for money (assess).

(c) Switching services and suppliers (act).[121]

5.3 This chapter is primarily concerned with the first two of these three areas: whether customers (pension fund trustees) have access to the necessary information to evaluate investment consultants and fiduciary managers, and to assess the value for money of alternative providers.[122] The ability to access, assess and act on such information is critical in driving competition in the markets in question.

5.4 The chapter is structured as follows:

(a) We first present our broad conceptual framework.

(b) We discuss our evidence base for the analysis.

(c) We analyse the information on fees and quality (for both current and potential customers) in investment consultancy.

[120] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3 (Revised), April 2013).
[121] (CC3 (Revised)), paragraphs 296 and 297.
[122] Appendix 3 (trustee engagement) covers the final area, ie whether trustees are able to act on the outcome of their assessment. This may be through switching provider, or through negotiating an improved deal with the incumbent provider.

(d) We then analyse the information on fees and quality (for both current and potential customers) in fiduciary management.

Conceptual framework

5.5 In order to drive effective competition, it is important that customers have access to information on both the fees and quality of alternative providers in the market.

5.6 As a guiding principle, we consider that this information should be both clear and provided regularly. Clarity is particularly important in an industry such as this, where much of the information is inherently complex and customers are (generally) not investment experts. Excess investment costs and poor investment decisions can have a substantial impact on scheme outcomes.

5.7 Regularity is important as both the absolute and relative levels of fees and quality can change over time. A service may represent good value for money at one point in time but not another; regular information enables trustees to assess this and prompts them to act if necessary. This is important in the context of this industry as firms are (generally) providing a long-term service with 'evergreen' contracts.

5.8 We note that different types of information are important in different contexts. In particular:

(a) Information provided to current clients should be clear and regular, but complete consistency across firms may not always be necessary or possible. Trustees should be able to assess their incumbent provider's value for money, but may choose to do so based on their own objectives and understanding of the industry, rather than by benchmarking against other schemes or providers.

(b) Information provided to prospective clients should be clear and, as far as possible, consistent across firms. Trustees should be able to compare competing firms on a like-for-like basis; this helps them to select the best provider for them and encourages competition on its merits. We recognise however that complete consistency can often be difficult to achieve, for example due to the use of alternative technical methodologies.

Evidence base

5.9 Our analysis in this chapter draws heavily on information received directly from parties. This includes written responses to our market questionnaire (issued to investment consultants and fiduciary managers) and related follow-up information requests. These information requests have covered fee reporting, performance reporting and the implications of regulatory developments such as MiFID II. We have also considered evidence provided by parties in hearings and in response to our issues statement and working papers. Chapter 1 provides an overview of the sources of evidence used throughout the report.

5.10 As part of our market questionnaire, we requested access to documents distributed by investment consultants and fiduciary managers to their clients over the last three to five years. These documents consist of:

(a) Information provided to current clients: we requested all documents distributed to a sample of current clients over the last three to five years. We have reviewed the documents of around 50 clients (across 15 firms) in detail, covering DB, DC and hybrid schemes; and advisory and fiduciary management clients.

(b) Information provided in tenders: we requested all documents submitted as part of a tender process over the last three to five years. We undertook a matching exercise to identify rival bids for the same tender, allowing us directly to assess the comparability of different bids. Overall, we have reviewed over 100 bids for around 25 unique tenders.

(c) Information distributed in 'marketing materials': we have reviewed hundreds of marketing materials distributed by 15 firms (large and medium-sized providers). These include brochures, flyers, presentations and information made available through firms' websites.

5.11 In analysing this evidence, we have had particular regard to recent developments and current practice. We consider that historical evidence is also informative however in indicating whether these practices are sufficiently well-established and embedded in the market. To fully understand the market, it is not sufficient to focus exclusively on one particular point in time.

5.12 Our analysis and findings also draw on the results of the CMA survey. We present and examine relevant survey results within each section below, and consider this alongside the evidence. Overall, the results of the CMA survey show that a majority (and for some questions, a large majority) of trustees said that they found it very easy or fairly easy to monitor and/or compare fees or performance. In interpreting these results, we are mindful of the following factors:

(a) As we set out in chapter 10, this is a heterogeneous service and fees are negotiated on an individual basis in both investment consultancy and fiduciary management. Therefore, even if a majority of trustees consider that there is sufficient information to assess the offers of different providers, the benefits that they receive from this (eg from lower prices) do not necessarily extend to those who experience difficulties in assessing offers.

(b) In many cases the reporting of fees or quality may be affected by methodological differences and technical assumptions. Understandably, trustees may not be fully aware of these issues or their potential impact on the comparability of information across providers.

(c) We have had access to a large number of documents from a wide range of schemes and providers. We have found that there is considerable variation in the level of detail and clarity in these documents. Trustees generally have access only to those documents relevant to their own scheme(s). As noted by PLSA, the survey results may therefore reflect that many trustees do not know 'what good looks like'.[123]

(d) Trustees are not the end consumers of these services, and are ultimately acting on behalf of scheme members. There may therefore be some incentive for trustees to over-report their confidence in their ability to assess and compare offers.

Investment consultancy clients

Information on fees

Current clients

- *Fees paid to the investment consultant*

5.13 The most common fee structures for investment consultancy clients are a fixed retainer, hourly (or time-cost) fees and pre-agreed 'project' fees. Many clients use a retainer for basic regular services, such as attending meetings and reporting performance, with hourly or project fees used for additional work. Most firms offer their clients a choice between the above options.

5.14 Clients typically receive monthly or quarterly invoices. For those using a retainer or fixed fee, this usually consists of a single line specifying the

[123] PLSA response to the information on fees and quality working paper.

amount due for the period.[124] For those using hourly or project fees, invoices are usually itemised. The level of detail varies from case-to-case, although we have reviewed several examples of very clear and detailed itemised invoices.[125]

5.15 For those clients using hourly or project fees, proposed changes to the investment strategy could result in additional revenues for the consultant. We would therefore expect that clients are given information in advance regarding changes to their fees. In our document review, we have seen several examples of good practice. In one case for example, a client was provided with a detailed spreadsheet itemising the consultant's expected fees over the coming year, benchmarked against the initial anticipated budget for each project.[126] In another case, the client was provided with a detailed itemisation of fees versus budget.[127]

5.16 Our analysis therefore shows that investment consultancy clients are generally provided with clear and regular information on the fees they pay to their provider. This is consistent with evidence from the CMA survey, which found that 56% of clients found it very easy to monitor the fees they pay to their investment consultant, and 33% found it fairly easy (7% found it not very easy and 1% found it not at all easy; 2% don't know, 1% not applicable).

Investment consultancy clients are generally provided with clear and regular information on fees.

5.17 In its response to our working paper, bfinance submitted that different elements of the advisory services should be separately itemised in fee reporting. It submitted that this would enable investors to assess the cost and value for money of each aspect of the service.[128]

5.18 We have found however that, in many cases, invoices are already itemised at a granular level. This may include separate allocations to services such as asset allocation advice, risk management/hedging and manager selection. It may not always be possible however meaningfully to separate these different services. The decision of how to allocate fees and costs between them may therefore sometimes be arbitrary. Further, we have received no

[124] See, for example, invoices provided to clients by [✂] (dated 20/9/2017) and [✂] (dated 31/10/2017).
[125] See, for example, invoices provided to clients by [✂] (dated 15/6/2017), [✂] (dated November 2017), [✂] (dated 31/3/2015), [✂] (covering Q3 2017), [✂] (dated 8/6/2017) and [✂] (dated 31/5/2017).
[126] Documents provided to a client by [✂] (dated May 2017 and November 2017).
[127] [✂] (dated 31/5/2017).
[128] Bfinance response to the information on fees and quality working paper.

evidence that there is systematic demand from trustees for this particular breakdown of costs.

- *Fees paid to third parties*

5.19 In an advisory model, trustees enter into separate contracts with asset managers and other third parties. Information on such fees is therefore provided directly to trustees, although they may request that their investment consultant collates and summarises this information on their behalf.[129]

5.20 As trustees have direct access to such information, we would not expect investment consultants to provide invoices or fee statements covering third party fees. To assess the suitability of their clients' investments however, we would expect consultants to undertake periodic reviews of third party fees, particularly those paid to asset managers, and how such fees compare to market alternatives.[130] Regulatory guidelines for example state that trustees should consider the impact of fees on investment returns, and check that fee levels are competitive.

5.21 For DB schemes, we found little evidence in our document review that investment consultants regularly undertake this kind of analysis for trustees. The main exception to this is when a consultant is recommending a change to the investment strategy or underlying funds. In such cases, clients are typically provided with the expected fees of alternative managers and an estimate of the transition costs.[131] From the documents we have reviewed however, it is not generally made clear how the client's overall fees are likely to be impacted by the change, or how this might impact overall net returns.[132]

5.22 For DC schemes, there are specific regulatory requirements regarding the reporting of fee information. In particular, trustees of DC schemes (unless exempt) are required to undertake an annual Value for Members assessment. This must be explained in the Annual Chair's Statement,

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[129] Asset managers generally have an obligation (eg under MiFID II) to provide regular information to their clients regarding costs and charges. Trustees may request that such information is collected by their consultant on their behalf. We note that the institutional disclosure working group (IDWG) is currently creating templates for the reporting of asset management costs and charges. This includes both a granular disclosure and a high-level summary for investors. We would expect consultants to ensure that their customers receive this information in a suitable form and with appropriate regularity.
[130] We note for example that TPR's DB Investment Guidance states that trustees should 'consider the impact of [investment managers'] fees on investment return, as this affects the net return the scheme receives. You should check fee levels for competitiveness against appropriate market comparators for the size and type of mandate'.
[131] See, for example, documents provided to clients by [✄] (dated 9/1/2017 and 15/3/2017) and [✄] (dated 25/8/2016 and 1/7/2017).
[132] The documents cited at footnote 131 for example do not include information on the impact of the change to asset management products on overall fees or net returns.

together with a disclosure of member-borne costs and charges.[133] Additional requirements introduced in April 2018 have, generally speaking, strengthened the requirements over the reporting of costs and charges in relation to DC schemes.[134]

5.23 These requirements should ensure that trustees of DC schemes seek to receive clear and regular information on third party fees and their competitiveness. Indeed, we have reviewed a number of Value for Members assessments undertaken by investment consultants, and these include clear information on third party fees.

5.24 We note however that the level of analysis varies considerably across clients. In some cases, the Value for Members assessments we have seen (undertaken by investment consultants) explicitly compare the client's fees for each fund against relevant market benchmarks.[135] This allows trustees easily to assess the competitiveness of their investments. Other Value for Members assessments however include only a general statement on the suitability of fees.[136] This may simply note for example that fees are generally reasonable. We also note that TPR research conducted in 2017 found that only around half of small schemes have a 'documented process in place to assess, at least annually, the extent to which member-borne charges and transaction costs represent value for members'.

5.25 Our document review therefore indicates that many clients (particularly DB and hybrid schemes) currently receive only limited information from their investment consultant on third party fees. In the CMA survey, 34% of trustees responded that they found it very easy to monitor third party fees based on the information received from their consultant. A further 40% found it fairly easy, although a significant proportion of trustees (16%) found it not very easy and 5% found it not at all easy (2% don't know, 4% not applicable). In view of the factors outlined in paragraph 5.12, we therefore consider that taken in the round the evidence shows that many schemes receive limited information from their investment consultant on third party fees.

5.26 Some parties have raised practical issues with the reporting and analysis of third party fees. Mercer submitted that the investment consultant may not

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[133] Regulation 25(1) Occupational Pension Schemes (Scheme Administration) Regulations 1996
[134] The Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018, S.I 233/2018 require trustees of DC schemes to include information on the level of costs and transaction charges in the Chair's annual statement for both the default arrangements and self-select funds. This information must be made publicly available.
[135] See, for example, a document provided to a client by [✂] (dated May 2017).
[136] See, for example, a document provided to a client by [✂] (dated 6/11/2015).

have access to all of the necessary information, and LCP indicated that there may be contractual issues over securing data provision.[137] Redington submitted that for large and complex schemes the investment consultant does not have visibility over all costs, and even for small schemes the resource required to collect such information may detract from more important work (such as strategic asset allocation advice).[138]

5.27 WTW however submitted that more could be done to provide clients with information on third party fees, including the total expense ratio (TER) of underlying funds, as well as changes to third party fees resulting from portfolio changes.[139] They submitted that such information could be included in regular performance monitoring reports.

5.28 We recognise that there may be some practical issues with the reporting of third party fees, and trustees should have access to such information directly from underlying managers (and other third parties). We consider that the introduction of MiFID II and the related IDWG templates should significantly improve the availability and clarity of such information. Investment consultants can play an important role in assisting trustees in processing and understanding this information. From a competition perspective, this is important in helping trustees to assess the performance of their investments, and therefore the quality of investment advice they receive, and in turn to drive competition between providers.

MiFID II and the Institutional Disclosure Working Group templates should significantly improve the availability and clarity of information on investment fees.

Prospective clients

5.29 As set out in our conceptual framework (paragraphs 5.5 to 5.8), information on fees provided to prospective clients should be clear and, as far as possible, consistent across firms. Our document review indicates that although trustees are generally provided with clear and detailed information on the services that will be included as part of their contract with the investment consultant, it is often difficult to compare the overall fee for those services on a like-for-like basis.

[137] Mercer and LCP responses to the working paper on information on fees and quality.
[138] Redington response to the working paper on fees and quality.
[139] WTW response to the working paper on fees and quality. [✂].

5.30 There are two main reasons for this lack of comparability. First, different consultants often use different fee structures such as hourly rates and fixed fees. Where a hybrid approach is proposed, it is often unclear how the cost is split between fixed and time cost-fees.

5.31 One tender that we reviewed for example included a bid based on a retainer plus hourly fees,[140] and another bid based on a fixed price.[141] The former did not indicate an overall estimated cost, and the latter included a very large range for the likely overall cost. Based on these tender documents, it is therefore very difficult to compare the price of these two bids.

5.32 We recognise that pricing flexibility can be beneficial for trustees, and the use of different fee structures promotes innovation and competition. In some of the documents we have reviewed however, this can make the comparability of bids challenging. As outlined in paragraph 5.35, we have also reviewed cases in which fee comparability was relatively easy, despite the use of different structures. We therefore note that it is possible to maintain comparability whilst allowing trustees and firms to decide which fee structure is most appropriate for them.

5.33 Second, the fee questions asked by trustees in their request for proposals are often vague. For example, tenders often do not require firms to itemise their fees according to a list of specified services.[142] In many cases, the difference in the list of services included in estimates from firms leads to high variation in the overall cost across responses.[143] Moreover, questions in tenders often do not indicate the metric (eg time-period) that firms should be using to estimate the cost of investment consultancy services. This can also hinder the comparison of rival bids.[144]

5.34 Overall, the quality and detail of fee information in tenders for investment consultancy services varies considerably. Some tenders are extremely short and ask very general, open questions. In some cases there are no direct questions regarding the proposed fees charged by the bidding firms.[145]

5.35 We have also reviewed some very structured and precise tender documents, which appear to be more common when the process is mediated by a TPE.

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[140] [✂] response to an invitation to tender (dated [✂]/2017).
[141] [✂] response to an invitation to tender (dated [✂]/2017).
[142] For example, an invitation to tender from a DB scheme (dated 2014) submitted to the CMA by [✂], [✂] response to an invitation to tender (dated [✂] 2017).
[143] For example, [✂]response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2015),
[144] For example, [✂] response to an invitation to tender (dated [✂]/2017), [✂] response to an invitation to tender (dated [✂] 2017).
[145] For example, an invitation to tender from a DB scheme (dated [✂] 2015) submitted to the CMA by [✂], an invitation to tender from a DB scheme (dated [✂] 2015) submitted to the CMA by [✂].

Tenders mediated by TPEs typically require firms to provide a quote for a full list of services, specified in the tender, and to indicate how the fee is split between ‘ongoing’ and ‘project’ work. In the cases we have reviewed, this enabled a direct comparison of the competing bids.[146]

5.36 We have therefore found in our document review that it is often difficult to compare the fees of competing bidders. Aon, Hymans, Mercer and WTW however have submitted that the results of the CMA survey indicate that trustees are generally satisfied with the information that they receive.[147] The CMA survey found that 35% of trustees say they found it very easy to understand and compare the fees payable to the investment consultant in the proposals that they received; 46% found it fairly easy; 9% found it not very easy; and 2% found it not easy at all (6% don’t know, 1% not applicable).

5.37 We agree that the CMA survey results indicate that trustees generally find it easy to compare the fees of rival bids when tendering. However, the survey is one piece of the overall evidence base, and our document review has shown that there is considerable variation in the quality of tenders and the comparability of information.[148] We have therefore seen that in some cases it is much easier to compare the fees of alternative providers than it is in others. We have been able to identify clear examples of ‘good’ and ‘bad’ practice.

5.38 As set out in paragraph 5.12, trustees do not have the benefit of being able to directly compare the type of questions and information requested in such a wide range of tenders. We therefore consider that in this instance, the CMA survey results may reflect the fact that many trustees do not know ‘what good looks like’.

5.39 Barnett Waddingham and KPMG submitted that fees are negotiated as part of an appointment process, and clients will challenge them if their fees are out of line with competitors.[149] We recognise that fees may subsequently be negotiated downwards after tendering, although it is still important that fees are broadly clear and comparable at the point of tendering. This is important to put competitive pressure on fees by providing a counterfactual for what could be achieved elsewhere. By relying on negotiations at a later stage,

[146] For example, [✂] response to an invitation to tender (dated [✂] 2016), [✂] response to an invitation to tender (dated [✂] 2017), [✂] response to an invitation to tender (dated [✂] 2017).
[147] Aon, Hymans, Mercer and WTW responses to the information on fees and quality working paper.
[148] We also note that at our trustee roundtables, price was a relevant factor for trustees when choosing an advisor, but several trustees had found it hard to understand whether proposed fees were like-for-like (trustee roundtable summary).
[149] Barnett Waddingham and KPMG responses to the information on fees and quality working paper.

trustees may be discounting providers that would have offered more competitive terms.

Information on quality

Current clients

5.40 Trustees receive information from their investment consultant on the investment performance of their scheme through regular performance reports (typically quarterly) and strategic reviews (typically every three years). Performance information can also be included in ad hoc pieces of analysis, for example when trustees are considering a change to their investment strategy, and through online monitoring tools.

5.41 The level of detail in regular performance reports varies considerably across clients, in part reflecting trustees' preferences. Many firms offer a basic report with further information available for an additional charge. Most reports include information on the performance of the underlying funds and overall scheme returns, whilst information on risk is generally an optional extra; many regular performance reports include little or no explicit analysis of risk.[150] This includes both 'pure' investment risk and investment risk relative to liabilities.

5.42 Fund-level performance information is generally clear and well presented. The format is largely standardised: returns are shown over the latest quarter and year (often longer) and are benchmarked against relevant market indices. We note that there is a lack of consistency across providers however as to whether performance is reported gross or net of asset management fees.[151] Sometimes it is not stated whether returns are gross or net of fees.[152]

5.43 As highlighted in our analysis of asset manager product recommendations (Appendix 2), reporting on a gross of fees basis may give a misleading impression of the performance of a fund or investment product. Indeed, TPR

[150] See, for example, documents provided to clients by [✂] (covering Q2 2017), [✂] (covering Q4 2016) and [✂] (covering Q2 2017).
[151] Information is provided on a gross of fees basis in, for example, a document provided to a client by [✂] (covering Q4 2016). Information is provided on a net of fees basis in, for example, documents provided to clients by [✂] (covering Q1 2017) and [✂] (dated May 2017). Information is provided on a gross and net of fees basis for different products/funds in, for example, documents provided to clients by [✂] (dated 2/2/2016), [✂] (dated September 2017), [✂] (dated November 2016) and [✂] (dated May 2017).
[152] See, for example, a quarterly monitoring report provided to a client by [✂] (covering Q2 2017).

guidance recommends that trustees of both DB and DC schemes consider the impact of asset managers' fees on investment returns.[153]

5.44 For DB schemes, overall scheme returns are compared to either an aggregate benchmark, based on the underlying fund-level benchmarks, or to the change in liabilities, ie the funding level progression. As the overall returns are based on aggregating the fund-level returns, there is again a lack of consistency in whether this information is presented on a gross or net of fees basis.

5.45 We note that the scheme's overall performance is not generally shown against the trustees' strategic objectives.[154] Relatedly, we have seen very few examples in which the investment consultant is set, and subsequently reports progress against, explicit performance targets. Regular access to such information would help trustees to fully assess their investment advisor's performance.[155]

5.46 For DC schemes, many performance reports include little or no information on overall scheme outcomes.[156] Although there is no statutory funding objective for a DC scheme, we would still expect trustees to monitor the overall performance of the scheme on a strategic level. This is consistent with TPR guidance, which states that trustees should consider the scheme's investment strategy rather than simply the performance of underlying funds.[157]

5.47 TPR guidance also states that trustees of DC schemes should consider how investment performance has impacted different members of the scheme.[158] Our document review however indicates that the majority of schemes do not receive regular information on expected 'member outcomes'.

5.48 Beyond the regular performance reports, more detailed analysis is included in strategic reviews. For DB schemes this can include information on long-

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[153] For DB schemes: TPR guidance on 'monitoring DB investments' (part of TPR's DB Investment Guidance), which accompanies Code of Practice 3 ('funding defined benefits'). For DC schemes: TPR guidance on 'investment governance', which accompanies Code of Practice 13 ('the DC code').
[154] Many regular performance reports that we have reviewed do not track progress against the trustees' strategic objectives. See, for example, documents provided to clients by [✂] (dated 14/11/2016), [✂] (covering Q4 2016), [✂] (covering Q2 2017), [✂] (dated September 2016), and [✂] (dated May 2017).
[155] TPR's DB Investment Guidance for example emphasises the importance of the scheme's longer-term investment strategy relative to short-term investment manager performance, and encourages trustees to 'focus on the long-term when monitoring investment strategy' (p77).
[156] See, for example, documents provided to clients by [✂] (covering Q2 2017), [✂] (covering Q2 2016) and [✂] (covering Q4 2016).
[157] TPR code of practice 13 ('the DC code').
[158] Code of practice 13 ('the DC code') for example states that trustees are expected to consider the scheme's investment strategy as a whole and not just the performance of underlying funds. The accompanying guide states that 'it is important to consider how the performance has impacted different members or groups of members' (p24).

term funding level developments and an assessment of risk (such as scenario modelling and 'value at risk' analysis). Strategic reviews generally provide detailed analysis on suitable future investment strategies, including (in some cases) the projected flight plan and proposed asset allocation. However, they are generally forward-looking and do not typically analyse historical performance against schemes' strategic objectives.[159]

5.49 For DC schemes, strategic reviews can include detailed analysis of the scheme's funds and recent performance. This may include some simple assessment or discussion of projected member outcomes.[160]

5.50 A number of firms now provide online monitoring tools for their DB clients. A basic service typically enables clients to monitor daily funding levels, with some firms providing optional extras including risk analysis and scenario modelling. We note however that online monitoring tools are not currently provided as standard to advisory clients. Some firms do not provide this service, and clients are generally charged an additional fee or subscription for access.[161] Evidence collected from parties indicates that the number of clients using this service remains relatively low.[162]

5.51 Overall therefore, our evidence indicates that trustees generally have access to clear and regular information on the investment performance of their scheme. This is consistent with evidence from the CMA survey, in which 64% of trustees responded that it is very easy to monitor the overall investment performance of their scheme, and 30% responded that it is fairly easy (2% found it not very easy and 1% found it not at all easy).

5.52 We have, however, identified some areas of concern, including reporting performance on a gross of fees basis and not explicitly monitoring performance against the trustees' strategic objectives. These practices may hinder trustees in accurately assessing the performance of their investments and, in turn, the quality of the advice provided by their investment consultant.

5.53 In terms of reporting gross of fees, Mercer have submitted that the decision to report gross or net of fees depends on client requirements, and that reporting on a gross of fees basis allows for comparison against the manager's stated performance targets. They also make it clear in their

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159 For examples of DB strategic reviews, see documents provided to clients by [✂] (dated 4/8/2017 and 17/6/2015), [✂] (dated 20/10/2016), [✂] (dated 22/10/2015), [✂] (dated 12/1/2015) and [✂] (dated August 2017).
160 For examples of DC strategic reviews, see documents provided to clients by [✂] (dated May 2016), [✂] (dated September 2016) and [✂] (dated November 2014).
161 Responses to CMA market questionnaire.
162 Around a third of [✂] and [✂], and a quarter of [✂], DB advisory clients currently use their online monitoring systems for example.

reporting whether returns are gross or net.[163] KPMG submitted that returns should be reported net of fees, in line with TPR guidance.[164]

5.54 We consider that even in cases where a manager's performance targets are stated on a gross of fees basis, information should also be available on a net of fees basis wherever possible, as this is the return that is received by the client. This is particularly true when aggregating across all managers to calculate overall scheme returns; ie it is important that trustees have sight of overall returns on a net of fees basis. The ability to report in this way should be aided by the introduction of MiFID II and the IDWG fee templates.

5.55 In terms of monitoring performance against strategic objectives, WTW have submitted that in an advisory model, trustees may not have a set goal or objective for fund performance.[165] In WTW's view it is therefore challenging to provide performance information that allows trustees to track progress towards that goal.[166]

5.56 Our view however is that it should be incumbent on trustees to develop clear strategic objectives for their scheme. To assess the quality of their investment consultant's advice, we would expect trustees to have a clear sense of what they are trying to achieve, and how this will be measured. Part of the role of an effective investment consultant is in helping trustees to establish such parameters.

5.57 This is consistent with the views expressed by Cardano for example, who noted that a greater focus on outcomes, with clear objectives in place including performance targets relating to liabilities, would help trustees to hold their managers and investment consultants to account.[167] TPR guidance also states that DC scheme trustees should assess advisors' and service providers' performance 'against documented targets, measures and/or objectives on a regular basis' (see Appendix 3).[168]

5.58 We note that in fiduciary management, providers may be set clear strategic objectives as part of the IMA.[169] This helps trustees directly to monitor and

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[163] Mercer response to the fees and quality working paper.
[164] KPMG response to the fees and quality working paper.
[165] WTW response to the fees and quality working paper.
[166] Section 223 and section 244 of the PA04 require trustees to prepare, maintain and revise the Statement of Funding Principles (SFP) and the Statement of Investment Principles (SIP) respectively. The SFP should set the trustees' policy for meeting the statutory funding objective without specifying it. The SIP should cover trustees' policies relating to expected return on investments alongside other information on the current asset allocation and asset managers. Indeed, our document review indicates that the SIP often contains clear information on the expected investment return objectives. However, trustees rarely mention their long-term funding target.
[167] Cardano hearing summary.
[168] TPR guidance on 'scheme management skills' (accompanying code of practice 13).
[169] See, for example, investment management agreements signed by [✂] (dated December 2016), [✂] (dated December 2014 and May 2016) and [✂].

assess the performance of their provider. In many circumstances, we consider that performance-related targets would also be appropriate in investment consultancy. In other cases, eg if the investment consultant is hired to advise on a specific issue, broader qualitative objectives may be appropriate.

5.59 Some parties have submitted that investment consultants should provide more detailed performance information to current clients. The Investment Association submitted that performance reports should separately demonstrate the relative impact of strategic asset allocation advice and manager selection advice.[170] We have found however that it can often be very difficult to meaningfully separate these two components, and so estimating their individual contributions to overall performance can be extremely challenging.[171]

5.60 Bfinance submitted that we should clearly distinguish between information on scheme performance and consultant performance.[172] In our view, scheme performance can generally be used as an outcome measure against which the quality of advice provided by the consultant can be evaluated. As noted above, this is greatly facilitated if the trustees and their investment consultant have agreed a clear set of objectives that they are trying to achieve.

Prospective clients

5.61 When tendering for investment consultancy services, trustees typically ask questions relating to quality of service factors and for previous examples of successful investment advice or ideas. The level of detail in both the tender and responses varies considerably, ranging from short descriptions to detailed case studies and client testimonies.[173]

5.62 The focus on these qualitative factors likely reflects trustees' preferences, and the factors that are most important to them. Trustees want to understand which firm best understands their needs and has a positive track record of working with similar clients. As noted by Mercer, some of the factors that are valuable to trustees are best demonstrated through case studies and client feedback.[174] The CMA survey results indicate that trustees generally feel

[170] The Investment Association response to the fees and quality working paper.
[171] In our document review for example we have reviewed a case in which the consultant ([✂]) proposed that the scheme adopt an LDI strategy. As part of the move into LDI, the consultant provided details (and recommendations) on two alternative LDI managers. Such advice includes elements of both asset allocation and manager selection.
[172] Bfinance response to the fees and quality working paper.
[173] For example, [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2017), [✂] response to an invitation to tender (dated [✂] 2017), [✂] response to an invitation to tender (dated [✂] 2017).
[174] Mercer response to the fees and quality working paper.

that they can understand and compare the overall quality of each proposal when tendering for investment consultancy services.[175]

5.63 Qualitative responses and case studies however do not enable like-for-like comparisons across providers, particularly regarding the quality of their investment advice. In our document review we have seen very few tenders in which firms have submitted explicit quantitative evidence of their investment abilities.[176] In each case this has related to the performance of recommended asset managers.[177] This information (together with related information on proprietary funds or fund-of-funds) has also been distributed via marketing materials, such as magazine features and conference presentations, and is available on the website of some providers.[178] We consider the comparability and accuracy of this information below.

We have seen very few tenders in which firms have given explicit, quantitative evidence of their investment abilities.

Information on asset manager product recommendations

5.64 As noted in paragraph 5.63, it is not common for investment consultancy firms to submit quantitative evidence of their investment abilities in tenders. Where they have done so, this has related to the performance of their recommended asset management products. This information has also been used by firms in marketing materials and is relatively common in fiduciary management tenders. In a number of cases the firm has indicated that their recommended or proprietary funds have 'added value' or outperformed relevant benchmarks.[179]

5.65 There are three main approaches used by firms to present the performance of their recommended asset management products:

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[175] 31% of trustees found it very easy to understand and compare the overall quality of each proposal and 51% found it fairly easy. 4% found it not very easy and 2% found it not at all easy (10% answered don't know and 2% not applicable).
[176] The CMA survey results indicate that many trustees find it difficult to compare the investment track record of rival consultants when tendering for investment consultancy services. Just 21% of trustees found it very easy and 35% found it fairly easy to understand and compare the investment track record of rival investment consultants when tendering. 19% found it not very easy and 7% found it not at all easy (11% answered don't know and 7% not applicable).
[177] For example, [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2017).
[178] Responses to CMA market questionnaire.
[179] See, for example, a document produced in 2016 by [✂], [✂] response to an invitation to tender (dated [✂] 2017), a document produced in August 2017 by [✂], a 2016 document produced by [✂].

(a) A comparison of the aggregate performance of 'buy rated' products against their respective benchmarks over a specified number of years.

(b) A comparison of the performance of 'buy rated' products to 'sell rated' products over a specified number of years, and

(c) The construction of a 'model portfolio' to show the performance of products the firm's consultants would select if they had no constraints.

5.66 We note that a number of providers have also presented information on the historical performance of their 'multi-asset funds' (also known as 'portfolios', 'strategies' or 'fund-of-funds') in marketing materials and in presentations to clients.[180] This typically includes information on both the risk and return of the fund over a particular period, often compared to market benchmarks or similar funds offered by other providers.[181]

5.67 Based on our review of these materials, we have identified a number of factors that make it difficult for trustees accurately to assess each provider's ability to select asset management products that outperform their benchmarks. As identified by our empirical analysis (Appendix 2), a particularly important factor is whether information is presented gross or net of fees. The implied success of the product recommendations can be substantially affected by this distinction: gross returns are more likely to have beaten the benchmark, but it is net returns that are ultimately achieved by pension schemes.

It is important whether investment performance is presented net or gross of fees.

5.68 There is a lack of consistency across firms in this regard, and in some documents, it is not clearly stated whether the information being presented is gross or net of fees.[182] If the fee basis is not clear, trustees may make investment decisions based on the incorrect belief that the (gross) returns

[180] Responses to CMA market questionnaire and information requests.
[181] Multi-asset funds typically comprise products offered by a number of asset managers. Information on the performance of such funds is therefore conceptually similar to information on the performance of recommended asset management products. In some documents this link is made explicitly, for example by discussing the manager research capabilities of the firm and their interactions with managers.
[182] This is the case for both marketing materials and tender documents. For example, a response from [✂] to a tender in [✂] 2015 reported the performance of their recommended asset managers on a gross of fees basis. A response from [✂] to the same tender in [✂] 2015 did not state whether performance was gross or net of fees. A 2016 document produced by [✂] did not indicate whether returns were gross or net of fees; a 2016 document [✂] was reported 'net of fees where available'; a 2016 document regarding the [✂] hedge fund composite was reported 'net of management fees [and others]' but 'gross of [✂] fees'. A document produced in August 2017 by [✂] regarding the performance of their [✂] was presented on a gross of fees basis.

represent the (net) returns that they would have achieved had they invested in the particular product or fund.

5.69 A number of parties have responded on the issue of gross versus net reporting of recommended products.[183] Mercer submitted that gross of fees information is more informative as it enables investors to assess whether the firm has a reliable system in place for identifying managers that can outperform a passive benchmark.[184] It is asset managers' fees that absorb outperformance, and consultants can help trustees to reduce those fees.

5.70 Relatedly, Mercer, Redington and WTW all stated that there are complications with estimating average asset management fees.[185] WTW submitted that investment consultants do not have visibility over asset management fees in all asset classes, and therefore need to rely on assumptions that may not be correct. Hymans, Mercer and WTW all noted that fees vary considerably on a client-by-client basis for example, and some clients pay considerably lower fees than average (and lower than those applied in the CMA analysis).[186]

5.71 KPMG however submitted that net of fees information is more representative of the 'real world' experience of clients, and that fees can materially distort a product's apparent investment performance.[187] Redington submitted that returns should be shown on a net of asset-weighted fees basis,[188] and PLSA submitted that an informative approach would be to deduct fees from both the return of the product and the benchmark.[189] PLSA note however that this would be complicated in practice. Bfinance and JLT submitted that information on both gross and net of fees performance should be presented.[190]

5.72 Aside from the issue of fees, we have identified several other factors that distort the reported performance of recommended asset management products. We summarise each of these factors here, and further details are provided in Appendix 2.

(a) **Survivorship bias**: Some of the methodologies used are subject to survivorship bias, as products that are not recommended for the entire

[183] In this section we consider parties' submissions on asset manager product recommendations that relate to the way in which information is presented. In Appendix 2 we address submissions that relate to the technical aspects of our quantitative analysis.
[184] Mercer response to the asset manager product recommendations working paper.
[185] Mercer, Redington and WTW responses to the asset manager product recommendations working paper.
[186] Hymans, Mercer and WTW responses to the asset manager product recommendations working paper.
[187] KPMG response to the asset manager product recommendations working paper.
[188] Redington response to the asset manager product recommendations working paper.
[189] PLSA response to the asset manager product recommendations working paper.
[190] Bfinance and JLT responses to the asset manager product recommendations working paper.

period shown are removed from the analysis.[191] This may inflate the apparent performance of the recommended set of products.

(b) **Backfill bias**: This may occur if products are only added to a database after a certain period of time; those that perform well may be added, whilst those that perform poorly are unlisted. This may inflate the performance of products in the database.

(c) **Simulated returns**: The (hypothetical) historical performance of new products in the database may be 'simulated' using statistical techniques. Such techniques might be used to produce strong historical returns in order to attract prospective investors.

(d) **The inclusion of all recommended products and asset classes**: We have reviewed some tender documents in which a firm presented the performance of its recommended products in a subset of asset classes.[192] This may be misleading if firms only show those products or asset classes that have performed particularly well.

(e) **Time periods**: Different providers use a variety of different time periods over which they show the performance of their recommended products. This makes it more difficult for trustees to directly compare different providers.

5.73 These factors, and the fact that different providers account for them in different ways, make it difficult for trustees to assess the ability of each provider to select the most competitive asset management products.

Fiduciary management clients

Information on fees

Current clients

5.74 Almost all fiduciary managers use some form of *ad valorem* pricing (ie in which fees are a percentage of assets under management). The most common fee structure is a flat percentage fee for the 'core' fiduciary management service – including investment advice and implementation –

[191] When presenting the performance of products over 10 years for example, some methodologies only consider a product to be 'recommended' if it was recommended for the entire 10-year period. This is likely to inflate the performance of the 'recommended' products, as those products that performed poorly are likely to have been removed from the buy-list during the 10-year period. We consider that some of the analysis submitted by [✂] to the CMA regarding the performance of its asset manager recommendations is likely to be subject to survivorship bias.
[192] See, for example, a bid submitted by [✂] to a tender in March 2015.

and variable percentage fees for asset management services. The latter will vary depending on the particular investments in the portfolio, and, in many cases, will ultimately be paid to third party asset managers.

5.75 Some providers instead offer their clients a completely fixed all-in fee, which is also typically charged as a percentage of assets. The all-in fee covers both the core fiduciary management service and asset management services. This pricing structure is more common amongst providers that are also asset managers.

5.76 The main sources of fee information for current clients are the initial contract signed by the trustees and the provider, often known as an IMA, and regular invoices or fee statements. Due to the coming into force of MiFID II on 3 January 2018, many providers are also introducing additional ‘MiFID cost and disclosure statements’ or equivalent for their clients. However, not all fiduciary management activities/providers are governed by the MiFID II regime.[193]

5.77 We cover each of these sources of information in turn. We concentrate in particular on DB clients, highlighting any significant differences for DC clients where relevant.

Investment Management Agreements

5.78 The initial contract sets out the agreed fee schedule, with the level of detail reflecting the particular fee structure that is used.[194] Where the client pays an all-in fee for example, the contract may simply state the overall percentage figure. In other cases, the contract may state an agreed (fixed) percentage fee for the core fiduciary management service, and an approximate (variable) percentage fee for asset management products. In some cases, the IMA includes a list of charges on a fund-by-fund basis.

5.79 We note that MiFID II has implications for the information that providers must disclose prior to agreeing a contract with a new client. This is discussed in further detail below (paragraphs 5.86 to 5.90).

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[193] As noted in the legal and regulatory framework section in chapter 3, the MiFID II regime applies only in respect of the financial instruments specified in the MiFID II Directive (paragraph 3.48(c) and footnote 37) and some firms are exempt from MiFID II as they are subject to the regulatory regime applied by a designated professional body (paragraph 3.49 and footnote 38).
[194] See, for example, investment management agreements signed by [✂] (dated [✂] 2016), [✂] (dated [✂] 2014 and [✂] 2016) and [✂].

Regular invoices and fee statements

5.80 To the best of our knowledge, all firms now provide their fiduciary management clients with regular invoices or fee statements, although we note that some suppliers have only recently begun to do so.[195] There is significant variation across both firms and clients however in terms of the fees that are included in such statements, and the level of disaggregation.

5.81 In terms of the inclusion criteria, we note that many fees are deducted directly from the client's assets rather than invoiced separately. In many cases these deductions are not included in regular fee statements.[196] Such deductions often include some or all asset management costs, particularly if such costs are paid to third parties. We note that a number of firms also do not include performance fees and transaction costs in their regular fee statements to clients.[197]

Many clients are not regularly notified of the fees they pay their fiduciary management provider for investment products.

5.82 Many clients are, therefore, not regularly notified of the fees they pay their provider for the asset management products in their portfolio. Based on our client document review and information requests for example, we understand that many of [✂] and [✂] fiduciary management clients do not receive information on asset management charges in their regular fee statements. Further, [✂] and [✂] do not include information on all third-party management fees to all their clients in their regular invoices/fee statements.

5.83 In terms of the level of disaggregation, we have found that practice varies considerably across providers. For clients that pay an all-in fee for example, [✂] and [✂] do not itemise their fee statements; both the core fiduciary management fee and the asset management fees are included but are not disaggregated.[198] At our trustee roundtables, some trustees noted that bundled (all-in) fees are common for small schemes using fiduciary

[195] [✂] has recently updated its fee reporting practices, and previously did not provide its fiduciary management clients with regular invoices (as fees and expenses are deducted on a monthly basis from clients' assets and so clients are not required to make a separate payment). Source: responses to CMA information requests.
[196] Responses to CMA market questionnaire and CMA information requests.
[197] Responses to CMA information requests.
[198] Responses to CMA information requests.

management.[199] In our document review we have also reviewed several cases in which the client receives aggregated invoices or fee statements.[200]

5.84 A number of providers (including [✂] and [✂]) itemise overall asset management costs in their regular fee statements for at least some of their fiduciary management clients.[201] Other providers (including [✂] and [✂]) provide partially disaggregated asset management costs.[202] [✂] for example disaggregates asset management charges into 'return seeking' and 'liability hedging' assets. This reflects the fact that the two types of asset can incur very different charges, with return seeking assets typically being costlier than liability hedging assets.

5.85 Finally, some providers itemise asset management fees on a fund-by-fund basis for at least some of their full fiduciary management clients. This includes [✂], [✂]and [✂].[203]

MiFID II requirements and implementation

5.86 A number of parties are in the process of updating their reporting practices to comply with MiFID II, which came into force on 3 January 2018. For firms subject to that regime, MiFID II has implications for both the ex-ante and ex post reporting of costs and charges.[204]

MiFID II has implications for both the ex-ante and ex-post reporting of investment costs and charges.

5.87 The key requirements are summarised here:

(a) Firms must disclose, in good time, all costs and associated charges, including charges relating to investment services, the cost of any advice and the cost of financial instruments recommended or marketed to the client, also encompassing any third-party payments. Where applicable, such information must be provided on a regular basis, and at least annually, during the life of the investment.[205]

[199] Trustee roundtable summary.
[200] See, for example, invoices provided to clients by [✂] (dated 23/10/2017), [✂] (dated 12/10/2017), [✂] (dated 24/10/2017) and [✂] (dated 16/1/2017).
[201] Responses to CMA information requests.
[202] Responses to CMA information requests.
[203] Responses to CMA information requests.
[204] Article 24(4) MiFID II Directive 2014/65 and Articles 46, 50 and 60 MiFID II Delegated Regulation 2017/565.
[205] Article 24(4)(c) MiFID II Directive 2014/65.

(b) All costs and charges must be aggregated, with an itemised breakdown being provided if requested by the client.[206] The aggregated costs and charges must be expressed both as a cash amount and as a percentage.[207]

(c) In both the ex-ante and ex post disclosure, firms providing investment services must provide an illustration of the cumulative effect of costs on the returns of the investment.[208]

(d) Any material change to the information provided on ex ante or ex post costs and charges must be notified to the client 'in good time'.[209]

5.88 We also note that additional ex post reporting requirements are imposed on firms offering 'portfolio management' services, which constitutes the core investment service provided under fiduciary management arrangements.[210] Firms that provide portfolio management services must provide each client with a periodic statement[211] that covers (among other matters) the performance of the portfolio during the reporting period and includes the total amount of fees and charges incurred during the reporting period, itemising at least (i) total management fees and (ii) total costs associated with execution; it must also include, where relevant, a statement that a more detailed breakdown will be provided on request.[212]

5.89 Based on an information request issued to parties, there appears to be significant variation in how firms are proposing to implement the MiFID II fee reporting requirements.[213] A number of providers are planning to go beyond the minimum requirements set out above. [✂], [✂] and [✂] for example are all proposing separately to itemise the core fiduciary management fee and overall asset management fees (sometimes labelled as 'service costs' and

[206] Article 24(4) MiFID II Directive 2014/65.
[207] Article 50(2) MiFID II Delegated Regulation 2017/565.
[208] Article 50(10) MiFID II Delegated Regulation 2017/565.
[209] Article 46(4) MiFID II Delegated Regulation 2017/565.
[210] 'Portfolio management' means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments that are covered by MiFID II (Article 4(1)(8) and (15) and Annex I, Section C MiFID II Directive 2014/65).
[211] Unless such a statement is provided by another person (Article 60(1) MiFID II Delegated Regulation 2017/565).
[212] Article 60(2)(d) MiFID II Delegated Regulation 2017/565. We understand that the reference to management fees covers the explicit fees of the fiduciary management provider and (as applicable) any asset management fees for the service of taking discretionary decisions in respect of the investment of the portfolio. We understand also that the reference to execution costs covers those costs incurred in giving effect to the discretionary decisions; that is, the implicit costs of processing client orders and making investments and these will vary by transaction.
[213] As MiFID II came into force in January 2018, the ex-ante reporting requirements should already have been complied with. As ex post information on costs and charges must be provided at least annually, however, some firms have indicated that they are yet to implement those requirements.

‘product costs’). Within these categories, some providers will also indicate one-off charges, ongoing charges, transaction costs and incidental costs.

5.90 Other providers have indicated that they will comply with the MiFID II requirements by providing aggregated information on all costs and charges to their clients (with further information available upon request). This includes [✂] and [✂].[214] [✂] has submitted that they will comply with the reporting requirements as set out in the FCA Handbook.[215]

- *Our assessment of the evidence*

5.91 Our evidence shows that many fiduciary management clients receive clear and regular information on the overall cost of the service they receive, although in many cases regular fee statements do not include all costs incurred by the client.[216] MiFID II ensures that most clients should receive this information at least annually. We note that MiFID II requires firms to provide a broad aggregation of *all* costs and charges – including transaction costs, performance fees and fees paid to third parties.[217]

5.92 Our evidence indicates that there is no consistent approach to the itemisation of fees across providers, particularly asset management fees. Many clients receive aggregated fee statements, which include both the core fiduciary management fee and asset management charges.[218] A number of providers have indicated that they will provide aggregated fee disclosures in order to comply with MiFID II.

5.93 We consider that aggregated (or ‘bundled’) fee statements make it difficult for trustees fully to assess the value for money of their provider. In particular, we consider that the core fiduciary management fee (covering advice and implementation) and asset management fees should be itemised separately in regular fee statements.

5.94 It is the role of the fiduciary manager to identify competitive asset management products, and to negotiate fees on behalf of their clients. Our analysis has found that in practice such discounts can be considerable.[219] Trustees therefore require access to information on the costs of their portfolio to be able fully to assess their provider’s performance. Disaggregating each of the core fiduciary management fee, asset

[214] Responses to CMA information requests.
[215] Responses to CMA information requests.
[216] See paragraphs 5.81 to 5.82.
[217] Article 24(4)(c) MiFID II Directive 2014/65 and Articles 50 and 60 MiFID II Delegated Regulation 2017/565.
[218] See paragraph 5.83.
[219] See paragraphs 9.53 to 9.65.

management fees and other charges would additionally help trustees to monitor the competitiveness of their fiduciary management service against (say) the alternative of a purely advisory arrangement.

5.95 Our evidence has also shown that where asset management fees are itemised separately, or where firms are proposing to do so as part of their MiFID II reporting practices, such costs are not often disaggregated on a fund-by-fund basis.[220] Given the range of products in each client's portfolio, and the typically large variation in both performance and cost, this information is important to help trustees assess the quality of the portfolio selected by their provider.

5.96 We note for example that advisory clients are provided with this information directly from their asset managers, and the transparency of this information (for advisory clients) should be enhanced by MiFID II and the templates being produced by the IDWG. We consider that fiduciary management clients should have access to comparable information.

5.97 The CMA survey found mixed results in terms of the ease with which trustees can monitor the fees paid for their fiduciary management service:

(a) 45% of trustees found it very easy to monitor the fees paid to their fiduciary manager; 37% found it fairly easy; 11% found it not very easy and 2% found it not at all easy (4% don't know and 1% not applicable).

(b) 24% of trustees found it very easy to monitor the fees paid to third parties; 40% found it fairly easy; 22% found it not very easy and 4% found it not at all easy (4% don't know and 5% not applicable).

Just 24% of trustees found it very easy to monitor investment fees paid to third parties – CMA survey.

5.98 WTW have submitted that the CMA survey results indicate that trustees generally find it easy to monitor fees.[221] We agree that a large proportion of trustees responded that it is very easy or fairly easy to monitor the fees paid to their fiduciary manager. However, a quarter of respondents indicated that they did not find it easy to monitor third party fees. We consider this to be a relatively high percentage, and as noted in paragraph 5.12, fees are set on an individual basis. Therefore, those who are not able to monitor the fees

[220] See paragraphs 5.84 and 5.89.
[221] WTW response to the information on fees and quality working paper.

that they pay are not 'protected' from paying high prices from those who are able to monitor their fees.

5.99 Further, our document review and submissions from parties have demonstrated that many clients do not receive regular information on the fees they pay to third parties.[222] It is our view that all trustees should have insight into all fees paid throughout the value chain, in particular those paid for their asset management products.

5.100 This is supported by responses from a number of parties. Baillie Gifford and Hymans have both submitted that they are concerned about the 'bundling' of fees in fiduciary management.[223] Baillie Gifford submitted that providing aggregate costs without appropriate granularity prevents current or potential customers from assessing the value for money of all components of the service.[224]

5.101 Hymans submitted that unbundling fees for 'strategic advisory services' and asset management services is necessary to enable trustees to assess separately the provision of strategic advice and asset management, and to appoint separate firms for these two roles if they wish to do so. This is important for retaining and enhancing the competitive landscape. [225] WTW has submitted that the bundling of fiduciary management fees with underlying asset management fees could create incentives for fiduciary management providers to appoint the cheapest (rather than best) asset managers to improve their fee share to the detriment of the client.[226]

5.102 To summarise, we have found that fee reporting practices vary widely in fiduciary management. Many clients receive regular information on the overall costs of the service, and we expect that shortfalls in this area will generally be covered by MiFID II. We have also found however that many clients do not receive clear and regular information on the fees they pay throughout the value chain, particularly for their asset management products and funds. Access to this information is important for trustees to assess whether their underlying funds are competitive.

In fiduciary management, fee reporting practices vary widely.

[222] See paragraphs 5.81 to 5.82.
[223] Baillie Gifford and Hymans responses to the information on fees and quality working paper.
[224] Baillie Gifford response to the information on fees and quality working paper.
[225] Hymans response to the information on fees and quality working paper.
[226] WTW response to the information on fees and quality working paper.

Prospective clients

5.103 Our document review indicates that, although fee information in fiduciary management tenders is generally more standardised and comparable across competing providers than in investment consultancy, there are some factors that make it challenging to compare fees on a like-for-like basis.

5.104 Fiduciary management tenders make widespread use of ad valorem pricing and the categorisation of services into the core fiduciary management elements of advice and implementation, and asset management elements. Common categories into which fiduciary management fees are itemised include (i) the core fiduciary management fee, (ii) the overall investment management fee, (iii) transition costs (discussed further below), (iv) custodian costs, and (v) other costs.[227]

5.105 The presentation of fees appears to be particularly clear when trustees use a TPE. In the cases we have reviewed, TPEs typically require firms to complete a specified table with well-defined breakdowns of their proposed fees. It is also explicitly stated which metrics (eg time-periods) should be used to complete the table.[228] This generally allows for direct comparisons of fees across the various bids. A stylised example of a fee table used in a tender run by a TPE is provided here.

Table 1: Fiduciary management fees in tenders – typical breakdown when using a TPE

	Fee (per annum)
Fiduciary management fee	
Investment management fee	
Transition fee	
Custodian fee	
Other fees	
Total	

Source: CMA tender documents review

5.106 Although we have reviewed some examples of good practice, we have identified several factors that could make it difficult for trustees fully to assess and to compare on a like-for-like basis the fees charged by each provider. First, we have found that the overall cost of the service is often not

[227] For example, [✂] response to an invitation to tender (dated [✂] 2016), [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2017), [✂] response to an invitation to tender (dated [✂] 2016).
[228] For example, [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2016), [✂] response to an invitation to tender (dated [✂] 2016).

indicated in firms' responses.[229] This basic information is important to help trustees assess the full cost of the service they are purchasing.

Prospective customers often do not see the overall cost of a fiduciary management service in tenders.

5.107 As discussed in paragraphs 5.86 to 5.87, MiFID II requires this information to be provided to prospective clients prior to entering into the contract. This includes stating the fee in both cash and percentage terms, and illustrating the cumulative effect of costs on the returns of the investment. We consider that this information would help trustees to make informed decisions at the point of tendering (including making an assessment of the overall value for money of a fiduciary relative to advisory arrangement).

5.108 We have also found that the level of detail on the underlying asset management fees can vary considerably across bids. We have seen examples where firms provide trustees with a detailed breakdown of the asset manager fees for the proposed portfolio.[230] In some cases however the bid included only an overall (all-in) fee for both fiduciary management and asset management services.[231] Some other bids have not indicated the overall asset management fees that the client will likely incur (some bids include no information on asset management costs).[232]

5.109 As asset management fees account for a considerable proportion of the overall fee, a lack of information on these fees makes it very difficult to assess the overall cost of the proposal. The use of different approaches across rival bids also makes direct comparisons of each element of the overall service more challenging.

5.110 Trustees at our roundtables who had bought fiduciary management services stated that good fee information was particularly important at the point of selecting a provider, and trustees supported standardisation of fee information at tendering. Trustees noted that they would like to know the total fee that would be paid. Many trustees also thought that this information should be provided on a regular basis and that this would particularly help

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[229] For example, [✂] response to an invitation to tender (dated [✂] 2016), [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2015).
[230] For example, [✂] response to an invitation to tender (dated [✂] 2016), [✂] response to an invitation to tender (dated [✂] 2015).
[231] For example, [✂] response to an invitation to tender (dated September 2015), [✂] response to an invitation to tender (dated April 2016), [✂] response to an invitation to tender (January 2016).
[232] For example, [✂] response to an invitation to tender (dated [✂] 2016), [✂] response to an invitation to tender (dated [✂] 2015).

schemes whose trustees did not have the expertise needed to demand this information.[233]

5.111 Although many tender documents request information on the estimated transition/entry fee into the proposed service (as indicated in Table 1), we have found that this can be interpreted by firms in a variety of ways. Some firms provide an estimate of the overall costs of transferring the underlying assets into the proposed portfolio.[234] Other firms indicate only the cost of the 'onboarding services' that they provide.[235] The difference in cost is significant. Whilst the cost of transferring assets could typically be in the range of 0.1% to 1% of assets (see chapter 6), onboarding services are usually included in the core fiduciary management fee.

5.112 Whilst we recognise that clients are generally provided with information on transition costs before assets are ultimately transferred, such costs are often not indicated in tenders.[236] Given that these costs are generally significant, and will vary depending on each provider's proposed portfolio, this is relevant information when choosing between alternative providers. If the client is moving into fiduciary management for the first time, an early indication of these costs can also help trustees make an informed decision as to the relevant costs and benefits of the advisory and fiduciary models.

5.113 As discussed in detail in chapter 6, we also note that similar costs may be incurred when exiting a fiduciary management arrangement. However, these costs are not necessarily equivalent, and in some cases, may be higher than the costs of entry.[237] We consider that both the entry and exit costs are important pieces of information for prospective clients, although we have seen no instances to date in which firms indicate these potential exit costs when tendering for fiduciary management services. Some trustees at our roundtables were concerned that information on transition costs and exit charges were poorly disclosed at tendering.[238]

[233] Trustee roundtable summary.
[234] For example, [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2015).
[235] By 'onboarding services' we mean the explicit (one-off) costs that the firm charges the client. This could include fees charged to assist in the transitioning of assets or one-off advice. See, for example, [✂] response to an invitation to tender (dated [✂] 2015), [✂] response to an invitation to tender (dated [✂] 2015).
[236] We have reviewed examples whereby clients were provided with detailed information on such costs before the transition of assets took place, and examples where the client received a detailed ex post evaluation of the transition process. See, for example, documents provided to clients by [✂] (dated January 2016), [✂] (dated November 2014) and [✂] (dated October 2016).
[237] We have heard for example that fiduciary managers may use more complex investment portfolios than those recommended by investment consultants which could increase the cost of switching (LCP response to the trustee engagement working paper).
[238] Trustee roundtable summary.

5.114 As was the case for current clients, the CMA survey results indicate that although many trustees found it very or fairly easy to compare fees, a relatively high proportion of trustees have difficulty in understanding and comparing the fees paid to third parties:

(a) 32% of trustees found it very easy to compare the fees payable to the fiduciary manager; 52% found it fairly easy; 11% found it not very easy and 1% found it not at all easy (3% don't know and 1% not applicable).

(b) 15% of trustees found it very easy to compare the fees payable to third parties; 50% found it fairly easy; 28% found it not very easy and 2% found it not at all easy (3% don't know and 2% not applicable).

5.115 Given that fiduciary management fees can represent a substantial proportion of a pension scheme's total costs, it is extremely important that trustee boards are easily able to assess and compare the fees of alternative providers. This includes assessing the value for money of different providers at each level of the value chain (eg both for the fiduciary management and asset management products/services). Our document review indicates that although there are many examples of good practice, in many cases it is difficult accurately to compare rival bids.

5.116 As discussed in chapter 6, we have also found that the cost of switching fiduciary management providers can be substantial, and the nature of the relationship (including the use of journey plans and long-term objectives) implies that most appointments can be expected to last for several years. It is therefore critical that trustees can make fully informed decisions when appointing a new provider.

5.117 Our views are supported by some parties: WTW submitted that some clients may find it difficult to compare the fees of alternative providers.[239] It stated that the bundling of the fiduciary management fee with third party fees and the use of performance fees can make it difficult for clients to gauge the cost of each provider. Aon commented that there is not a single approach to fee structure across the fiduciary management space and this makes it difficult for trustees to compare the fees of different providers.[240]

5.118 Charles Stanley submitted that fee illustrations for prospective clients should contain an accurate annual estimate of all fees to be paid by the client, including both those paid to the fiduciary manager and third parties.[241] Law

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[239] WTW responses to the information on fees and quality working paper.
[240] Aon hearing summary.
[241] Charles Stanley response to the information on fees and quality working paper.

Deb submitted however that it is generally becoming easier to compare fiduciary management providers' fees.[242]

Information on quality

Current clients

5.119 Performance information is similar in fiduciary management to investment consultancy, with clients receiving regular updates through performance monitoring reports, and more detailed analysis during strategic reviews. Further, many firms now include access to online monitoring tools as standard for their fiduciary management clients. These tools enable clients to monitor funding levels on an ongoing basis, with additional functionality including scenario modelling, risk analysis and asset valuation.[243]

5.120 Our document review indicates that the information included in regular performance reports is generally clearer and more detailed in fiduciary management than investment consultancy. For DB clients, there is a greater focus on long-term funding level developments, with many reports explicitly tracking performance against the trustees' strategic benchmarks.[244] In some cases progress is tracked against explicit performance targets that the provider has been set.[245]

5.121 This 'strategic' overview of performance appears to be more common in fiduciary management than investment consultancy because clear investment objectives are typically set out in the initial contract (the IMA). This can include targets for the overall funding level development, often known as a 'flight path', and pre-agreed de-risking triggers. As fiduciary management is a delegated service, the provider is more directly accountable for the performance of the scheme; this accountability is reflected in many of the performance reports that we have reviewed.

5.122 Fiduciary management performance reports are also more likely to include information on both scheme risk and performance attribution (ie the contribution of different parts of the portfolio to overall returns). The former can include information on the tracking error, volatility, scenario analysis and hedging analysis.

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[242] Law Deb hearing summary.
[243] Responses to CMA market questionnaire.
[244] See, for example, documents provided to clients by [✄] (covering Q2 2017), [✄] (covering Q3 2017) and [✄] (covering Q4 2016).
[245] See, for example, a document provided to a client by [✄] (covering Q3 2017).

5.123 Our document review indicates that trustees using fiduciary management services are generally provided with clear and regular information on the performance of their scheme. This is consistent with the results of the CMA survey, in which 63% of respondents found it very easy to monitor the performance of their scheme or investments, and a further 29% found it fairly easy (1% found it not very easy and 1% found it not at all easy; 4% don't know and 2% not applicable).

5.124 As in investment consultancy, our document review indicates however that some performance reports use gross of fees returns for the products or funds in the portfolio.[246] As discussed in paragraph 5.67, this may give a misleading impression of the true performance of each fund once costs have been deducted. We note that TPR guidance states that trustees should consider the impact of asset managers' fees on investment returns.[247]

5.125 We consider that providers should report on a net of fees basis when tracking scheme performance against strategic targets (eg in quarterly monitoring reports), and when presenting the performance of the underlying funds in the portfolio.

5.126 Charles Stanley have submitted that performance information is currently provided in a variety of different formats by fiduciary managers.[248] They submit that it is important that two pieces of information are provided separately: overall scheme performance against target, and the performance of the growth and matching (eg hedging) portfolios against their respective benchmarks. The first allows trustees to assess whether overall performance is on track, the second allows trustees to assess how well the provider's investment team are performing.

5.127 We agree with the principle that disaggregated performance information is important in helping trustees to assess the quality of their provider. Our document review however indicates that information on the performance of the various components of the portfolio is already typically provided in regular monitoring reports.[249] We therefore do not consider that trustees currently lack access to the necessary information in this regard.

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246 See, for example, documents provided to clients by [✂] (covering Q2 2017) and [✂] (covering Q3 2016/17).
247 For DB schemes: TPR guidance on 'monitoring DB investments' (part of TPR's DB Investment Guidance), which accompanies Code of Practice 3 ('funding defined benefits'). For DC schemes: TPR guidance on 'investment governance', which accompanies Code of Practice 13 ('the DC code').
248 Charles Stanley response to the information on fees and quality working paper.
249 Performance reports include performance on a fund-by-fund or asset class basis.

Prospective clients

5.128 Our document review indicates that the majority of fiduciary management tenders ask firms to provide information on their investment track record. The most common questions relate to the historical investment performance of the firm's full fiduciary management clients ('FM track records') and the performance of their recommended asset management products.[250]

5.129 We have found that the responses to these questions are not generally comparable on a like-for-like basis. There are two main reasons for this. First, performance-related questions in the tender are often insufficiently detailed to elicit comparable answers. Firms may be asked for example to 'demonstrate' how they have added value in manager selection, or for 'evidence' of their track record for 'relevant' mandates. Responses to such questions are typically descriptive, with technical aspects often not well defined or explained.[251]

5.130 Second, firms use a variety of measures and methodologies to demonstrate their FM track record.[252] Table 2 summarises the methodologies used by the seven largest providers. Whilst most providers focus on the changes in the average funding level of their clients, the time period over which this is presented varies considerably. We also note that the calculation of the average varies across firms, with some taking a simple (equally weighted) average, and others taking a weighted average.

Fiduciary management providers use very different ways of measuring investment outcomes to demonstrate their performance to prospective clients.

5.131 There are therefore significant differences across providers in both the outcome measures used (such as the measure of 'success' and over what time period) and the specific steps taken to calculate such measures. We recognise that firms may use different approaches for valid reasons, although these differences can make direct comparisons across providers extremely challenging.

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[250] For example, [✂] response to an invitation to tender (dated [✂] 2016), [✂] response to an invitation to tender (dated [✂] 2014), [✂] response to an invitation to tender (dated [✂] 2016), [✂] response to an invitation to tender (dated [✂] 2016).

[251] For example, [✂] response to the invitation to tender (dated [✂] 2014), [✂] response to an invitation to tender (dated [✂] 2014), [✂] response to an invitation to tender (dated [✂] 2014), [✂] response to an invitation to tender (dated [✂] 2015).

[252] We discuss the reporting of recommended asset management products in paragraphs 5.64 to 5.73.

Table 2: Comparison of 'FM track record' methodologies.

Firm	*Outcome Measure*	*Time-period*	*Weights*	*Fees*	*Comparators*
[✂]	Funding level	2008 -	Asset-weighted	Net	PPF Purple book schemes
[✂]	Funding level	Calendar year + each year over the past 6 years	Equal	Net	PPF 7800 schemes
[✂]	Funding level	2013 -	Asset-weighted	Net	1. FTSE 350 schemes. 2. PPF 7800 schemes.
[✂]	Funding level	2009 -	Equal	Net	PPF Purple book schemes
[✂]	Funding level	2003 -	Asset-weighted	Net	1. PPF 7800 schemes. 2. 'Diversified static' benchmark.
[✂]	Excess return vs liability benchmark	Calendar year + 3 and 5 years	Equal	Net	None
[✂]	Excess return of growth portfolio vs liability benchmark	Calendar year + 3 and 5 years	Asset-weighted	Net	None

Source: CMA analysis of the parties' submissions on the FM track records.

5.132 We requested the underlying data used by these seven firms to calculate their track record. Our analysis of this data has highlighted that the criteria used to include or exclude certain clients from the track record calculation vary considerably across firms.[253] Whilst the specific 'inclusion criteria' are generally disclosed by firms when presenting their track record, our analysis has found that, in practice, some methodologies can result in the exclusion of a large number of clients. We have found, for example, that for one firm, only around 60% of its full fiduciary management clients are included in its track record. Table 3 shows the inclusion criteria used by each firm.

[253] We also found that the construction of track records involves a number of technical assumptions, eg around actuarial valuations. This also applies to the comparator or 'average' pension scheme used by some firms as a benchmark. In practice, the performance of this average scheme may be heavily modelled.

5.133 Again, we note that the use of alternative methodologies can make direct comparisons across alternative providers extremely difficult. In cases where the inclusion criteria are very ‘strict’, there is also a concern as to whether the track record provides an accurate reflection of the firm’s overall investment performance.

Table 3: Inclusion criteria used to produce FM track records

Firm	*Clients included in the track record*
[✂]	All full fiduciary management clients and Delegated Advisory clients, where [✂] provides directive advice.
[✂]	All full fiduciary management clients that have a full track record over the period in question.
[✂]	Full fiduciary management clients with 100% liability hedging of assets.
[✂]	All full fiduciary management clients.
[✂]	Full fiduciary management clients with 100% liability hedging of assets.
[✂]	Full fiduciary management clients excluding those who have • restrictions on the asset classes • liability hedging strategy that can be used, or, select a growth portfolio that differs from [✂] standard Growth Portfolio.
[✂]	Full fiduciary management clients who are deemed to follow the standard model portfolio.

Source: CMA analysis of the parties’ submissions on the FM track records

5.134 The difficulty in comparing the track record of alternative providers is partly reflected in the CMA survey: 16% of trustees found it very easy to understand and compare the investment track record of alternative bids, 57% found it fairly easy; 20% found it not very easy and 1% not easy at all. As set out in paragraph 5.12, in this situation there are complex methodological differences between providers of which trustees may not be fully aware. Many trustees may therefore believe that it is easier to compare alternative providers than it actually is.

Provisional conclusions

Investment consultancy

5.135 Trustees are generally provided with clear and regular information on the fees paid to their investment consultant. Where hourly or project fees are used, we have found that invoices are usually itemised at a granular level.

5.136 We have found however that it can be difficult to compare the fees of alternative providers. Our evidence shows that information in tenders is often very limited, and rival bids are not directly comparable. At the same time, we have reviewed some examples of clear and detailed tenders in which it was possible directly to compare bids. There is therefore significant variation across schemes, and it is possible to improve standards in this area.

5.137 Most schemes receive regular information on the performance of their scheme from their investment consultant. Whilst this information is generally clear, we are concerned at certain practices such as the reporting of performance on a gross of fees basis. We have also found that very few performance reports demonstrate progress against the trustees' strategic objectives.

5.138 When tendering, trustees typically rely on qualitative examples of performance and quality to compare providers. In some cases however, firms present quantitative information on the performance of their recommended asset management products and funds; similar information is also included in marketing materials and is available on the website of some providers.

5.139 We have identified several factors that make it difficult for trustees accurately to assess and compare each provider's ability to recommend products that outperform their benchmarks. This includes the reporting of performance on a gross of fees basis, which can materially affect the implied returns of a product or fund. We also note that such details are not always clearly disclosed when presenting this information.

Fiduciary management

5.140 Fee reporting practices in fiduciary management vary widely. Many fiduciary management clients are provided with regular information on the overall fee they pay for their service, and this should be strengthened by the introduction of MiFID II.

5.141 We have found however that many trustees do not receive clear and regular information on the fees paid for their asset management products and funds. Some firms 'bundle' the fiduciary management and asset management fees for some of their clients. We consider that unbundling these fees is important in enabling trustees to assess whether their fiduciary manager has identified competitive asset management products; including securing a competitive price for these products. This also ensures that trustees have visibility over the costs paid for their core fiduciary management service (including advice and implementation). This is important in enabling trustees to benchmark the price paid for their fiduciary management service, and – importantly – to compare this price against a purely advisory model.

5.142 Although there are examples of good practice in tenders which ask for specific breakdown of fees across providers, the overall cost of the service is often not indicated in firms' responses. Given that fiduciary management fees can represent a substantial proportion of a pension scheme's total costs, we consider that it is extremely important that trustees assess the full cost of the service they are purchasing. Further, there is no consistent framework for reporting fees, and there is wide variation in the reporting of asset management fees (and in some cases these are 'bundled' with fiduciary management fees). In some cases, this can make it very challenging to compare the fees of alternative providers.

5.143 We have also found that many tenders include no information on the costs of transitioning into and out of these services. As we detail in the following chapter on trustee engagement, such costs can be considerable, and disclosure of these costs is important for trustees to be able fully to evaluate the potential costs of the service.

5.144 Finally, we have found that performance reporting for current clients is often clear and detailed, with the scheme's overall progress often tracked against the trustees' strategic objectives. We have concerns about certain practices such as the reporting of performance on a gross of fees basis however. For prospective clients, it is difficult to compare the performance 'track record' of competing providers. The methodologies used to produce such track records vary considerably, and it is extremely difficult to draw like-for-like comparisons.

6. Trustee engagement

Our main findings

Trustee bandwidth and capabilities

- There is substantial variation in the bandwidth and capabilities of trustees to monitor and assess their investment advisors.

- Whilst trustees generally are experienced and well-qualified, there is evidence that many trustees do not regularly challenge or scrutinise investment advice, or have the knowledge and understanding that's expected.

- Therefore, a proportion of trustee boards lack sufficient bandwidth and capabilities to be able effectively to monitor and scrutinise the investment advice they receive. These issues are most prominent amongst small schemes and DC schemes.

Levels of engagement: investment consultancy

- Small schemes and DC schemes are less engaged in the investment consultancy market, whilst schemes with an investment sub-committee are more engaged than average. DC schemes in particular have considerably lower rates of switching and tendering than average.

- There are not material costs or barriers to switching investment consultant. A switch can occur at minimal cost and be completed within a few weeks.

Levels of engagement: fiduciary management

- It is difficult to assess levels of engagement in fiduciary management as this is a relatively new and growing market.

- Whilst most indicators of engagement, such as switching and tendering, are lower than in investment consultancy, it may be too soon for many schemes to have formally assessed the performance of their provider.

- However, the process for switching fiduciary manager typically takes several months and can incur significant costs.

- Therefore, in many cases there are likely to be material barriers to switching fiduciary manager.

Introduction

6.1 This chapter sets out our analysis of trustee engagement in the markets for investment consultancy and fiduciary management. It considers the extent to which trustees can assess the value for money of providers, and (where necessary) act on the outcome of that assessment. This may be through switching provider or improving the terms offered by their current provider.

6.2 The chapter is structured as follows:

(a) We first present our conceptual framework.

(b) We discuss our evidence base for the analysis.

(c) We present evidence on the 'bandwidth and capabilities' of trustees to assess their investment consultant or fiduciary manager.

(d) We then consider in turn the 'formal' levels of engagement in both investment consultancy and fiduciary management.

Conceptual framework

6.3 This chapter analyses whether trustees can and do assess the value for money of alternative investment consultants and fiduciary managers, and act on the outcome of that assessment. This builds on our analysis in the previous chapter, which considered whether trustees have access to the necessary information to assess their current and alternative providers.[254]

6.4 To assess value for money, trustees require an understanding of the quality of service they receive, including the quality of investment advice, and whether the fees that they pay are competitive. This is not an easy task in a complex sector such as this, and lay trustees are not generally expected to be investment experts. We also recognise that trustees have a wide range of duties to fulfil and competing demands on their time.

6.5 We therefore first consider the extent to which trustees have the necessary **bandwidth and capabilities** to assess the value for money of investment consultants and fiduciary managers. We analyse trustee characteristics, including the typical experience of trustees on a board and the level of their investment expertise. We consider, for example, the use of investment sub-committees and professional trustees.

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[254] See paragraph 5.2 for a discussion of the 'access-assess-act' framework.

6.6 We also consider the extent to which trustees are able to challenge and scrutinise the investment advice that they receive. This is important both in assessing the quality of their investment advisor(s), and in ensuring that prudent investment decisions are made on behalf of underlying members. We analyse the role of the scheme sponsor and other advisors in assisting trustees in this respect.

6.7 In addition to these general capabilities, we analyse 'formal' **levels of engagement** in both investment consultancy and fiduciary management. This relates to both the 'assess' and 'act' strands of our demand side framework (see paragraph 5.5.2).

6.8 In terms of 'assess', we consider rates of tendering as well as formal and external reviews of fees and/or quality. These indicators show the extent to which trustees are actively testing the market and assessing the alternative offers that are available.

6.9 In terms of 'act', we consider the frequency with which trustees switch provider, and the process for doing so. As highlighted in our Guidelines, the ability to switch provider easily is critical in applying competitive pressure and ensuring that customers are able to obtain good value for money. We therefore analyse the process and costs of switching both investment consultant and fiduciary manager in detail.

Evidence base

6.10 Our analysis of trustee bandwidth and capabilities draws on both the CMA survey and third-party research. This includes the Pension Regulator's (TPR's) 2015 Trustee Landscape Survey. This survey was based on 816 telephone interviews with trustees of DB, DC and hybrid schemes with 12 or more members.

6.11 Our analysis of the 'headline' levels of engagement, such as tendering and switching, is based primarily on the results of the CMA survey. We have also considered relevant input from the trustee and in-house investment staff roundtables, as well as submissions from parties. This includes responses to our trustee engagement working paper.

6.12 Our analysis of the switching process is based largely on responses to an information request issued to 14 investment consultants and fiduciary managers. In addition, we arranged follow-up conversations with the Investment Association, two fiduciary managers and three TPEs to further understand the process for switching fiduciary management providers.

6.13 We have also received input from trustees and in-house investment staff on the switching process through the CMA survey and roundtables. We issued some follow-up questions on the switching process to those trustees in the survey that use fiduciary management and indicated that they would be willing to take part in further research. We received eight responses to this request.

Trustee bandwidth and capabilities

6.14 In this section we analyse the extent to which trustees have the necessary bandwidth and capabilities to assess the value for money of investment consultants and fiduciary managers. We begin by considering the main reasons why trustees use investment consultants and fiduciary managers. We then consider the characteristics of trustee boards and the role of the scheme sponsor and other parties in assisting trustees in their role.

6.15 We present the evidence for each sub-section and discuss the overall findings and conclusions at the end of the section.

Reasons for using investment consultants and fiduciary managers

6.16 Figure 9 shows the main reasons that trustees provided for using investment consultants based on the CMA survey.[255] We note three points in particular:

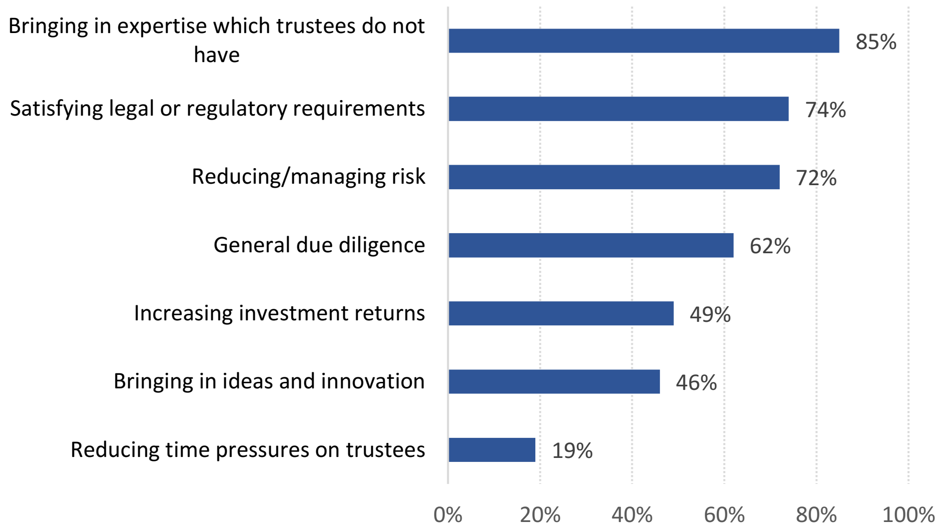
(a) First, the most important motivation for using investment consultants is to bring in expertise which the trustees do not have. This is an important motivation for all types of scheme, but particularly for DB schemes (87% consider it to be very important, compared to 78% of DC and 79% of hybrid schemes).

(b) Second, 'satisfying legal or regulatory requirements' is one of the key motivations for using investment consultants. Although not displayed in the figure, this percentage is even higher amongst DC schemes – 90% of DC scheme respondents stated that this was a 'very important' motivation compared to an average of 74%.

(c) Third, reducing or managing risk appears to be a more important motivation for using investment consultants (on average) than increasing overall investment returns. This is true across all types (DB/DC/hybrid) and sizes (small/medium/large) of scheme.

[255] This is based on the percentage of respondents stating that a particular factor is a 'very important' reason for using investment consultants.

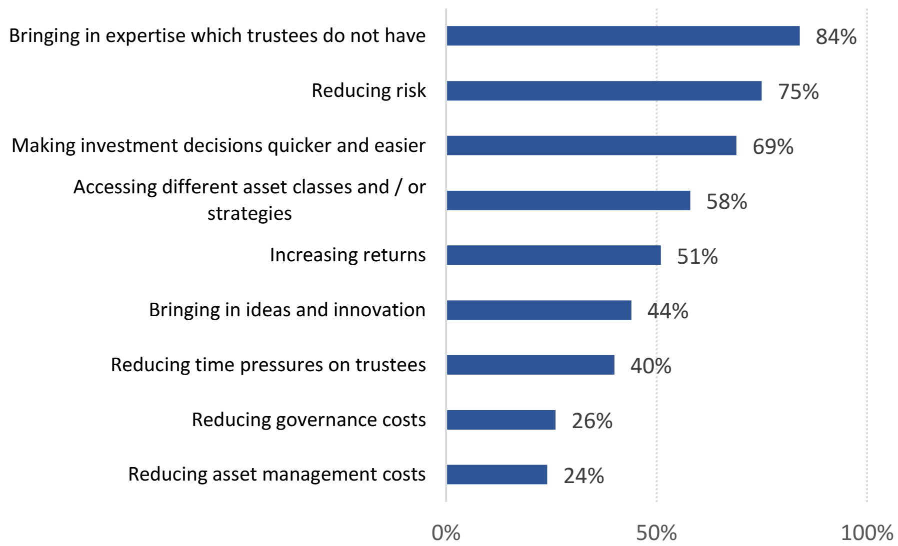
Figure 9: Reasons for using investment consultants



Source: CMA survey.[256]

6.17 As demonstrated in Figure 10, the motivations for using fiduciary management are broadly similar to those for investment consultancy. The two most important factors are to bring in additional expertise and to reduce risk. Trustees also value making investment decisions quicker and easier, and gaining access to different asset classes and strategies.

Figure 10: Reasons for using fiduciary management



Source; CMA survey.[257]

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[256] Question C1: "So, how important is [...] as a reason to buy investment consultancy services?" Base: all (709). The chart shows the percentage that responded 'very important'.
[257] Question K1: 'How important is each of the following as a reason to [buy fiduciary management]?' Base: all (145). The chart shows the percentage that responded: 'very important'.

Trustee characteristics

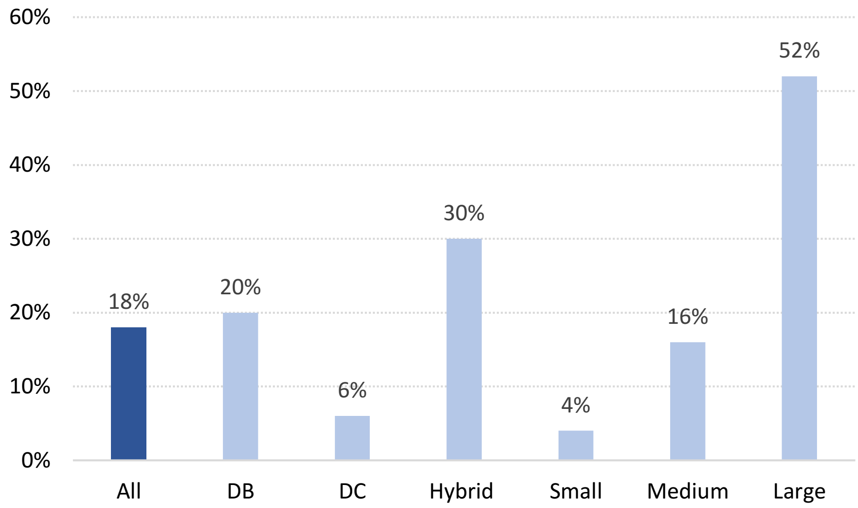
Trustee board composition

6.18 TPR's 2015 Trustee Landscape survey[258] found that the average trustee board includes three members. The vast majority of schemes (88%) have fewer than six trustees on the board, although boards with six to ten members are reasonably common amongst large schemes (22%).[259]

6.19 The Trustee Landscape survey found that just over half (52%) of schemes have a professional or corporate trustee on the board.[260] Around a quarter (27%) of trustee boards contain only professional or corporate trustees.

6.20 The CMA survey indicates that 18% of schemes have an investment sub-committee. As shown in Figure 11 however, this percentage varies considerably across schemes. In particular, both DC schemes and small schemes are considerably less likely to have an investment sub-committee than average.[261] More than half of large schemes have an investment sub-committee.

Figure 11: The prevalence of investment sub-committees



Source: CMA survey.[262]

[258] TPR Trustee Landscape Quantitative Research, 2015.
[259] TPR's research also found that almost a third (31 percent) of schemes have just a single trustee (which includes sole corporate trustees). In both the CMA survey and the TPR Trustee Landscape Quantitative Research, 2015, the size of the scheme is based on the number of members. Small schemes are defined as those with 12-99 members, medium schemes are those with 100-999 members, and large schemes are those with 1000+ members.
[260] TPR defines a corporate trustee as 'a company which acts as a trustee' (see TPR's glossary). This may be a professional trustee company, although the sponsor itself may be the corporate trustee.
[261] These findings are broadly consistent with evidence from TPR's Trustee Landscape survey, which found that 16% of schemes overall have an investment sub-committee, with 19% of DB schemes and 7% of DC schemes.
[262] Question B1: "Does the scheme have an investment sub-committee?" Bases: all (966), DB (679), DC (125), hybrid (162), small (259), medium (454), large (253).

- *Frequency of meetings*

6.21 Based on the Trustee Landscape survey, the majority of trustee boards meet at least every quarter or six months (79%), and trustees spend around 11 days a year on average on 'trustee duties'.

> **Across all schemes, pension trustees spend 11 days a year on average on their duties. For DC schemes, the average is less than 5 days. *TPR research***

6.22 Both the frequency of meetings and the time spent on trustee duties are considerably lower than average for DC schemes and small schemes:

(a) Amongst DC schemes, just 62% of boards meet at least every 6 months.[263] Around half (49%) of DC scheme trustees spend less than 5 days a year on trustee duties.

(b) Amongst small schemes, 62% of boards meet at least every 6 months, and on average trustees spend 9 days a year on their duties.

6.23 There is limited evidence of the amount of time that trustee boards spend addressing investment issues. Aon's Mapping the Trustee Landscape survey however found that up to a quarter of time at board meetings is typically spent on 'investment matters'.[264]

- *Trustee experience, qualifications and training*

6.24 The CMA survey indicates that trustees have on average 11 years of experience.[265] The survey further found that two thirds of trustees sit on just one board. Professional trustees, accounting for 17% of our survey sample, on average sit on 16 trustee boards.

6.25 TPR's Trustee Landscape survey investigated the qualifications held by trustees and their recent levels of training. To summarise their findings:

(a) 70% of non-professional trustees have a 'relevant' qualification (as described by TPR), which is a professional qualification relating to finance, investments, pensions, law or actuarial science. Eighty nine

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[263] 6% meet less than annually and 9% have never met.
[264] Research undertaken by Leeds University Business School (LUBS) and Aon. This research is based on an online survey of 197 trustees and scheme managers.
[265] This is across all schemes rather than any given scheme.

percent of professional trustees or directors of corporate trustees have at least one of these qualifications.

(b) The average level of qualifications is lower for DC schemes and small schemes.[266]

(c) Half of all respondents stated that at least some of their non-professional trustees had undertaken formal, structured training within the last 12 months. This number was lower for small schemes (37%) and DC schemes (32%). The most common source of training was TPR's trustee toolkit.

6.26 Appendix 3 outlines TPR's codes of practice and related guidance that assist trustees in meeting their legislative requirements. We note that the Trustee Landscape survey found that only half of respondents stated that all non-professional trustees on their board met the standards set out in code of practice 7 ('trustee knowledge and understanding').

6.27 This number was substantially lower for small schemes (38%) and DC schemes (36%).

Challenging and scrutinising advisors

6.28 As noted in paragraph 7.6, it is important that trustees can understand and scrutinise the advice they receive to be able fully to assess the quality of service of their provider. This is also important because the investment decisions made by trustees can have a major impact on scheme outcomes and the retirement incomes of underlying members.

6.29 TPR guidance indicates that trustees should be able to scrutinise their investment strategy and the advice they receive (see Appendix 3 for details). Code of practice 3 ('funding defined benefits') states that 'trustees should have sufficient and appropriate knowledge and understanding to enable them to provide sound and prudent oversight of the investment strategy'. Code of practice 13 ('the DC code') states that the trustee board should have sufficient breadth of knowledge and understanding to 'fully understand any advice they receive' and to be able to 'challenge advice they are given'.

6.30 There is evidence from third party research that many trustees only rarely challenge the advice of their advisors. The Trustee Landscape survey found

[266] Amongst non-professional trustees/directors of corporate trustees, 39% of DC trustees/directors and 41% of small scheme trustees/directors do not have any of the above qualifications (compared to 30% overall). Amongst professional trustees/directors, 20% of DC trustees and 18% of small scheme trustees/directors do not have any of the above qualifications (compared to 11% overall).

that 11% of respondents never disagree with their investment consultant, and a further 57% rarely disagree; 26% sometimes disagree and no trustees responded that they often disagree (6% don't know). We note however that this is based on just 79 respondents, and higher proportions of respondents never disagree with the other categories of advisor included in the question.[267]

> **11% of pension trustees never disagree with their investment consultant and 57% rarely disagree. *TPR research***

6.31 Additionally, research undertaken in 2016 by Aon and Leeds University Business School found that 76% of trustees said that they do not often reject the recommendations of their investment consultant. In addition, almost 40% of trustees said that they 'never' or 'not often' consider alternatives to the investment consultant's recommendations. This percentage was highest amongst small schemes (those with assets below £100 million).

6.32 Asset managers who attended a CMA roundtable discussion which was held as part of this investigation told us that they believe that some pension scheme trustees generally lack sufficient investment expertise to take complex financial decisions, although they noted that there are exceptions to this and that the presence of professional trustees can facilitate better decision-making.[268]

6.33 This view is supported by [✂] who submitted that 'trustees did not, in general, have the skills and knowledge to allow them to effectively challenge their advisors'.[269] Further, PLSA submitted that the UK has a highly fragmented pensions scheme, where many smaller schemes do not have the governance capacity and necessary investment expertise to deal with the many challenges facing both DB and DC schemes.[270]

6.34 Law Deb submitted that on some occasions trustees might accept advice without challenge simply because it is given by investment consultants.[271]

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[267] The other categories, with the percentage that never disagree in parentheses, are auditor (41%), legal advisor (29%), IFA (27%), covenant advisor (19%), investment/fund manager (19%) and actuary (15%).
[268] Asset manager roundtable summary.
[269] [✂].
[270] PLSA issue statement response.
[271] Law Deb hearing summary.

BlackRock[272] also submitted that it is uncommon for trustees to act contrary to the PA95 advice they receive from their investment consultant.[273]

6.35 Several parties however submitted to us that they are frequently challenged by their clients. For example:

(a) BBS and Baillie Gifford submitted that given the increased use of professional trustees, trustee boards are now more likely to challenge the advice that their investment consultants provide.[274]

(b) Mercer submitted that it is frequently challenged by its clients and this is likely to increase further with the rise of professional trustees and recent initiatives by TPR (see Appendix 3 for a discussion of these initiatives).[275]

The role of the sponsor and other advisors

6.36 Trustees are supported in their role by the scheme sponsor and a number of other advisors and professionals. This can include actuaries, legal advisors, administrators, covenant advisors and internal pension teams. Here we focus on the role of these participants in monitoring and scrutinising investment consultants and fiduciary managers.

- *The scheme sponsor*

6.37 Scheme sponsors play a formal role in monitoring the investment advice that trustees receive, in that trustees are required to consult the sponsor when revising the scheme's Statement of Investment Principles (SIP), which must be done at least every three years.[276]

6.38 Sponsors can also play a more active role in monitoring the investment decisions of trustees. In our client document review for example, we have seen a case in which the sponsor asked to be updated on the impact of a proposed change to the investment strategy on fees,[277] and another in which

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[272] BlackRock issue statement response.
[273] Trustees have a duty under PA95, section 36(3), before actually investing, to obtain and consider written 'proper advice' on the question of whether the investment is satisfactory, so far as relating to the suitability of investments, and to the principles contained in the statement of investment principles.
[274] BBS and Baillie Gifford hearing summaries.
[275] Mercer response to the trustee engagement working paper.
[276] PA95, section S35(1)(b) and the Occupational Pension Schemes (Investment) Regulations 2005, SI 2005 No. 3378.
[277] An email sent by [✂] to a client (dated 20/12/16).

the investment consultant wrote to the employer to explain recent developments in the investment strategy and funding level.[278]

74% of pension trustees say that their scheme sponsor and its advisers are important in monitoring and scrutinising their investment consultant. *CMA survey*

6.39 In the CMA survey, 42% of respondents stated that the scheme sponsor and its advisers are very important in monitoring and scrutinising their investment consultant; 32% said that they are fairly important, 13% said they are not very important and 5% said they are not at all important (2% don't know and 5% not applicable).

6.40 We note that trustees of DC schemes were considerably less likely to consider the sponsor and its advisors to be very important in monitoring and scrutinising their investment consultant – 30% compared to 42% overall.

- *The scheme actuary*

6.41 Broadly speaking, the role of an actuary is to analyse the liability side of a DB pension scheme, whereas the role of the investment consultant is to analyse the asset side of the scheme. Inevitably there is some overlap in these roles; based on responses to our information requests, we understand that it is common for actuaries to have at least some involvement in the following work of investment consultants:

(a) **Journey planning**. This involves analysing how the funding level of the pension scheme is likely to change over time and setting appropriate targets. Actuarial input is particularly important in understanding future liability movements.

(b) **De-risking triggers**. A de-risking strategy requires input from the actuary on suitable long-term targets and timescales. De-risking triggers may also impact the actuarial assessment by altering the calculation of present-value liabilities.

(c) **Hedging strategies**. Actuaries can advise on the expected impact of interest rates and inflation on the funding ratio, and on the design of suitable hedging strategies.

[278] A document from a DB client of [✂] (2015).

6.42 Around half of the respondents to the CMA survey said that the scheme actuary was very important in scrutinising and challenging their investment consultant (49%); a further 22% said that the actuary was fairly important, 13% said the actuary was not very important and 7% said the actuary was not at all important (2% don't know and 7% not applicable).

6.43 We also note however that it is common for investment consultancy and actuarial services to be purchased from the same provider. The CMA survey indicates that 55% of schemes that purchase investment consultancy also purchase actuarial services from the same provider.

55% of pension schemes purchase actuarial services from their investment consultancy firm. *CMA survey*

- *Other advisors*

6.44 The CMA survey asked respondents how important other advisors, both internal and external, were in monitoring and scrutinising their investment consultant. Overall, fewer schemes see such advisors as important than the numbers who see the sponsor or actuary as important:

(a) On average, 14% of all trustees responded that in-house advisors were very important for monitoring and scrutinising their investment consultant. A further 21% responded that they were fairly important. We have found that only the very largest pension schemes typically employ in-house advisors, mostly those with assets above £1 billion.

(b) On average, 22% of trustees responded that external advisors were very important for monitoring and scrutinising their investment consultant. A further 24% responded that they were fairly important.

6.45 A number of schemes use dedicated TPEs when tendering, and/or to monitor their current provider. The CMA survey found that 31% of schemes used a TPE when tendering for investment consultancy services, and 59% used a TPE when tendering for fiduciary management (when moving into fiduciary management for the first time).

6.46 Figures from the latest KPMG FM Survey found that 60% of new fiduciary management appointments were advised by an independent third party in 2017. They also found that 17% of schemes use a 'third party overseer' in conjunction with their fiduciary manager.

- *Multiple investment consultants*

6.47 The use of multiple investment consultants can provide a competitive constraint on each provider by enabling trustees to compare the level of fees and quality, and through challenging and scrutinising each other's advice. The CMA survey however found that the vast majority of schemes (91%) use a single investment consultant; 5% use two providers and just 1% use three or more.

6.48 We would expect that larger schemes are more likely to use multiple consultants than smaller schemes. This is partly reflected in the CMA survey, with 9% of large schemes using two or more providers, compared with 5% of small schemes.

Our assessment of trustee bandwidth and capabilities

6.49 The evidence in this section highlights that there is substantial variation in the governance structures of pension schemes and the bandwidth and capabilities of trustees to monitor and assess their investment advisors. The variation in the governance capacity of schemes has been noted in submissions from several parties.[279]

6.50 We have found that trustees tend to be experienced and the majority hold a relevant qualification (as defined by TPR). The CMA survey also shows that the scheme sponsor and other advisors can play an important role in supporting the work of trustees, and some large schemes are supported by sophisticated in-house teams. Around half of schemes have a professional trustee on the board.

The majority of pension trustees hold a relevant qualification, as defined by TPR.

6.51 On the other hand, a key motivation for using investment consultants is to satisfy legal and regulatory requirements, and there is evidence that the majority of trustees rarely disagree with or challenge their investment advisors. Research from TPR also indicates that a large proportion of lay trustees do not meet the minimum standards of 'knowledge and understanding' expected by the regulator.

[279] Eg Aon, First Actuarial, SEI Investment and Spence & Partners IS issues statement responses. JLT, Russell Investment and Baillie Gifford hearing summaries.

6.52 We therefore consider that a proportion of trustee boards lack sufficient bandwidth and capacity to monitor and assess their investment advisors effectively. Our evidence indicates that these issues are most prominent amongst small schemes and DC schemes:

(a) Small schemes and DC schemes are less likely than average to have an investment sub-committee.

(b) The trustee boards of small schemes and DC schemes meet less frequently than average.

(c) Trustees of small schemes and DC schemes are less likely than average to have a 'relevant' qualification.

(d) Trustees of small schemes and DC schemes are less likely than average to meet the standards of knowledge and understanding expected by the regulator, and

(e) Trustees of DC schemes are less likely than average to consider the scheme sponsor to be very important in monitoring and scrutinising their investment consultant.

Levels of engagement: investment consultancy

Headline indicators of engagement

6.53 We note that engagement is a broad concept and it is not feasible to measure all aspects of engagement. In this section, we have concentrated on four 'headline' indicators of engagement that (i) we are in a position to measure, and (ii) are important in driving effective competition between providers:

(a) **Switching from one provider to another**. As noted in the Guidelines, the ability to switch provider is important in driving effective competition.[280] The CMA survey asked trustees whether they had switched within the last five years.

(b) **Switching and/or tendering**.[281] Even if a customer chooses not to switch, organising a tender may enable them to extract lower fees or a higher quality of service from their current provider. Tendering also enables customers formally to assess the alternative offers available in

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[280] (CC3 (Revised)), paragraphs 296 and 297.
[281] We consider switching and tendering jointly as this captures the overall group of trustees/schemes that have either changed provider or actively searched and considered the alternative offers available in the market.

the market. The CMA survey asked trustees whether they had switched and/or tendered within the last five years.

(c) **A formal review of fees and/or quality**. This can be an important mechanism for ensuring that the incumbent provider is offering value for money. As a result of such a review, customers may be able to negotiate lower fees or an improved level of service. The CMA survey asked trustees whether they had undertaken a formal review of fees and/or quality within the last three years.

(d) **An external review of fees and/or quality**. This may be a more formal or rigorous assessment of the value for money offered by the incumbent provider. The CMA survey asked trustees whether they had undertaken an external review of fees and/or quality within the last three years.

6.54 Table 4 presents the levels of engagement across each of the four 'headline' indicators discussed above based on the CMA survey.

6.55 In each column, we first show (row 1) the percentage of all schemes that have undertaken the relevant action within the reference period.[282] Within each column, we then show how the level of engagement differs from average for different types of scheme. These numbers are percentage point differences – eg in column 1 the rate of switching across all schemes is 27%; the entry of '+1' in the row for DB schemes indicates that the rate of switching for DB schemes is 28%.

6.56 We have tested the statistical significance of these differences, and reported results at the 5% significance level – positive and significant differences from average are shown in green, and negative and significant differences are shown in red.

27% of pension trustee boards have switched investment consultant in the last five years. Amongst DC schemes, only 16% have switched.

6.57 We highlight the following results from Table 4:

(a) DC schemes are significantly less likely to have engaged on any of the four headline indicators of engagement. The rate of switching for

[282] This is the last five years for switching and tendering, and the last three years for a formal or external review of fees and quality.

example falls from 27% on average to 16% for DC schemes, and the rate of switching and/or tendering falls from 41% to 29%.

(b) There is some evidence that scheme size is correlated with engagement. Smaller schemes are less likely than average to have undertaken a formal review of fees and/or quality, whereas large schemes are more likely than average to have done so. Large schemes are also significantly more likely to have undertaken at least one of the four actions. Further, we note that although not all indicators are statistically significant, there is a clear and consistent pattern in that larger schemes are more engaged than average across each measure.

(c) There is some evidence that schemes with an investment sub-committee are more engaged than average. In particular, such schemes are more likely to have undertaken a formal review of fees and/or quality, and more likely to have undertaken at least one of the four actions.

(d) There is little evidence that bundling services (eg by purchasing investment consultancy and actuarial services from the same provider) reduces engagement. Customers who purchase 'nothing else' from their investment consultant for example are no more likely than average to switch and/or tender, and are less likely to undertake an external review of fees and/or quality.[283] Interestingly, those schemes that also purchase fiduciary management services from the same provider are more likely to undertake an external review of fees and/or quality of their investment consultant.

6.58 Table 4 also suggests that rates of switching, and rates of switching or tendering, are lower than average amongst clients of the three largest providers. This does not imply however that the clients of such firms are less likely to switch. This is because the survey asked trustees about their *previous* switching patterns (whether they had switched in the last 5 years) and to identify their *current* provider.[284]

6.59 In Appendix 3 we have run some simple regressions to control simultaneously for the various scheme and provider characteristics analysed in Table 4. Doing so does not substantively change the main results highlighted above.

[283] We have also tested whether schemes that specifically bundle investment consultancy, actuarial services and administration together are more or less likely to be engaged than others. We have found no evidence that this is the case.

[284] The result is therefore consistent with declining market shares of the three largest providers over the last five years (based on the number of clients).

Table 4: Headline indicators of engagement – investment consultancy

	Obs.	*Switched*	*Switched and/or tendered*	*Formal review of fees and/or quality*	*External review of fees and/or quality*	*Any of these actions*
All schemes	**783**	**27%**	**41%**	**63%**	**15%**	**73%**
Type of scheme						
DB	567	+1	0	+1	0	+1
DC	70	-11*	-12*	-15*	-9*	-12
Hybrid	146	+2	+7	+5	+4	+5
Size of scheme						
Small	149	+3	0	-10*	-1	-8
Medium	396	-3	-1	+1	-1	-1
Large	238	+2	+2	+9*	+3	+9*
Investment subcommittee						
Yes	196	-5	-4	+11*	+1	+8*
No	587	+1	+1	-3	0	-3
Type of provider						
3 largest	194	-14*	-9*	-1	+1	-5
Other	589	+5*	+3	0	0	+2
Number of services purchased						
Fewer than 3	50	-2	-6	-15	-10*	-10
Between 3 and 5	289	-3	-3	-6*	-3	-4
Between 6 and 7	444	+2	+3	+6*	+3	+4
Other services purchased from investment consultancy provider						
Actuarial services	445	-3	-2	+1	-1	+1
Fiduciary management	99	+6	+9	+6	+11*	+5
Scheme administration	411	-4	-2	-2	-2	-2
Nothing else	189	+2	0	-4	-5*	0

Source: CMA analysis of CMA survey.
*Note: * indicates a statistically significant difference from 'all' (p<0.05). The numbers in each cell (unless a % is indicated) are percentage point differences from the overall percentage for the relevant column. We measure rates of switching and/or tendering over the last five years, and formal/external reviews of fees and/or quality over the last three years.*

6.60 The rates of switching and tendering in Table 4 are based on the CMA survey. In its response to our issues statement, IC Select submitted evidence on the switching and tendering rates of DB schemes based on data collected from 'major consultancy firms'.[285]

6.61 The IC Select evidence suggests that there has been a notable decline in switching and tendering rates since 2007, with particularly low rates in 2015

[285] IC Select issues statement response. It is not stated exactly which firms are included in their analysis. However, they state that the number of schemes covered each year varies between 1,783 and 2,010.

and 2016. Their evidence also suggests that switching and tendering rates are much lower in general than those suggested by the CMA survey:

(a) Their data suggests a five-year switching rate of around 7 to 8% for DB schemes. This compares to 28% in the CMA survey (Table 4).

(b) Their data suggests a five-year tendering rate of around 10 to 12% for DB schemes. This compares to 26% in the CMA survey.[286]

6.62 Due to this discrepancy, we have sense-checked our survey figures using our client-level data collected from parties. Based on data from nine major investment consultancy firms, we have analysed the proportion of schemes that undertook a 'structured bidding process' over each of the last five years. This shows that on average around 5% of schemes undertook a structured bidding process each year; this indicates an overall five-year 'tendering' rate of around 25%. There is no evidence of a decline in 2015 or 2016.

6.63 This evidence is therefore much more consistent with the CMA survey results than the evidence presented by IC Select. We also note that the CMA survey is based on a weighted sample of almost 1000 trustees, which is not restricted to any subset of suppliers. We therefore consider that the CMA survey is the better evidence available on the rates of switching and tendering in the market.

6.64 WTW have submitted that rates of switching and tendering are 'not appropriate indicators' of engagement as they do not indicate if trustees have difficulty in identifying the best value for money.[287] They submit that there are many reasons that trustees may decide not to switch or tender; they may be satisfied with their current service, and there are efficiencies generated from having a long-term relationship with a provider. The relevant indicator, it is argued, 'should be the ability of trustees to make informed decisions on switching and to switch with ease'.

6.65 We agree that there may be perfectly valid reasons why some trustees have chosen not to switch supplier. However, switching and tendering rates are informative as they indicate the extent to which trustees actively test the market. They can also help to identify any barriers to switching; eg if switching rates are particularly low for certain types of scheme. We agree that this should be complemented by additional indicators of engagement, as

[286] This figure is not shown in Table 4, which consider tendering and switching rates jointly.
[287] WTW response to the trustee engagement working paper.

well as a deeper analysis of the switching process. That is the approach that we have taken in our analysis.

6.66 A number of parties have commented on our findings that the headline levels of engagement are lower for small schemes and DC schemes. Regarding small schemes, Redington submitted that lower levels of engagement are explained by governance capacity, with small schemes on average able to dedicate less time and resource to the management of their scheme.[288] PLSA submitted that a scheme's quality of governance is determined not only by its trustees, but also by the support structures and staff available.[289] By focusing on the 'day to day' tasks, support staff enable trustees to focus on strategic issues. PLSA submitted that 'a well-resourced executive function may be beyond the means of smaller schemes'.

6.67 Mercer submitted that small schemes and DC schemes are generally less complex than large schemes and DB schemes (respectively).[290] They also argued that [✂]% of DC members invest all of their contributions through default arrangements; frequent changes to the default strategy would have cost implications for members as well as communication and administration costs. Aon also submitted that DC schemes tend to be focussed on low-risk, low-volatility passive investments for which 'switching can incur costs disproportionate to gains'.[291]

6.68 We acknowledge these points, and recognise that in some circumstances it may be rational for trustees of DC schemes to make less frequent changes to their underlying investments than DB schemes. It is concerning however that, as shown in Table 4, trustees are less likely to be actively engaged in monitoring and assessing their investment consultant along a range of indicators. Even if less frequent changes are made to underlying investments, we would still expect trustees to monitor and assess the performance of their advisors regularly.

6.69 WTW and PLSA submitted that lower levels of engagement amongst DC schemes may reflect the fact that investment risks are borne by the individual rather than the employer.[292] WTW stated that 'DC scheme trustees do not need to worry about the scheme being underfunded' and so their need for investment consultancy services is therefore very different, as compared to DB schemes.[293] Similarly, PLSA noted that trustees may be

[288] Redington response to the trustee engagement working paper.
[289] PLSA response to the trustee engagement working paper.
[290] Mercer response to the trustee engagement working paper.
[291] Aon response to the trustee engagement working paper.
[292] WTW and PLSA responses to the trustee engagement working paper.
[293] WTW response to the trustee engagement working paper.

more focused on reducing their DB scheme funding gaps (ie in hybrid schemes or amongst those trustees that sit on several boards).[294] This would be consistent with evidence from the TPR, which shows that hybrid schemes typically spend the vast majority of their time addressing DB-specific issues.[295]

6.70 In our view, the fact that investment risks are borne by individual members makes the lower levels of engagement amongst DC scheme trustees more concerning. As highlighted in paragraph 6.52, there is also evidence that the general bandwidth and capabilities of DC trustee boards are lower on average than those of DB boards.

The process for switching investment consultant

6.71 In principle, switching investment consultant can be achieved by signing an 'investment consultancy agreement' or 'engagement letter' with the new provider. This will set out the scope of the work and associated fees. Other than any legal costs incurred, the switch can occur at minimal cost.

6.72 In our view, therefore, there are not material costs or barriers to switching investment consultant. This is largely reflected in the results of the CMA survey, in which respondents who had switched investment consultant within the last five years were asked how easy they found the process. Overall, 47% of respondents said that they found the process very easy, 35% found it fairly easy, 9% found it not very easy and 2% found it not at all easy.

6.73 Redington submitted that some prospective clients find it hard to switch investment consultant, although they frequently anticipate that the costs and time taken to switch will be greater than they are in practice.[296] Aon submitted that transitioning an investment consultancy client takes no longer than a few weeks, and clients bear no significant fees for any transitional activities.[297] Barnett Waddingham also submitted that the switching process might take around one month.[298]

Our assessment of engagement in investment consultancy

6.74 There is significant variation across schemes on our headline indicators of engagement. As we found in our analysis of trustee bandwidth and capabilities, levels of engagement for small schemes and DC schemes are

[294] PLSA response to the trustee engagement working paper.
[295] TPR Trustee Landscape Quantitative Research, 2015.
[296] Redington Issues Statement response.
[297] Aon Issues Statement response.
[298] Barnett Waddingham hearing summary.

lower than average across a number of indicators. This is particularly true for DC schemes, which are less likely to have engaged on any of our four headline indicators. We have also found that schemes with an investment sub-committee are more engaged than average.

6.75 Overall, in our view an average switching rate of 27% in and of itself does not raise major concerns about a lack of competition in this market. We recognise that investment decisions are made over a horizon of several years, and it is important to avoid an excessive focus on short-term performance. In addition, we have found that competitive pressure can be exerted in other ways than switching alone. For example, schemes may run a tender exercise or undertake a formal (internal or external) review of their provider. Our evidence shows however that the extent to which schemes engage in these activities varies considerably.

6.76 We have not found that there are material costs or barriers to switching investment consultant. As noted in our in-house investment staff roundtable however, and in parties' submissions, the incumbent investment consultant acquires a detailed knowledge and understanding of the scheme over time. Trustees may not want to lose this knowledge, and it will take time for the new provider to develop a similar level of knowledge. This could act as an 'inherent barrier' to switching.

Levels of engagement: fiduciary management

Headline indicators of engagement

6.77 Table 5: shows the overall levels of engagement in fiduciary management across our four headline indicators, and compares these to the overall levels in investment consultancy. Due to the low numbers of observations for different types of scheme within fiduciary management, we are not able to replicate the disaggregated results in Table 4:.

6.78 Table 5 indicates that the average rate of switching is lower in fiduciary management (9%) than investment consultancy (27%). This may reflect the fact that fiduciary management is an emerging service however. Indeed, the CMA survey found that the average tenure of current fiduciary management providers is six years, compared to eight years in investment consultancy.[299] In both cases however we note that these tenure rates should be treated with caution, as they are likely reduced by clients that have only recently

[299] Based on survey questions C3 and K3. Question C3: 'How long has the board of trustees bought investment consultancy from your investment consultant?' (base = 783). Question K3: 'How long has the board of trustees bought fiduciary management from your fiduciary manager?' (base = 145).

begun using these services. The switching rates in both fiduciary management and investment consultancy imply average tenures that are considerably higher than those indicated here.[300]

6.79 To account for this growth in fiduciary management, we can adjust the switching rate by removing those schemes that have only recently started using the service. To do so, we remove schemes that have been with their current provider less than five years, and have not switched within the last five years.[301] When we do this, the overall rate of switching increases to 17%. An equivalent exercise for investment consultancy services increases that switching rate to 30%.

6.80 There is therefore some evidence that overall switching rates are lower in fiduciary management than investment consultancy, although it is difficult to draw any firm conclusions on this because fiduciary management is an emerging market. Although we can 'mechanically' adjust the switching rate to account for this in a statistical sense, in practice it may be too soon for many schemes to have formally assessed the performance of their provider. As noted by Aon for example, fiduciary managers are generally appointed with long-term objectives that stretch beyond a five-year period.[302]

6.81 With the above in mind, we note that each of the other headline measures of engagement are lower in fiduciary management than investment consultancy, with the exception of an external review of fees and/or quality (which is 22% compared to 15%). The fact that fiduciary management is a relatively new market makes it difficult to draw firm conclusions from these findings.

6.82 We have not presented disaggregated results for fiduciary management due to small numbers within each category. Due to these small numbers, we do not place weight on the specific percentages, although we highlight the following results:

(a) There is some evidence that schemes with an investment sub-committee are more engaged than others. Such schemes are significantly more likely than average to have undertaken a formal review of fees and/or

[300] A five-year switching rate of 27% implies that just over 5% of schemes change provider each year. Based on this rate of change, we would expect a scheme to remain with their current provider for almost 20 years.
[301] From the CMA survey, we do not know when a scheme first joined fiduciary management. Our approach removes schemes that, based on their survey response, have joined fiduciary management within the last five years. It is also possible that some of the schemes that switched also joined fiduciary management within the last five years. We do not have the information to remove such schemes.
[302] Aon submission to the trustee engagement working paper.

quality, and significantly more likely to have undertaken at least one of the four actions in Table 5.[303]

(b) Large schemes are significantly more likely than average to have undertaken a formal review of fees and/or quality.[304]

Table 5: Comparative levels of engagement – investment consultancy and fiduciary management

	Obs.	*Switched*	*Switched and/or tendered*	*Formal review of fees and/or quality*	*External review of fees and/or quality*	*Any of these actions*
Investment consultancy	783	27%	41%	63%	15%	73%
Fiduciary management	145	9%	37%	53%	22%	69%

Source: CMA analysis of CMA survey. We measure rates of switching and/or tendering over the last 5 years, and formal/external reviews of fees and/or quality over the last 3 years.

6.83 WTW have submitted that because many schemes have only recently moved into fiduciary management, it is likely that our evidence on switching rates actually captures schemes that moved from investment consultancy into fiduciary management.[305] In our view however the survey clearly asked trustees whether they had recently switched their *provider of fiduciary management services*.[306] We have received no evidence to indicate that, in responding to this question, trustees were referring to a switch from investment consultancy into fiduciary management.

6.84 WTW further submitted that by not explicitly analysing schemes that have switched from investment consultancy into fiduciary management, our analysis omits a 'material category of engagement'.[307]

6.85 We agree that by separately analysing switches within investment consultancy and fiduciary management, we are not capturing those schemes that have switched between the two services. The aim of our analysis here is not to derive an overall 'switching rate' across pension schemes however. Instead, we are interested in levels of engagement and the ease of switching within each of the two separate markets. Switching rates are an important

303 37 of the 145 schemes have an investment sub-committee. For these schemes, the percentage that undertook a formal review of fees and/or quality increases to 75%, and the percentage that undertook none of the actions falls to 17%.
304 50 of the 145 schemes are 'large'. For these schemes, the percentage that undertook a formal review of fees and/or quality increases to 69%.
305 WTW response to the trustee engagement working paper.
306 Question O1: 'May I just double check, in the last 5 years, have you switched your [main] provider of fiduciary management services'
307 WTW response to the trustee engagement working paper.

indicator of the ease of switching, although we recognise that additional qualitative work is also necessary.

6.86 We explicitly analyse those schemes that have moved from investment consultancy into fiduciary management in chapter 7.

The process for switching fiduciary manager

Overview

6.87 In this section we provide an overview of the process and costs of switching fiduciary management provider. A detailed analysis is provided in Appendix 3.

Switching fiduciary manager usually involves a considerable revision to the client's investment strategy.

6.88 For context, we note that switching fiduciary manager typically involves a considerable upfront revision to the client's investment strategy and portfolio; this requires assets to be transferred from one set of funds to another. Due to this revision, and the potentially costly transfer of assets, the switching process usually involves both a 'planning phase' and an 'implementation phase'.

6.89 In the **planning phase**, the trustees and fiduciary manager develop the investment objectives, strategy and proposed portfolio. These investment guidelines will be included in the IMA. The completion of this agreement will involve a period of negotiation and legal review. As part of the planning phase, the provider will also devise a transition strategy to reallocate the client's assets into the proposed portfolio.

6.90 Estimates from parties indicate that the planning phase could last between a week and several months.[308] This will depend on the complexity of the scheme's investment strategy, negotiations between trustees and the provider, and the frequency of trustee board meetings. We understand that the main monetary costs incurred are legal fees, which will depend on each scheme's particular arrangements (eg the use of in-house or external legal advisors).

[308] Responses to CMA information requests.

6.91 The **implementation phase** involves the transfer of assets from the current to the new portfolio. The timings and costs vary considerably on a client-by-client basis, depending in particular on:

(a) The client's current portfolio. If a client is invested in highly illiquid assets for example (such as infrastructure), there may be significant exit charges and lock-in periods. Transition costs may also be higher if the client has a very complex portfolio.

(b) The process for redemption and investment of assets. In some cases, it may be possible to simple 'novate' assets from one provider to another. This involves changing the contractual documentation and can occur at minimal cost. In other cases, it will be necessary to either redeem current holdings for cash, or transfer stocks and shares directly (an 'in specie' transfer). Both of these approaches can incur significant transaction costs.

6.92 Estimates provided by parties indicate that the implementation phase would typically take several months, although depending on the factors above, this could be considerably shorter. Typical transaction costs could be in the range of 0.1% to 1% of assets under management, although again there is considerable variation on a case-by-case basis.[309]

6.93 We note that these transaction costs are ultimately paid to the banks and brokers that trade the underlying securities, rather than the fiduciary managers themselves. We also recognise that the incoming fiduciary manager has an incentive to minimise transaction costs. This is due to the use of ad valorem pricing (whereby fees are directly related to the size of assets under management), and the fact that the fiduciary manager agrees asset-based objectives with the client in the IMA.

6.94 We have not found that fiduciary management contracts typically include restrictive exit clauses or penalties. Most contracts include a minimum notice period, although this is considerably shorter than the length of time we would typically expect trustees to remain with their provider. The notice period is often set at 30 days (eg Mercer, Russell Investments, [✂]), [✂]. BlackRock submitted that notice periods are negotiated on a client-by-client basis.

6.95 WTW submitted that their standard template contract includes a [✂] minimum term, which is due to the significant upfront costs associated with taking on a client. [✂]. In any case, we would expect the vast majority of

[309] Responses to CMA information requests.

fiduciary management appointments to be made on a longer-term basis than [✂], and so in our view this is not a material barrier to switching.

6.96 To summarise the overall timings and costs involved in the switching process:

(a) The switching process typically takes several months. This is driven by the time taken to agree an investment strategy, review and sign contracts and transfer assets to the new portfolio.

(b) Monetary costs are mostly incurred in the transitioning of assets. These costs vary considerably on a client-by-client basis, although a reasonable range is 0.1% to 1% of assets. For a scheme with £100 million of assets, this implies transaction costs of approximately £100,000 to £1 million.

The costs of switching fiduciary manager can typically range from 0.1% to 1% of assets.

Our assessment of the switching process

6.97 Switching fiduciary managers is, in general, a time consuming and costly process. Whilst we recognise that this varies significantly on a case-by-case basis, the process typically takes several months and incurs costs in the range of 0.1% to 1% of assets.

6.98 To put these costs into context, we note that the annual cost of a full fiduciary management service (excluding asset management costs) might typically be in the range of 0.2% to 0.3% of assets.[310] Switching costs could therefore be equivalent to an additional year's worth of fiduciary management fees, and in some cases even higher. This is consistent with some of the input we have received from the trustee roundtables and in survey follow-up questions.

6.99 In responding to our analysis of switching costs, as set out in our working paper on trustee engagement, parties have made two related points:

[310] Ernst & Young, Fiduciary Management Fees Survey 2017. This estimates a median fee (excluding investment management costs) of around 0.2-0.3% of assets per year, and overall fees (including investment management costs) of around 0.5-0.7% per year (for assets up to £250 million).

(a) Our estimate of switching costs is driven by changes to the investment portfolio rather than the change in fiduciary manager per se. It is not always necessary to revise the portfolio when switching manager.

(b) The ultimate costs of switching are similar in fiduciary management and investment consultancy. The only fundamental difference is that there is an upfront revision to the investment portfolio in fiduciary management, whereas the portfolio is changed more gradually in investment consultancy.

6.100 We respond to these two points jointly as they are similar in essence. First, we have received feedback from several sources that, in practice, there will usually be a substantial revision to a client's investment portfolio when switching fiduciary manager.[311] There are several reasons for this:

(a) In practice, a switch will generally be triggered because trustees are dissatisfied with the investment performance of the incumbent provider. In switching, trustees are seeking a change in the investment strategy. A number of trustees at our roundtable strongly indicated that fiduciary management switching costs were high because the portfolio would almost always change when switching provider.[312]

(b) The new provider may have a preferred investment approach and funds. The provider may not want to transfer the existing holdings. We note for example that for schemes investing less than £[✂] of assets, investments into [✂] fiduciary management service must be made as cash.[313]

(c) Based on feedback from trustees and in-house pension teams, we understand that in certain cases it is not possible to simply transfer products or funds from one manager to another. One trustee at our roundtable for example stated that some providers insist that their own LDI product is used.[314] PLSA have also submitted that some investment 'vehicles' may be proprietary to the original fiduciary manager.[315] The client may therefore be forced to divest these funds, incurring transaction costs.

(d) TPEs have told us that trustees using full fiduciary management would typically prefer not to leave some assets with the incumbent whilst

[311] This includes submissions from parties, trustee roundtables and discussions with TPEs.
[312] Trustee roundtable summary.
[313] Response to CMA information request.
[314] Trustee roundtable summary.
[315] PLSA response to the trustee engagement working paper.

transferring others to the new provider. For many schemes a key rationale for using full fiduciary management is to simplify governance; having different assets with various providers complicates the investment strategy and creates practical issues (eg around monitoring).

6.101 This implies that in many cases there are likely to be significant upfront costs incurred when switching fiduciary manager. This is not generally the case when switching provider of investment consultancy services.

6.102 Second, costs may be incurred when switching fiduciary manager even if there are no substantial changes to the investment portfolio. If a client is invested in a provider's fund of funds (or 'multi-asset pooled fund') for example, underlying asset management fees are typically passed on to the client without any additional charge. In effect, the scheme receives a discounted price for investing in the fund-of-funds because they are a fiduciary management client of the provider.

6.103 If the client were to switch fiduciary manager, but remain invested in the funds, they would likely have to pay an 'access' fee to the provider on top of the underlying asset management fees. We understand from speaking to a TPE that a typical range for this fee could be around 0.1% to 0.3% of assets under management.

6.104 Switching fiduciary manager can therefore incur material costs even in the absence of changes to the underlying portfolio. We understand that this is not the case when switching investment consultant.

Our assessment of engagement in fiduciary management

6.105 Assessing levels of engagement in fiduciary management is challenging as this is a new and emerging market. Although the CMA survey indicates that engagement is lower than in investment consultancy on most of our headline indicators, in practice it may be too soon for many schemes to have switched or formally assessed the investment performance of their current provider. We therefore do not draw firm conclusions regarding levels of engagement in fiduciary management.

6.106 The process for switching fiduciary manager varies considerably across schemes. We recognise that there are some cases in which the switching process can be completed quickly and at minimal cost. We have found however that, in general, the process of switching fiduciary manager is lengthy – on a timescale of several months or longer – and incurs significant costs. This could act as a material barrier to some schemes in switching provider.

Provisional conclusions

Trustee bandwidth and capabilities

6.107 Our evidence shows that there is substantial variation in the bandwidth and capabilities of trustees to monitor and assess their investment advisors. Trustees typically have several years of experience and most hold a relevant qualification (as defined by TPR). At the same time however, there is evidence that many trustees do not regularly challenge the investment advice they receive or consider alternative options. Third-party research also indicates that many lay trustees do not meet the standards of 'knowledge and understanding' expected by the regulator.

6.108 We have found that governance is weakest in small schemes and DC schemes. This is reflected, among other indicators, in the fact that the trustee boards of these schemes are less likely to have an investment sub-committee, meet less frequently, and trustees are less likely than average to meet the standards of knowledge and understanding expected by the regulator. In DC schemes the scheme sponsor is less likely to play an important role in monitoring and scrutinising the investment consultant.

Levels of engagement: investment consultancy

6.109 In our view, in and of itself an average switching rate of 27% does not raise major concerns about a lack of competition in the investment consultancy market. We recognise that investment decisions are taken in order to achieve long-term outcomes, and we would therefore not expect all schemes to be switching every few years.

6.110 We have found however that levels of engagement, including switching, vary considerably across schemes. In particular, small schemes and DC schemes are less engaged in this market based on a number of indicators. DC schemes for example have considerably lower rates of switching and tendering than average, and are less likely to have formally reviewed their provider. In the box below, we outline some of the broader concerns we have found regarding DC schemes.

6.111 In our view, there are not material costs or barriers to switching investment consultant. A switch can typically occur at minimal cost and be completed within a few weeks.

Levels of engagement: fiduciary management

6.112 It is difficult to assess levels of engagement in fiduciary management as this is a relatively new and growing market. Whilst most headline indicators of engagement, such as switching and tendering, are lower than in investment consultancy, in practice it may be too soon for many schemes to have switched or formally assessed the performance of their provider. In particular, we recognise that fiduciary managers are generally appointed with long-term objectives and so assessing their investment performance may require several years' worth of evidence.

6.113 Our analysis has shown however that the process for switching fiduciary manager typically takes several months and can incur significant costs. In many cases such costs could amount to approximately one year's worth of fiduciary management fees, and in some cases costs will be even higher than this. We therefore consider that in many cases there are likely to be material barriers to switching fiduciary manager.

DC pension schemes

Our investigation into investment consultancy and fiduciary management services has covered both DB and DC schemes as both use these services.

We have observed that one of the key dynamics in the pensions industry is a move by employers away from DB towards DC schemes. We recognise that DC schemes represent the future shape of the pensions industry.

While our focus has been on assessing competition amongst the providers of services to pension schemes, this work has led us to have some broader concerns over the governance and financial prospects of DC schemes. We set these out below.

Our provisional findings

We found that the use of investment consultancy and fiduciary management services is much lower amongst DC schemes than it is amongst DB schemes: the CMA survey found that only 38% of DC schemes use investment consulting and 5% use fiduciary management, compared to 82% and 14% respectively for DB schemes.

Our assessment shows that DC pension schemes are less likely to be 'engaged' customers of investment consultants and fiduciary managers: in particular, DC schemes have considerably lower rates of switching and tendering than average, and are less likely to have formally reviewed their provider.

TPR research also gives some indications that the strength of governance of DC scheme investment is lower: the average level of trustee qualifications is lower for DC schemes; fewer DC trustees undertake formal training; and only around a third of DC trustees believe all members of their boards meet the standards required in TPR's code of practice. The CMA survey found that DC schemes have fewer meetings and spend less time on their duties than DB trustees.

The CMA survey also found that trustees of DC schemes were less likely to consider the sponsor as 'very important' in monitoring and scrutinising their investment consultant. We have frequently been told by parties to this investigation that hybrid schemes typically devote much more time and attention to their DB element than their DC element. This is consistent with TPR research.[316]

Collectively, these points raise concerns about a lack of engagement and focus on members' outcomes in DC schemes.

We recognise that there are some reasons that could explain why engagement may appear to be lower among DC schemes: many DC schemes are smaller than DB schemes, and all types of smaller schemes tended to exhibit lower engagement in investment consultancy. This may be because, if they have fewer assets to invest, they pursue simpler investment strategies and have less need for advice than a larger scheme would. The existence of investment fee caps on the default arrangements limit their choice of investments and so may also limit their need for advice. Also, as many DC schemes are less mature, it is possible that they are currently more focussed on member contributions and scheme design, rather than on member outcomes via their investment strategy.

Overall conclusions and recommendation

In DC schemes, individual members, rather than sponsoring employers, bear the risk of poor investment outcomes. Yet we find that members are not engaged investors in these products, with the vast majority remaining in the default fund.

We think the indicators of low engagement with investment outcomes by DC schemes raise a risk to the financial outcomes for millions of DC scheme members in the longer term. We think that these schemes should

[316] TPR Trustee Landscape Quantitative Research, 2015.

be held to a very high standard of governance due to their responsibility to the interests of the end customer.

We recommend that DWP and TPR should consider what further measures may be necessary to achieve this.

7. The sale of fiduciary management services by investment consultancy firms

Our main findings

- Decisions about using fiduciary management services and which provider to choose are important for trustee boards and could have long lasting consequences.
- Many trustees have concerns about integrated investment consultants ('IC-FM' firms) steering clients into their own fiduciary management services.
- Half of pension schemes buying fiduciary management services have appointed their existing investment consultant to supply these services.
- IC-FM firms have strategies and financial incentives to sell fiduciary management to their existing advisory clients.
- Some of the ways that these firms introduce and advise on fiduciary management steer trustees towards the firm's own service and make it less likely that they properly consider alternatives.
- Overall, steering behaviours of IC-FM firms and low engagement by trustees when first buying fiduciary management contribute to an incumbency advantage for IC-FM firms, such that pension schemes are less likely to get best value deals.

Introduction

7.1 This section considers whether there are competition problems arising from the sale of fiduciary management services by integrated investment consultants, that is, firms providing both investment consultancy and fiduciary management services (IC-FM firms).

7.2 The main concern we investigated is whether trustee boards are being steered towards buying fiduciary management services from their existing investment consultancy firm who is acting as their advisor, and as a result are not getting best value deals.

7.3 We also considered the related issue of whether IC-FM firms are failing to manage conflicts of interest effectively when introducing and selling fiduciary management to their existing advisory clients. For example, a firm introduces a service when they do not believe that it is in a client's best interests.

7.4 The remainder of this section is structured as follows:

(e) We first present background on the growth of fiduciary management, relevant features of fiduciary management services and trustee concerns.

(f) We consider how pension scheme trustees make decisions around moving to fiduciary management and how they compare and select fiduciary managers.

(g) We then look at the practices of IC-FM firms when introducing and selling fiduciary management to trustees, alongside their strategies, incentives and conflict policies.

Background

7.5 This section sets out some background on fiduciary management services and the importance of this market for trustees. It explains that fiduciary management has grown strongly, sets out some relevant features of fiduciary management services and the IC-FM firm business model, and sets out the levels of trustee concern about these issues.

The growth of fiduciary management services

7.6 As set out in chapters 1 to 3 of this report, fiduciary management has grown strongly in recent years. The number of fiduciary management mandates and the value of assets invested through fiduciary management were over ten times higher in 2017 compared to a decade earlier. KPMG's survey indicates that there were 61 fiduciary management mandates (£12 billion of assets under management) in 2007 and 805 fiduciary management mandates (£135 billion of assets under management) by 2017.[317]

7.7 Based on CMA analysis of the CMA survey, 13% of UK pension schemes currently buy fiduciary management services.[318]

[317] KPMG: *UK Fiduciary Management Survey* (2017).
[318] This takes into account responses where the pension scheme was buying fiduciary management from a confirmed provider of fiduciary management services. Our list of confirmed providers of fiduciary management services includes 17 firms; a total of 145 respondents bought fiduciary management from one of these firms whereas 134 respondents said they bought fiduciary management from a firm that we were not able to confirm as a provider of fiduciary management services.

13% of pension schemes currently buy fiduciary management services.

About fiduciary management services

7.8 Fiduciary management involves a partial or full delegation of investment powers and decisions. When a fiduciary manager is appointed, the fiduciary manager makes and implements decisions for the investor based on the investor's investment strategy.

7.9 We have been told that fiduciary management services can bring benefits for pension schemes. For example:

(a) The PLSA submitted that 'Fiduciary management as an approach can offer many benefits to schemes, including the ability to take investment implementation decisions nimbly in response to market developments and a reduced governance burden more generally'.[319]

(b) Trustees, in-house investment staff, and asset managers that attended our roundtable events said that fiduciary management could be a beneficial service for pension schemes. Asset managers considered fiduciary management to be a method of pooling institutional investors' funds, which could achieve lower costs and fees, and provide greater exposure to different managers.[320]

(c) JLT submitted that '[fiduciary management] is often the quickest, most effective and efficient way for strategic ideas to be implemented by clients'.[321]

(d) WTW said that its fiduciary management clients had experienced significantly less volatility and stronger growth than the average UK DB scheme and that it expected that similar results applied across the FM industry.[322]

7.10 On the other hand, some parties said that independent investment advice (from a firm that doesn't offer fiduciary management) offers benefits such as

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[319] PLSA response to the fiduciary management working paper.
[320] Summary of discussion with pension scheme in house investment staff held on 16 May 2018, summary of roundtable with Pension Trustees held on 1 and 2 May 2018, summary of roundtable with Asset Managers held on 12 February 2018
[321] JLT response to the fiduciary management working paper
[322] WTW submission to the CMA.

objectivity and can deliver equivalent outcomes to fiduciary management.[323] Further analysis on fiduciary management services is also set out in chapter 10 on market outcomes.

7.11 Trustees who choose to delegate through fiduciary management arrangements generally receive more services (and pay fees that are higher) compared to those that only buy investment consultancy services.[324] In addition, trustees who delegate through fiduciary management arrangements become less involved in the investment decisions of the pension scheme.

7.12 As highlighted in chapter 6, the time and costs involved in switching fiduciary management providers can be considerable. We found switching costs to generally be in the range of 0.1% to 1% of assets; therefore, these costs could be equivalent to an additional year's worth of fiduciary management fees, and in some cases even higher.

Around two thirds of fiduciary management mandates are for all scheme assets.

7.13 At present, 61% of fiduciary management mandates are full mandates (where all assets are delegated) and around one-third are partial mandates (where less than 100% of assets are delegated).[325]

7.14 Where partial fiduciary management mandates are awarded, in some cases the size of the mandate will grow over time, either due to asset growth or due to trustees deciding to allocate more assets (or asset classes) to a fiduciary management provider.

7.15 Therefore, decisions about whether to buy fiduciary management services and which provider to appoint are very important decisions for trustee boards. These decisions may have long lasting consequences given the costs of switching fiduciary management provider or leaving fiduciary management altogether. This means that where a trustee moves from investment consultancy to fiduciary management with its existing investment consultancy provider, it is particularly important that the trustee has tested the market and considered alternatives.

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[323] For example: summary of hearing with Redington held on 13 November 2017.
[324] Source: CMA Analysis, Parties' Data.
[325] Source: CMA Analysis, Parties' Data. Analysis is for DB schemes moving into full fiduciary management services and does not control for any confounding factors.

7.16 We also recognise that there are potential benefits from integrated IC-FM business models, including the ability to tailor services to the scheme's needs, and economies of scale and scope. We were told by IC-FM firms and some other stakeholders that the IC-FM integrated business model brings synergies and benefits. For example, the PLSA submitted that 'There are also benefits to [fiduciary management] being offered by a scheme's incumbent investment consultant … as they may have a good understanding of the history and objectives of their clients.'[326]

Trustee concerns related to the sale of fiduciary management by IC-FM firms

7.17 The CMA survey asked trustees for their perception of potential conflicts of interest.[327] As shown below, the survey found that:

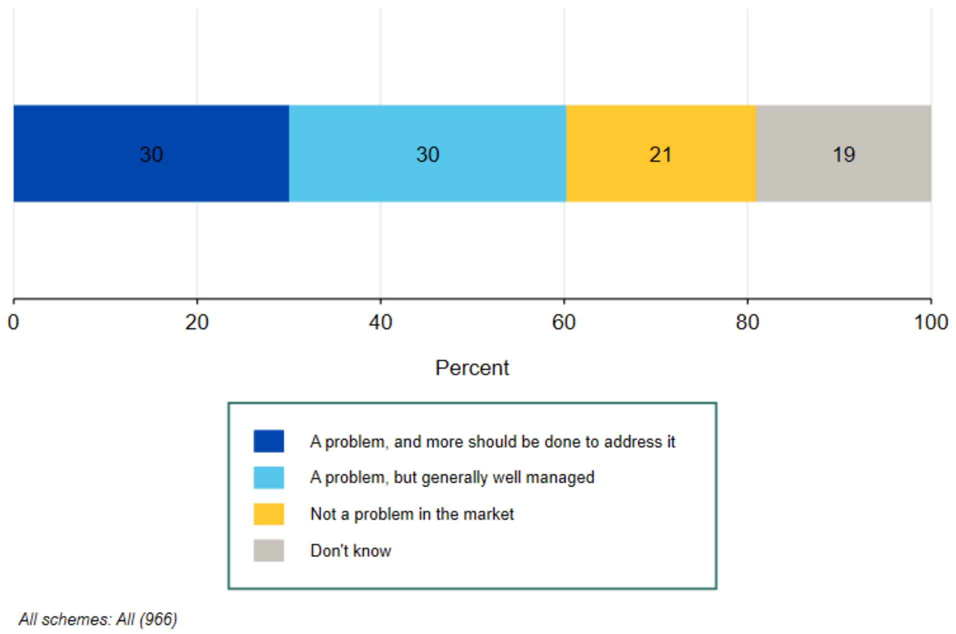
(a) 60% of trustees perceived that investment consultants steering clients into their own fiduciary management services was a problem;

(b) of those trustees that perceived that it was a problem, half said that it was generally well managed (30% of all trustees), whereas the other half said that more should be done to address it (30% of all trustees).

60% of pension scheme trustees thought that investment consultants steering clients into their own fiduciary management services was a problem.

[326] PLSA response to the fiduciary management working paper. See also Mercer response to the fiduciary management working paper, Aon response to the fiduciary management working paper and WTW response to the fiduciary management working paper.
[327] Based on all responses to the CMA survey.

Figure 12. Trustee perceptions of investment consultants using their position to steer clients into their own fiduciary management services



Source: CMA survey, question Q1_1 'Would you say investment consultants using their position to steer clients into their own fiduciary management services is…?'.

7.18 There were some notable differences in how different types of trustees perceived investment consultants steering clients into their own fiduciary management services:

(a) professional trustees were more likely to say that it was a problem and more should be done (62% of professional trustees, compared to 30% of all trustees);

(b) trustees of larger schemes were more likely to say that it was a problem and more should be done (42% of larger schemes, compared to 32% of medium schemes and 22% of smaller schemes).

7.19 We received a range of feedback and views on the CMA survey results. Aon, Mercer and WTW said that the question underpinning Figure 12 above was leading and may have biased or affected the objectivity of the results.[328] In preparing this part of the survey, we took steps to mitigate the risk of biased answers; we consider that the CMA survey provides useful evidence on trustees' attitudes concerning potential conflicts in the markets for IC and FM

[328] Aon, Mercer and WTW responses to the fiduciary management working paper.

services. We discuss parties' submissions on the survey further in Appendix 4.

7.20 Some parties highlighted other survey evidence, including statistics showing that many trustees were satisfied with fiduciary management providers overall and that few trustees not buying fiduciary management identified conflicts of interest as the reason for the decision.[329] We note these points but nonetheless the results at Figure 12 show that a substantial proportion of trustees have concerns regarding steering behaviour by firms. We discuss trustee satisfaction further in chapter 10.

7.21 WTW said that 'it appears that larger pension schemes would be able to remedy the problem caused by potential conflicts of interests through the use of intermediaries'.[330] They also said: '[✂]'.[331]

7.22 We have not concluded on whether professional trustees and trustees of larger schemes are better placed to judge these issues. However, we note that professional trustees may have more visibility and understanding of investment issues.

7.23 Overall it appears that a substantial proportion of trustees, in particular professional and larger scheme trustees, have concerns regarding this issue. We consider below how trustees are buying fiduciary management services and how IC-FM firms are introducing and selling these services.

Demand side: How trustees consider and make decisions on fiduciary management

7.24 To drive competition, trustees that are prospective customers of fiduciary management services need to be willing and able to access information about alternative firms in the market; assess or compare their offers; and actively select their preferred supplier.

7.25 The following section sets out our assessment of the evidence provided to us in relation to the fiduciary management purchase decisions that trustees have made, and the actions that they have taken when selecting a fiduciary management provider.

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329 For example, Aon response to the fiduciary management working paper.
330 WTW response to the fiduciary management working paper.
331 [✂].

Selecting fiduciary managers

7.26 We collected various data on the usage of fiduciary management and evidence from both the CMA survey and data submitted by the parties. This indicates that half of pension schemes buying fiduciary management have appointed their existing investment consultant to supply these services. In many cases these sources show similar results. The analysis of parties' data is based on a greater number of data points therefore we focus on this as our primary source of evidence.

Parties' data

7.27 We asked parties to supply us with data on their fiduciary management clients.[332] Of this sample:

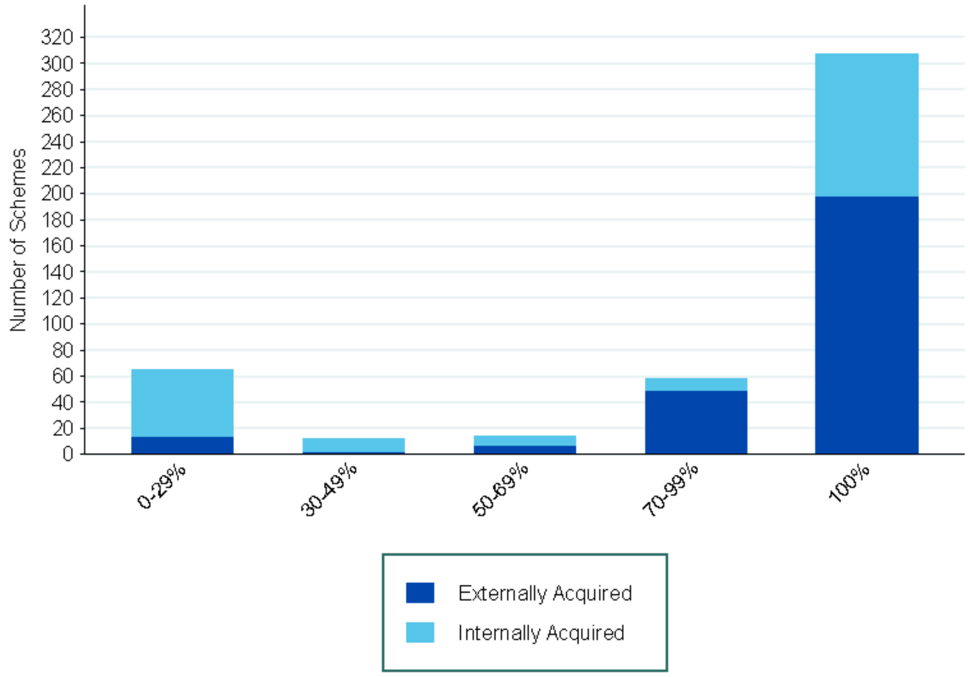
(a) the vast majority of customers (83%) bought fiduciary management services from an IC-FM firm;

(b) half (50%) bought these services from an IC-FM firm that was already supplying investment consultancy services to them.

7.28 Figure 13 below provides a breakdown according to whether the client delegated management of all assets to the fiduciary management provider, or only a proportion of assets. We distinguish between clients that were already buying investment consultancy services from the provider (these are 'Internally Acquired' schemes) and those that were not (these are 'Externally Acquired' schemes). In general, we note that the majority of schemes purchasing fiduciary management have delegated all or most of their assets: customers who are Externally Acquired tend to delegate more or all of their assets; those who only delegate a minority of their assets tend to be Internally Acquired.

[332] IC-FM and other fiduciary management firms provided us with detailed information on a total of 498 of their fiduciary management clients. See also Appendix 6 for more information on this data set.

Figure 13: Number of schemes analysed by level of delegation and source of acquisition



Source: CMA Analysis, Parties' Data

CMA analysis of CMA survey

7.29 The CMA survey asked trustees about the fiduciary management providers that their pension scheme first selected and that they currently used.[333] Our analysis of the survey results indicated that:

(a) when appointing their first fiduciary management provider, around half of all schemes buying fiduciary management appointed their existing investment consultant (47%), and

(b) as at the time of the survey, the majority of schemes buying fiduciary management also bought investment consultancy services from that provider (74%).[334]

[333] The CMA survey statistics presented in this section are based on responses where the pension scheme was buying fiduciary management from a confirmed provider of fiduciary management services.

[334] There are several possible explanations for the differences between the two statistics. Firstly, some schemes may have appointed a firm that was not previously their investment consultancy provider to supply investment consultancy and fiduciary management services through a single process. Secondly, some schemes may have appointed a firm that was not their investment consultancy provider to supply fiduciary management services, before subsequently also starting to buy investment consultancy services from that firm.

Around half of all schemes who have bought fiduciary management appointed their existing investment consultant.

7.30 Therefore both the parties' data and our analysis of the CMA survey indicate that around half of schemes buying fiduciary management have appointed their existing investment consultant to supply this service.

7.31 Several IC-FM firms said that that there were good reasons why trustees might want to buy from an existing service provider. For example:

(a) WTW said that 'it is altogether unsurprising that a good proportion…decide not to switch providers when moving from advisory to fiduciary management services. These are clients which are likely to have been with their advisory provider for many years and where a relationship of trust has been built'.[335]

(b) Aon submitted that 'In many instances, trustees will have already undertaken due diligence on their investment consultant firm's strategy, operational due diligence capability and manager selection expertise…so long as they are content with their existing investment consultant's strategy, it is natural for many trustees to conclude that their existing investment consultancy provider would be their best fit to provide fiduciary management.[336]

7.32 Cardano said that their interpretation of the evidence on fiduciary management purchasing patterns and market testing was that 'IC-FM firms have been disproportionately successful as a consequence of their clients *not testing the market*'.[337]

7.33 We recognise that customers may have good reasons to select an incumbent investment consultancy firm to supply fiduciary management services. However, whichever provider they appoint, we would expect customers buying fiduciary management to test the market in order to get the best value that they can for their pension scheme.

[335] WTW response to the fiduciary management working paper.
[336] Aon response to the fiduciary management working paper.
[337] Cardano response to the fiduciary management working paper.

Actions of customers when selecting a fiduciary management provider

7.34 We used several sources of evidence to assess the steps that trustees have taken when selecting a fiduciary management provider.[338]

7.35 We considered several indicators of engagement with fiduciary management selection, including usage of formal tenders, inviting proposals, usage of third party advice, and having a professional trustee on the trustee board. This work builds on chapter 6 of the report.

Parties' data

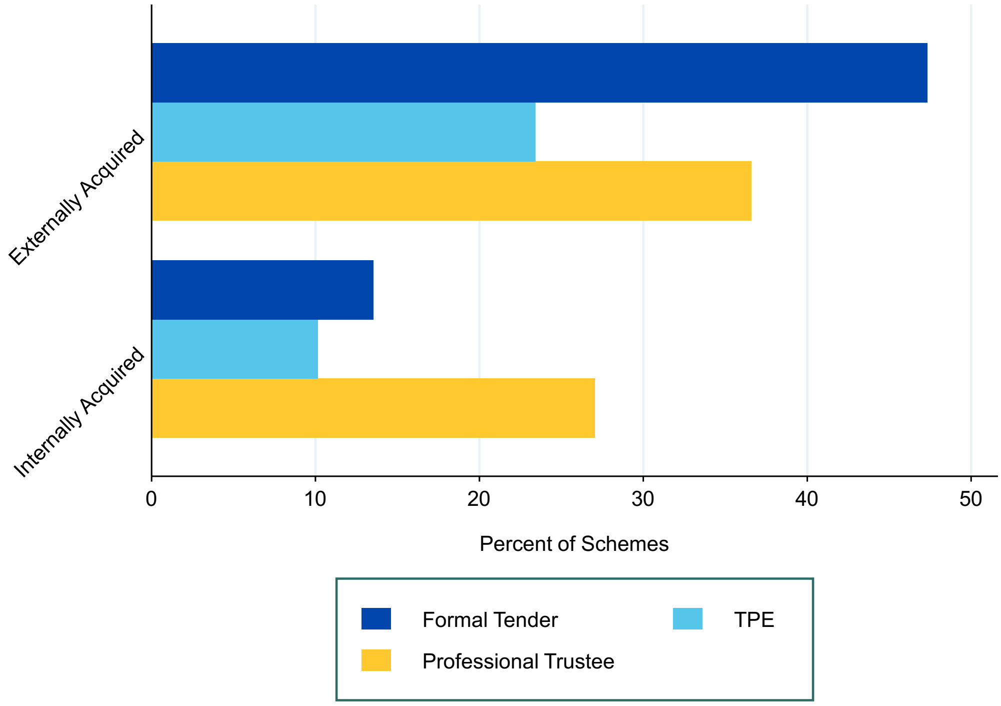
7.36 Based on data submitted by parties, average formal tender rates for all schemes buying fiduciary management are relatively low at around 34%.

Only 34% of schemes who bought fiduciary management had formally tendered.

7.37 Figure 14 below focuses on pension schemes buying fiduciary management services from an IC-FM firm. It shows the percentage of customers exhibiting three indicators of engagement when buying these services.[339]

[338] The CMA survey statistics presented in this section are based on 145 responses where the pension scheme was buying fiduciary management from a confirmed provider of fiduciary management services.
[339] This dataset comprises pension schemes that were fiduciary management customers of Aon, JLT, Mercer, River & Mercantile and WTW as of 2016. The engagement indicators used are the use of a formal tender, the use of a TPE and having a professional trustee on the board of trustees.

Figure 14: Proportion of schemes buying fiduciary management from an IC-FM firm that exhibit engagement indicators



Source: CMA Analysis, Parties data

7.38 Figure 14 shows that, of Externally Acquired schemes, 47% of schemes used a formal tender process, 23% used a TPE and 37% had a Professional Trustee. Whereas for Internally Acquired schemes, only 14% of schemes had formally tendered, 10% used a TPE, and 27% had a Professional Trustee.

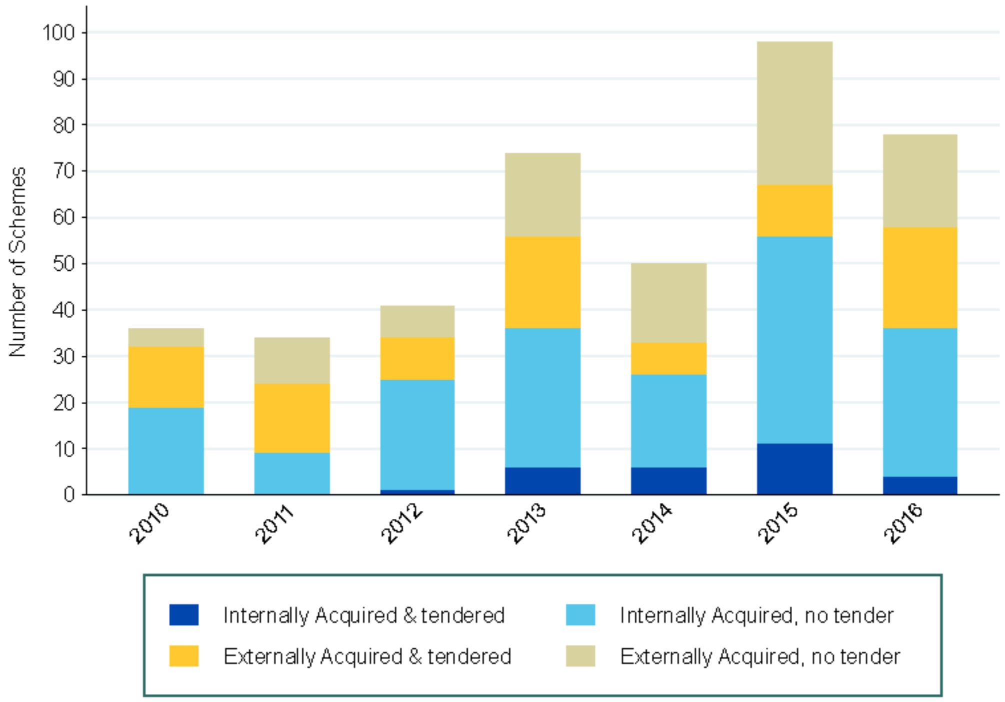
Only 14% of schemes who bought fiduciary management from their existing investment consultant had formally tendered.

7.39 These figures indicate that pension scheme engagement is substantially lower for Internally Acquired schemes compared to Externally Acquired schemes.

7.40 Figure 15 below shows how formal tender rates have varied through time, broken down according to whether customers were Internally Acquired or Externally Acquired.[340]

[340] This dataset comprises pension schemes buying fiduciary management from Aon, JLT, Mercer, River & Mercantile and WTW.

Figure 15: Stacked bar chart showing the number of schemes buying fiduciary management from an IC-FM firm



Source: CMA Analysis, Parties' Data.

7.41 Figure 15 illustrates that the proportion of Internally Acquired schemes (shown in blues) has been relatively consistent through time at around 50% in most years. It also shows that no Internally Acquired schemes had performed a formal tender prior to 2012. After 2012, a greater proportion of Internally Acquired schemes undertook a formal tender, although those doing so still represented a minority of schemes.

7.42 The data set used above is likely to include some purchases where schemes were switching from one fiduciary management provider to another, as well as purchases where schemes were buying fiduciary management for the first time. However, as fiduciary management is a new market and only a small proportion of schemes have switched provider to date,[341] we consider the evidence above to be indicative of trustee engagement when first buying fiduciary management.

[341] As set out in chapter 6 we found the average rate of switching in fiduciary management to be 9% over the last five years.

CMA analysis of CMA survey

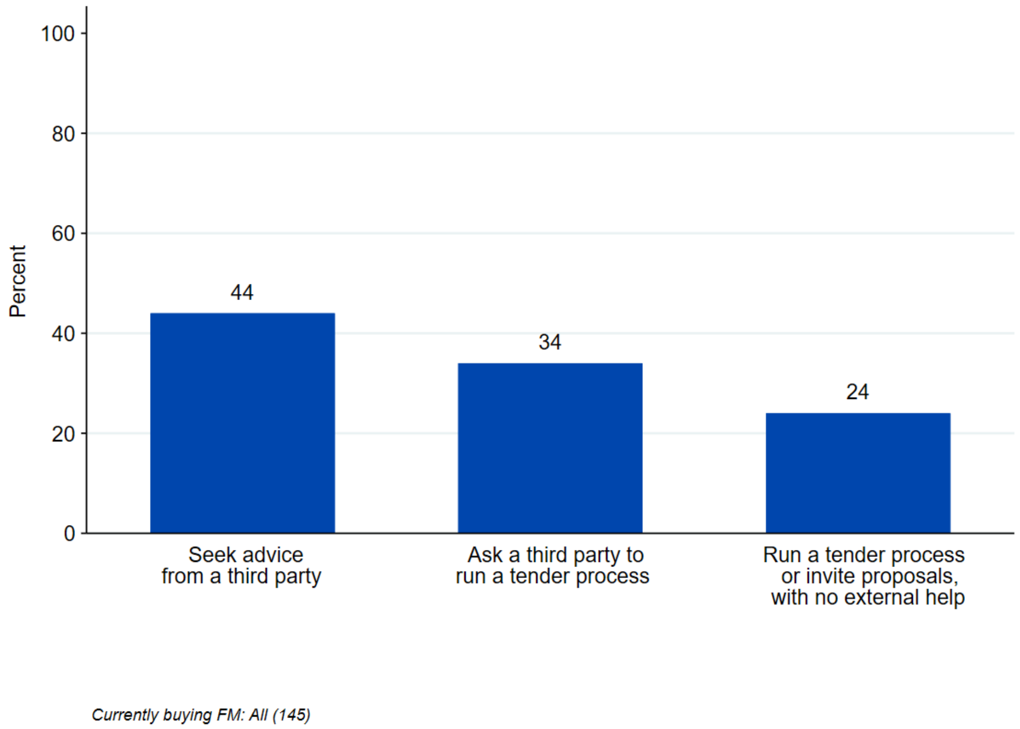
7.43 The CMA survey asked about the actions that pension scheme trustees took when first buying fiduciary management.[342] The chart below indicates that:

(a) fewer than half of schemes sought advice from a third-party when buying fiduciary management for the first time (44%);

(b) around a third of schemes asked a third-party to run a tender when buying fiduciary management for the first time (34%);

(c) around a quarter of schemes ran a tender process or invited proposals with no external help, when buying fiduciary management for the first time (24%);

Figure 16 Actions of customers when first buying fiduciary management



Source: CMA analysis of CMA survey data, question L5 'Which of the following, if any, did the board of trustees do when you were buying fiduciary management services for the first time?'.

7.44 Combining the results at (a) and (b) above, almost half (49%) of schemes received some form of third-party support (in the form of advice or running a tender) when buying fiduciary management services for the first time. We consider that asking a third-party to run a tender (as 34% of schemes were

[342] Source: CMA survey, question L5. '*Which of the following, if any, did the board of trustees do when you were buying fiduciary management for the first time?*'.

reported to have done) is likely to be a stronger form of market testing compared to only seeking third party advice.

7.45 Our analysis of the CMA survey found that the median number of providers invited to submit a tender or proposal was three; as was the median number of providers who responded to the invitation.[343]

7.46 While these are based on different data sets, we note that both the parties' data and our CMA survey analysis indicate that around a third of schemes have undertaken a formal tender when buying fiduciary management. As noted at paragraph 7.26 we focus on the former source, as it is based on a greater number of data points.

Other evidence on trustee engagement

7.47 KPMG's 2016 and 2017 surveys indicate that the proportion of new fiduciary management appointments in a given year that were advised by an independent third-party has grown from 23% in 2015, to 33% in 2016, and 60% in 2017.[344]

7.48 Some IC-FM firms submitted that trustees often test the market when buying fiduciary management. For example, Mercer submitted that 'Trustees frequently test the market – and seek independent third-party advice – before appointing a fiduciary management provider'.[345] Several parties highlighted the upward trend in the use of third parties in KPMG's 2017 survey.[346]

7.49 Some other fiduciary management providers submitted that levels of market testing were limited in their experience. For example, Cardano said they had a one-in-three success rate but were asked to tender in only around one-sixth of the market. They said they 'strongly suspect that many of the five-sixths of the market that did not consider Cardano did not undertake a full review of the options available'.[347]

7.50 Some IC-FM firms highlighted the role of other forms of engagement with the process of buying fiduciary management. Aon submitted that where trustees

[343] Source: CMA survey, questions L6. '*In total, how many providers did you invite to submit a tender or proposal?' and L8: 'How many tenders or proposals did you receive?'. Estimations are based on the sample of 119 fiduciary management clients who knew the number of fiduciary management providers they invited to submit proposals and the sample of 116 fiduciary management clients who invited proposals and knew how many fiduciary management providers submitted them.*
[344] KPMG: *UK Fiduciary Management Survey* (2017).
[345] Mercer response to the fiduciary management working paper.
[346] For example: WTW response to the fiduciary management working paper; Mercer response to the fiduciary management working paper, and Aon response to the fiduciary management WP working paper.
[347] Cardano response to the fiduciary management working paper.

first buying fiduciary management do not switch and do not use a TPE, this does not mean that they have not made an informed decision. They said that 'Trustees challenge us when moving from Aon's investment consultancy product to Aon's fiduciary management product, and frequently take input from other sources in parallel, such as their sponsor, actuaries or lawyers'.[348]

7.51 In-house investment staff at pension schemes told us that they consider it best practice for schemes to tender when moving into fiduciary management. They also told us that the use of third party evaluators can be a good way for schemes to ensure they get a good deal.[349] Some trustees felt that independent investment consultants and TPEs had been helpful in supporting trustee decision making when their scheme bought fiduciary management services.[350]

7.52 We consider that market testing exercises are likely to be stronger where they involve formal tenders, and that independent third-party advice can also play an important role for trustees.

Provisional conclusions on how trustees consider and make decisions on fiduciary management

7.53 The evidence we have reviewed indicates that half of pension schemes buying fiduciary management services selected a provider that was also their existing investment consultant. Of itself, this does not necessarily imply there is a competition problem; incumbent providers would typically have scheme knowledge and may have demonstrated their skills to trustees in the course of delivering investment consultancy services.

7.54 However, given the importance of fiduciary management purchase decisions, we were concerned to find low levels of engagement among customers when first buying fiduciary management. For example, only 34% of all fiduciary management appointments followed a formal tender process. Moreover, only 14% of fiduciary management appointments for incumbent IC-FM firms followed a formal tender process; and only 10% of these appointments involved a TPE.[351]

7.55 According to the KPMG survey, the rate of TPE usage in fiduciary management appointments was almost twice as high in 2017 compared to 2016. However, overall, the evidence that we have reviewed indicates that a significant number of trustees have not taken steps to test the market before

[348] Aon response to the fiduciary management working paper.
[349] Summary of discussion with pension scheme in house investment staff held on 16 May 2018.
[350] Summary of roundtable with Pension Trustees held on 1 and 2 May 2018.
[351] Source: CMA Analysis, Parties' Data.

buying fiduciary management for the first time. We consider that this contributes to an incumbency advantage for IC-FM firms compared to other providers of FM services.

Supply side: Firms' practices and incentives for selling fiduciary management

7.56 The way that IC-FM firms introduce, advise on and provide information relating to fiduciary management services can influence whether their advisory clients are able to make informed decisions about fiduciary management.

7.57 Therefore, in this section, we assess the strategies, policies and regulations that are relevant to the introduction and sale of fiduciary management, and evidence relating to how IC-FM firms behave in practice.

7.58 IC-FM firms supplying institutional investors in the UK include the following seven firms: Aon, Cambridge Associates, JLT, Mercer, River & Mercantile Russell Investments, WTW. In the section that follows we generally focus on these firms.

Firms' strategies and incentives

Evidence on strategies from internal documents

7.59 We reviewed a sample of internal strategy and board/committee documents produced by firms over the last five years. As part of this, we looked for evidence on firms' strategies for selling fiduciary management services.

7.60 These documents indicate that several IC-FM firms have actively sought to cross-sell fiduciary management services to their existing investment consultancy customers. For example:

(a) A strategy document (2017) contained a series of actions, including the following: 'Increase penetration of [fiduciary management] solutions within existing client base'.[352]

(b) A strategy document produced by another firm (2016) stated:[353]

[352] Document submitted by [✂] July 2017.
[353] Document submitted by [✂] Oct 2016.

(i) ‘Cross sell [fiduciary management and other services] in the acquired client base’;

(i) [in relation to investment consultancy] ‘Cross selling [fiduciary management]’

(c) Another firm produced a document (2017) stating that: ‘Within the corporate pension fund segment, we will concentrate our direct sales efforts on a focused list of 40 - 50 accounts where we have already built brand recognition or have existing ties through advisory or implementation services’ [354,355]

7.61 We found statements where firms indicated that they took account of client needs and identified client benefits. For example:

(a) A strategy document (2017) said ‘There is an opportunity to grow assets where appropriate for client needs’.[356]

(b) A strategy document produced by another firm (2014) said: ‘[fiduciary management can] bring our best ideas to our clients more quickly and at lower cost than the traditional advisory model’.[357]

7.62 Some of the statements that we reviewed in internal documents indicated that some firms have had particularly strong cross-selling strategies. For example, in one document (2014) a firm indicated that it planned to pursue the cross-selling of fiduciary management even though this could damage client relationships: ‘Adopt a [fiduciary management]-first approach with more clients and accept the risk of relationship damage and loss’.[358,359]

Some IC-FM firms have had particularly strong cross-selling strategies.

7.63 We also found evidence that some IC-FM firms have sought to use their investment consultancy staff as a gateway for fiduciary management staff to

[354] Document submitted by [✂] 2017.
[355] The firm told us that these accounts largely represented sources of new business and that the reference to existing ties was made with regard to a subset of these accounts ([✂]).
[356] Document submitted by [✂] July 2017.
[357] Document submitted by [✂] 2014.
[358] The firm told us that the ‘relationship damage’ referred to was that the client would be likely to go out to competitive tender which meant they would be lost as an advisory client ([✂]).
[359] Document submitted [✂] 2014.

sell fiduciary management services. For example, one firm produced a business plan document (2014) that said:[360]

(a) '[fiduciary management] Sales leads have regular meetings and 1:1s with our internal consultants;'

(b) 'Our internal consultants are still a barrier to raising [fiduciary management] (and [the fiduciary management] team accessing the client) however this has improved over the past year. Opportunities are still being missed', and

(c) 'A number of initiatives to continue to improve the flow of prospects from internal channels: Revenue generated in [the fiduciary management division] flows back to individual client teams in the [investment consultant division] – thus ensuring they do not feel they are cannibalising their own business'.

7.64 Mercer submitted that their experience was that 'cross-selling is not being pursued at inappropriate levels' and that evidence on cross-selling should be considered in the context of 'wider business plans that are implemented in an environment where the best interests of the client come first'.[361] WTW submitted that practices including strong and persistent cross-selling 'do not impact competition (and therefore cannot give rise to an adverse effect on competition)'.[362]

7.65 We recognise that firms have a legitimate interest in selling additional services and that none of the evidence above implies that firms are seeking to sell fiduciary management services that are against their clients' interests. However, our assessment is that the evidence demonstrates that IC-FM firms have strategies to sell fiduciary management services to existing investment consultancy clients.

Evidence on profitability from internal document review

7.66 We also reviewed firms' internal documents and found statements made about the profit margins that they earn when providing investment consultancy and fiduciary management services.

[360] Document submitted by [✄] 2015
[361] Mercer response to the fiduciary management working paper.
[362] WTW response to the fiduciary management working paper.

7.67 [✂].[363,364] Therefore, if net profit margins (in percentage terms) were equal across the two services, then firms would earn greater profit per fiduciary management client than per investment consultancy client.

Fiduciary management fees are four to five times higher than investment consultancy fees.

7.68 We found several statements indicating that some firms have viewed fiduciary management as having higher profit margins than investment consultancy. For example:

(a) One firm produced a document (2013) that said: 'Our current [fiduciary management] margins are exceptional [sic] high and may not be sustainable in the long term.' The same document also noted that 'fee compression will occur as the market develops.'[365]

(b) The same firm produced a document (2014) that said: 'This growth [in the fiduciary management business] will come from converting existing [firm name] clients to this higher-margin product.'[366]

(c) [✂].[367]

7.69 By contrast, we found that another firm had projected that fiduciary management would have a lower profit margin than other services, but that margins would increase over time. The firm produced a 2013 business plan that included a table of 'business as usual financials' projecting that the division that includes advisory work would have higher margins than the division including fiduciary management work.[368]

Evidence on profitability from parties' financial information

7.70 We examined the profitability of six IC-FM firms who were able to provide us with net profit margin figures for investment consultancy and fiduciary management. Overall, the aggregate net profit margin for investment consultancy and fiduciary management combined for those six providers in 2016 was [20% - 30%]. The aggregate net profit margin for those six

[363] Source: CMA Analysis, Parties' Data.
[364] [✂].
[365] Document submitted by [✂] 2013.
[366] Document submitted by [✂] 2014.
[367] Document submitted by [✂] 2014,
[368] Document submitted by [✂].

providers was [20% - 30%] for investment consultancy and [20% - 30%] for fiduciary management.

7.71 Several parties commented on the interpretation of these margin figures. For example:

(a) Hymans said that 'based on our experience…fiduciary management fees are much higher than advisory fees, with profit margins at least equal if not significantly higher than standalone investment consultancy work'.[369]

(b) Russell Investments said that our analysis should 'also take into account the added accountability, risk and complexity of running a fiduciary management mandate versus an investment consultancy mandate'.[370]

(c) WTW said that 'fiduciary management services require higher average profit margins to compensate investment consulting firms for the higher operational and market risks associated with these services'.[371]

(d) Mercer said that 'any perceived incentive that potentially higher margins would encourage firms to raise fiduciary management with their clients is undermined by the potential risk of losing the client altogether'.[372]

7.72 Overall, we did not find much difference between investment consultancy and fiduciary management net profit margins. However, as fiduciary management mandates generate higher revenues than investment consultancy mandates, it follows that total profits per mandate are higher for fiduciary management than for investment consultancy.

7.73 We were not in a position to assess whether the supply of fiduciary management services was more profitable than investment consultancy services on a risk-adjusted basis, as it would have been very difficult to calculate the cost of capital for investment consultancy and fiduciary management. Some parties claimed that running a fiduciary management mandate involved greater risk than an investment consultancy mandate, however no evidence was provided to support this.

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[369] Hymans response to the fiduciary management working paper.
[370] Russell Investments response to the fiduciary management working paper.
[371] WTW response to the fiduciary management working paper.
[372] Mercer response to the fiduciary management working paper.

Staff remuneration policies

7.74 We reviewed firms' staff remuneration policies in order to assess whether these incentivise investment consultancy staff to sell fiduciary management services to existing investment consultancy clients.

7.75 We asked IC-FM firms to provide us with details of their remuneration policies and to explain how staff are rewarded when existing advisory (ie investment consultancy) clients decide to purchase fiduciary management services from that firm. The submissions that we received[373] showed that:

(a) None of the IC-FM firms have remuneration policies that specifically reward advisory or fiduciary management staff for moving existing clients from investment consultancy to fiduciary management services.

(b) One of the IC-FM firms has a sales incentive plan that directly rewards certain fiduciary management sales staff with a monetary bonus when any customer (whether an existing advisory client or not) begins to buy fiduciary management for the first time. The bonus is based on a proportion of the expected revenue that will be earned from the fiduciary management client. This scheme is not available to advisory staff.[374]

(c) A second IC-FM firm said it was planning to setup a sales incentive plan that would directly reward certain fiduciary management sales staff through a monetary bonus when a customer (whether an existing advisory client or not) buys fiduciary management for the first time. This would apply only to sales staff, who are independent of the consulting teams.[375]

(d) Several IC-FM firms have bonus schemes under which advisory and fiduciary management staff may be eligible to receive a share of overall division profit, depending on how well they have performed in the year. Several firms said that advisory staff could therefore receive an indirect monetary benefit were they to play a role in facilitating the sale of fiduciary management services, where this increased firm revenue and where the sale was consistent with wider firm policy.[376]

7.76 Several parties have submitted that their remuneration policies do not create incentives to move investment consultancy clients towards fiduciary

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[373] Responses to market information request and follow up request on staff incentives and internal controls.
[374] [✂].
[375] [✂].
[376] [✂], [✂], [✂] and [✂].

management services.[377] Aon submitted that the CMA's evidence showed that staff are not rewarded for selling fiduciary management services as an alternative to investment consultancy services. [378]

7.77 Our assessment is that firms' remuneration policies do not appear specifically to incentivise staff to encourage investment consultancy clients to move to fiduciary management.

Trustee round table

7.78 Some trustees said that they had direct experience of being subject to repeated approaches from their IC-FM firm encouraging them to adopt a fiduciary management approach. For example, one trustee said the trustee board had communicated a clear decision against fiduciary management in one board meeting, yet had been presented with a partial fiduciary management product by their investment consultant at the next meeting. Those trustees considered that the intensity of these approaches had recently increased and that there was a presumption from IC-FM firms that schemes would adopt fiduciary management as a matter of course.[379]

7.79 Trustees also believed that there were large financial incentives for firms to convert investment consultancy clients into fiduciary management clients in terms of greater firm profitability or individuals getting bonuses.[380]

Summary of findings on firms' strategies and incentives

7.80 Overall, the evidence that we have reviewed indicates that IC-FM firms have strategies to sell fiduciary management services to their existing advisory clients. We place particular weight on firms' internal strategy documents in reaching this conclusion.

7.81 Given that fiduciary management mandates generate higher revenues than investment consultancy mandates, and profit margins are similar across the two services, it follows that fiduciary management mandates generate higher profits than investment consultancy mandates and that IC-FM firms have financial incentives to sell fiduciary management to their existing advisory clients.

[377] For example: Mercer response to the fiduciary management working paper and WTW response to the fiduciary management working paper.
[378] Aon response to the fiduciary management working paper.
[379] Summary of roundtable with Pension Trustees held on 1 and 2 May 2018.
[380] Summary of roundtable with Pension Trustees held on 1 and 2 May 2018.

IC-FM firms have financial incentives to sell fiduciary management to their existing advisory clients.

Conflicts of interest

7.82 In this section, we consider the extent to which FCA regulation covers the introduction and sale of fiduciary management services to existing investment consultancy clients. We also assess the extent to which firms' conflicts of interest policies and processes address potential issues in this area.

Regulation

7.83 As set out in paragraph 3.48, some of the activities of investment consultancy and fiduciary management providers are subject to FCA regulation and are also covered by MiFID II. They are subject to many and varied rules on conduct, including rules on how they must identify and prevent or manage conflicts of interest. This includes conflicts between their own interests and those of their clients, as well as conflicts between one client and another client.[381]

7.84 Parties submitted mixed views as to whether activities relating to the introduction and sale of fiduciary management services are covered by regulation. For example:

(a) Barnett Waddingham said that: 'the perimeter of existing regulation may not sufficiently cover [advice on fiduciary management in general or advice on a provider's own fiduciary management product]'.[382]

(b) Aon said that: 'the scope of FCA regulation is sufficiently broad that the promotion/recommendation of in-house fiduciary management services by an incumbent investment consultant should be identified as a conflict of interest by the fiduciary manager'.[383]

(c) Mercer said that: 'while certain aspects of providing investment consultancy services may be strictly speaking outside the regulatory

[381] See, for example, Principle 8, SYSC 10 and COBS 6 of the FCA Handbook, Article 23 MiFID II Directive 2014/65 and Articles 33 and 34 MiFID II Delegated Regulation 2017/565.
[382] Barnet Waddingham response to the fiduciary management working paper.
[383] Aon response to the fiduciary management working paper.

perimeter, in practice we apply a single approach to dealing with conflicts of interest'.[384]

(d) Russell Investments said that: 'We agree that the current definition of a personal recommendation does not include the suitability of a fiduciary management service'. They also said that: 'we believe that its current scope…is sufficient to cover the handling of potential conflicts of interest within the scope that it is designed to cover'.[385]

7.85 At our trustee roundtable, trustees said that they were not confident that FCA regulation, which requires authorised firms to act in their clients' best interests would be of any use if they were being steered towards products or services which were more clearly in the provider's interests than their own.[386]

7.86 Overall, in our view, not all of the activities of IC-FM firms relating to the introduction and sale of fiduciary management are covered by the conduct rules applicable to FCA-regulated activities. Nonetheless, the IC-FM firms in our sample do have conflict of interest policies. We consider these below.

Firms' conflicts of interest policies

7.87 All seven IC-FM firms in our sample provided us with written conflict of interest policies.[387]

7.88 A common feature of these documents was that they set out general principles for staff to follow, such as the importance of being fair, impartial and acting in the best interests of clients.[388]

7.89 Several firms submitted documents that set out recommended conflict management strategies at a relatively general level. These strategies included: avoiding a conflict by not providing a service; putting in place information barriers on either side of a conflict; and disclosing a conflict to clients.[389]

7.90 Some firms submitted policy documents that specifically identify the sale of fiduciary management to an investment consultancy client as an example of a situation where conflicts might arise.[390]

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[384] Mercer response to the fiduciary management working paper.
[385] Russell Investments response to the fiduciary management working paper.
[386] Summary of roundtable with Pension Trustees held on 1 and 2 May 2018.
[387] Responses to market information request.
[388] For example, policies submitted by [✂] (2017), [✂] (2017), [✂] (2017) and [✂] (2013).
[389] For example, policies submitted by [✂], [✂], [✂] (2017) and [✂].
[390] For example, policies submitted by [✂] (2017), [✂] (2017) and [✂] (2014).

7.91 Most of the firms that did so set out management strategies, for example a WTW document (2014) states that that there is a possible conflict of interest when a fiduciary business exists within an investment consulting firm, given that when an investment consultant advises its client on governance arrangements, 'there is a danger that it could use this role as a way to advocate for a delegated service.' It also says, 'The conflict can be managed via the use of a third-party firm to advise on the selection process.'

7.92 Finally, several firms submitted policy documents that encouraged or required staff to notify others in the organisation when potential conflicts are found, and/or specified sanctions that could apply to staff that fail to follow company conflict management policies.[391]

7.93 We consider that conflict policies that specifically cover best practice in relation to the introduction and sale of fiduciary management to advisory clients are more likely to play a role in addressing the risk that some clients are steered towards in-house products and do not get best value deals.

7.94 WTW said it would 'welcome suggestions to refine conflict policies and processes to make them more robust'.[392] Aon said it disagreed with any inference that high-level and principles-based policies result in poor compliance and said that they instigate regular conflicts of interest training.[393]

7.95 Several firms indicated in their Issues Statement responses that part of their conflict management strategy is to avoid providing advice in relation to their own fiduciary management service. For example, several firms said that they would introduce clients to fiduciary management, but would not advise on or recommend their own fiduciary management product.[394]

7.96 We consider that policies to 'introduce' but not 'recommend' own fiduciary management services may leave grey areas where customers are not clear whether a firm is providing impartial advice on fiduciary management as a governance model, or whether the firm is promoting their own product.

Firms' independent review processes

7.97 We also asked parties whether they had independent review processes in place in order to ensure that client moves from investment consultancy to

[391] For example, policies submitted by [✂], [✂] (2013), [✂] and [✂] (2013).
[392] WTW response to the fiduciary management working paper.
[393] Aon response to the fiduciary management working paper.
[394] See for example: Aon Issues Statement response; Mercer Issues Statement response; summary of hearing with Cambridge Associates held on 12 January 2018.

fiduciary management were in the best interests of the client and that any conflicts are appropriately managed. Based on six responses received:[395]

(a) Three parties said that they did not have an independent review process in advance of any move;[396]

(b) One party said that an independent review process was undertaken by compliance staff in advance of a move.[397]

(c) Two other parties noted that advice or documents supplied to clients were subject to independent peer review by investment consultant staff,[398] and

(d) Only one party said that it undertook retrospective client reviews. It said that these are undertaken periodically by investment consultancy staff that are independent of the client team to assess compliance with internal policies and procedures and include those instances where a client has moved from investment consultancy to fiduciary management.[399]

Provisional conclusions on conflicts of interest

FCA regulation covers only some of the activities of IC-FM firms.

7.98 FCA regulation covers only some of the activities of IC-FM firms that are most relevant to the introduction and sale of fiduciary management to existing advisory clients.

7.99 IC-FM firms' conflicts of interest policies and processes have the potential to at least partly address the risk that trustee boards are steered towards buying fiduciary management services. However, we note that:

(a) Some of the guidance in these policy documents is high-level and principle-based, which could create some grey areas for staff and customers. For example, from our review, it was unclear how staff would assess what is in their clients' best interests.

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[395] Responses to information request on staff incentives and internal controls.
[396] [✂], [✂] and [✂].
[397] [✂].
[398] [✂] and [✂].
[399] [✂].

(b) In addition, several firms say that they 'introduce' but do not 'advise' on their own fiduciary management products. This may leave grey areas where customers are not clear whether a firm is providing impartial advice on fiduciary management as a governance model, or whether the firm is promoting their own product.

7.100 We have not assessed firms' compliance with their conflicts of interest policies. We note that, as with other company policies, compliance may vary within and across firms.

7.101 In the next section, we consider the evidence provided to us on how IC-FM firms introduce and advise on fiduciary management in practice.

Conduct of firms when introducing and advising on fiduciary management

Review of documents supplied by firms to their clients

7.102 We have reviewed a sample of documents supplied by six IC-FM firms[400] to clients that were initially buying investment consultancy services and then subsequently bought fiduciary management services from the same firm. We have reviewed over 200 documents that were supplied by these firms to 27 clients over the last five years.[401] The sample mostly comprises DB pension schemes, but also includes some DC and hybrid schemes. Around half of these schemes bought partial fiduciary management services and around half bought full fiduciary management services.

7.103 From that review we identified examples of:

(a) the types of information and advice which firms provide to clients that are considering buying fiduciary management;

(b) the way that this information and advice is presented;

(c) how conflicts of interest are handled in these documents.

We then assessed whether, and if so how, these practices affect the ability of trustees to make informed decisions about fiduciary management and get best value deals.

[400] These are six of the seven IC-FM firms referred to earlier in this section. The firm that is not included in the document review does not have any full fiduciary management customers that were previously advisory customers.
[401] Documents submitted in response to market information request.

7.104 In undertaking this review, we did not seek to examine whether firms have complied with their conflict of interest policies.

7.105 We recognise that the firms will have also interacted with these clients through other channels of communication (for example, verbal exchanges) in addition to the documents that we reviewed. We also recognise that the examples presented in this section may not be representative of all the documents that IC-FM firms supply to their clients. Nonetheless, in our view the documents we have reviewed constitute relevant evidence covering a range of practices and firms.

7.106 Table 6 summarises some of the types of information and advice provided by IC-FM firms that may have a bearing on customer decisions to purchase fiduciary management services.

Table 6 Some types of information and advice provided by IC-FM firms that may have a bearing on customer decisions to purchase fiduciary management services

Stage of customer journey towards fiduciary management	*Types of information or advice*	*Example document types*
1. **Early consideration of fiduciary management:** customer is reviewing aspects of its strategy, developing its understanding of fiduciary management and deciding whether to explore further	General introductory information on fiduciary management.	• **Advisory presentations** to trustees or scheme sponsors explaining how fiduciary management works and the general advantages and drawbacks. The same documents may highlight current challenges facing the scheme, such as poor performance.
2. **Further assessment of fiduciary management:** customer is assessing whether fiduciary management would suit its needs and deciding whether to proceed with fiduciary management product selection	Advice or information on how fiduciary management solutions fit with client needs	• **Advisory presentations** to trustees or scheme sponsors explaining how fiduciary management could work for the scheme in question. • **Asset allocation advisory reports** that advise on how a proposed change in asset allocation strategy could be implemented, for example through fiduciary management and traditional advisory solutions. • **Other advisory reports** that explore aspects of investment strategy and provide information on implementation

Stage of customer journey towards fiduciary management	*Types of information or advice*	*Example document types*
		options, including fiduciary management options.
3. **Fiduciary management product selection decision:** customer is assessing specific fiduciary management products and making a purchase decision	Advice or information on specific fiduciary management products	• **Marketing presentations or reports,** setting out the features of the firm's own fiduciary management product. • **Manager/product selection advisory reports**, that compare a fiduciary management product to one or more alternative products or solutions. These are sometimes supplied as an input to a trustee meeting where the issue will be discussed and the decision taken. • **Formal advisory letters** regarding the suitability of the firm's fiduciary management product for the client.

7.107 Based on the documents that we have reviewed, the trustee customer journey from early consideration of fiduciary management through to final fiduciary management purchase decision can take several months or years. During this process IC-FM firms provide a range of information and advice. Given the nature and duration of this relationship, IC-FM firms will have a stronger competitive position with these clients, compared to other prospective providers of fiduciary management services who have not had the same degree of interaction.

The journey from initial consideration of fiduciary management to purchase can take months or years.

How firms introduce their own fiduciary management service

7.108 We reviewed documents in which firms provided early-stage advice on fiduciary management. In some cases, firms' documents mentioned their own fiduciary management service. In other cases, they only referred to fiduciary management in general terms, without mentioning any providers. For example:

(a) An investment strategy report (2013) mentions the firm's own fiduciary management solution.[402]

(b) An investment strategy review report (2015) includes strategic asset allocation advice and a comparison of two implementation options. It mentions that the firm has an in-house team that can take on the lower governance (fiduciary management) approach.[403]

(c) A training report for an Investment Sub-Committee (2014) sets out advantages, disadvantages and likely costs for various implementation models. It covers fiduciary management in general terms without reference to the firm's own fiduciary management product.[404]

(d) A report for trustees on investment strategy and governance (2015) covers fiduciary management in general terms without reference to the firm's own fiduciary management product.[405]

7.109 We did not find any examples in these early stage documents where firms mentioned the fiduciary management services of rival fiduciary management providers, or highlighted that trustees may benefit from also considering alternative services to fiduciary management.

7.110 Aon submitted that not mentioning rival providers was not egregious.[406] Barnett Waddingham said that 'we are yet to see a case where an IC-FM firm has mentioned the fiduciary management services of specific rival fiduciary management providers'. However, over the last couple of years, we have noticed a trend for more IC-FM firms to suggest taking advice from an independent investment advisory firm (TPE)'.[407]

7.111 WTW submitted that many examples of raising fiduciary management services with clients are 'simply the expected commercial practice of firms seeking to introduce additional services to clients where this is appropriate'.[408]

7.112 We recognise that there may be good reasons why firms would introduce additional services and would not highlight specific rival providers. However, where firms have a 'trusted adviser' role in relation to investment consultancy services, mention an in-house service to their existing clients,

402 [✂] 2013.
403 [✂] 2015.
404 [✂] 2014.
405 [✂] 2015.
406 Aon response to the fiduciary management working paper.
407 Barnett Waddingham response to the fiduciary management working paper.
408 WTW response to the fiduciary management working paper.

and do not prompt them also to consider other providers of that service, we consider that trustees would be less likely to properly test the market and end up with best value deals

How firms provide information on their own fiduciary management service

7.113 As trustees moved closer to the fiduciary management purchase decision, we found that IC-FM firms often provided more detailed information on their own fiduciary management service.

7.114 We reviewed some documents that appeared to have the main purpose of explaining or promoting the firm's own fiduciary management service. For example:

(a) A fiduciary management training presentation (2015) was provided near to the date that the trustees chose to adopt fiduciary management. This includes an overview of the firm's fiduciary management approach and an indication of the costs of these services. The title slide indicates that the document was prepared by the firm's fiduciary management division. The footer also mentions the firm's investment consultancy practice.[409]

(b) A presentation on a firm's fiduciary solution (2015) was provided near to the date that the trustees chose to adopt fiduciary management. This document appears to have a sales/marketing purpose, in that the title and contents mainly relate to the firm's own fiduciary management product. However, the footer on each slide indicates that the presentation was produced by the firm's investment consultancy practice rather than its fiduciary management practice.[410]

(c) A fiduciary management suitability report (2015) presents information on a firm's fiduciary management solution.[411]

7.115 We also reviewed documents where IC-FM firms provided detailed information on an in-house fiduciary management service as part of a wider advisory document:

(a) A document on governance and implementation options (2015) includes a case study which mentions the firm's own fiduciary management product. The document compares several implementation options using characteristics such as estimated fees, degree of hedging, investment efficiency, and trustee time and expertise required. The document is

409 [✂] 2015.
410 [✂] 2015.
411 [✂] 2015.

authored by a senior investment consultant and a senior investment analyst and includes, in small print, a disclaimer at the end of the slide pack stating it is 'for training purposes only' and 'is not intended to provide any advice.'[412]

(b) A governance and portfolio healthcheck presentation (2015) makes various recommendations, including a recommended change in asset allocation and a recommendation that trustees consider changing the governance model. The presentation also includes a one-page annex that compares the scheme's current portfolio to the firm's delegated service. The presentation does not include marking indicating whether it was prepared by investment consultancy or fiduciary management staff (although the firm said that client was fully aware of who the authors were).[413]

7.116 Aon submitted that firms producing more detailed information on their own fiduciary management service as trustees move closer to a fiduciary management purchase decision should not be considered egregious.[414]

7.117 WTW acknowledged our emerging finding that some investment consultancy firms do not distinguish sufficiently between providing impartial advice on fiduciary management products and promoting their own fiduciary management products and said that 'there is merit in ensuring that roles and responsibilities of investment consultancy firms and trustees are more clearly set out and that discussions [of fiduciary management services] with clients is not presented as advice'.[415]

7.118 Mercer said that 'We also agree with the CMA about the importance of clarity for customers on the difference between advice and marketing.'[416]

7.119 We have concerns about documents in which firms combine strategic advice (for example, advice on asset allocation) with information on their own fiduciary management service and are unclear about whether the material on the latter is advisory or marketing in nature. This may cause trustees to conflate strategic decisions (such as whether to adjust asset allocation in line with the firm's recommendation) with provider selection decisions (such as whether to use the firm's fiduciary management service to implement the recommendation). Given the nature and duration of the relationship with their existing provider, trustees may develop a bias in favour of the provider's own

412 [✂] 2015.
413 [✂] 2015.
414 Aon response to the fiduciary management working paper.
415 WTW response to the fiduciary management working paper.
416 Mercer response to the fiduciary management working paper.

fiduciary management product and be less likely to test the market properly in order to identify best value deals for fiduciary management.

It is unclear whether some documents given to customers on fiduciary management are advisory or marketing.

How firms compare their own fiduciary management service to other options

7.120 Where IC-FM firms compared their own fiduciary management service to alternative options, in each case that we reviewed, these alternative options were variants of the traditional advisory model,[417] in which trustees would retain responsibilities for selecting underlying asset managers. For example:

(a) A strategy implementation presentation (2015) compares the cost of four options; the schemes current portfolio on an investment consultancy or fiduciary management basis and an 'evolved portfolio' on an investment consultancy or fiduciary management basis. The firm names itself as the fiduciary management provider for the fiduciary management options. A cost breakdown is provided for each option. The subtitle of the presentation is 'trustee training'.[418]

(b) A manager selection report for trustees (2015) considers two approaches to implementing an asset allocation strategy. One of these is a fiduciary approach and the second is a 'traditional' advisory approach, with trustees retaining responsibility for monitoring and hiring/firing the underlying managers. The report compares the firm's own fiduciary option with the two managers/funds that are shortlisted for the advisory option.[419]

(c) A strategy review presentation (2014) compares four implementation options. One of these is to delegate to the firm through fiduciary management, and three of these would see the firm continue in a 'traditional consulting/investment advice' capacity.[420]

7.121 We did not find any examples of IC-FM firms comparing their own fiduciary management services to those of rival fiduciary management providers.

[417] In the examples that we reviewed, the firm recommended a shortlist of underlying managers that should be used, were the trustees to select an advisory option.
[418] [✂] 2015.
[419] [✂] 2015.
[420] [✂] 2014.

7.122 Barnet Waddingham said that 'the comparison of fiduciary management services to non-fiduciary management products could include inherent biases or behavioural 'nudges'. For example, placing more emphasis on the merits of fiduciary management than [on] non-fiduciary management, or describing fiduciary management services using more positive wording'.[421]

7.123 Where IC-FM firms compare their fiduciary management services to non-fiduciary management products or services, this may provide useful information for trustees. However, the documents that we reviewed were not always clear about the nature and scope of these comparisons. Trustees receiving documents of this nature may overestimate the extent to which the advice covers other options in the market and be less likely also to consider alternative fiduciary management providers.

How firms disclose conflicts of interest

7.124 Across the documents that we reviewed, we observed a range of approaches to disclosing conflicts of interest.

7.125 Most earlier stage documents that introduce or compare fiduciary management services either didn't mention conflicts of interest, or included a brief, general conflict statement. For example:

(a) A manager selection report (2015) that compares the firm's fiduciary option to advisory options does not mention conflicts of interest.[422]

(b) A report on investment strategy (2015) mentions the firm's own fiduciary management product and does not mention conflicts of interest.[423] A report on governance and implementation options (2015) for the same client mentions conflicts of interest in a general sense, but not in relation to advice on fiduciary management. The document includes, in small print, a disclaimer at the end of the slide pack stating it is 'for training purposes only' and 'is not intended to provide any advice.'[424]

(c) An investment strategy report (2013) that mentions the firm's fiduciary management product contains a notice saying that conflicts of interest disclosures can be accessed at the company's website or through the firm's representative.[425] A subsequent investment strategy and funding considerations report (2015) for the same client contains a notice saying

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[421] Barnett Waddingham response to the fiduciary management working paper.
[422] [✂] 2015.
[423] [✂] 2015.
[424] [✂] 2015.
[425] [✂] 2013.

that in certain circumstances the firm's advice will be limited to the solutions that it offers, and that the firm seeks to manage this conflict through procedures designed to protect the interests of clients.[426]

7.126 We reviewed several formal advisory letters to trustees, that were submitted close to the point at which trustees took a final decision to buy the firm's fiduciary management service. These letters generally contained a more specific discussion of potential conflicts related to supplying advice and offering an in-house fiduciary management service. For example:

(a) A letter providing 'confirmation of investment advice' (2016) says that the trustee is proposing to appoint the firm to provide fiduciary management services to the scheme. The letter contains advice under Section 34 of the Pensions Act 1995. The letter states that 'advising the Trustee in connection with [the firm's own fiduciary management service] raises a potential conflict of interest'. It says that the firm has drawn this to the attention of the trustee and discussed it with them. The letter says that, in the firm's view, its fiduciary management division has the knowledge and experience to manage the investments of the scheme.[427]

(b) A letter entitled 'change of investment strategy' (2016) contains formal advice under the Pension Act 1995. The letter contains a detailed section on conflicts and says that, when appointing an investment manager, consideration should be given to alternatives, or specific reasons agreed as to why not to review alternatives. The firm says it is 'comfortable in recommending that [its fiduciary management division] is suitably competent to undertake the…delegations'. The firm says it is not in a position to say whether similar services could be provided by another provider or what their costs and competency would be. The letter says that the fee range in an industry report 'should provide reassurance that the fees being proposed for the Plan are low compared to those offered by other Fiduciary Managers'.[428]

(c) A formal advisory letter to trustees regarding the suitability of its partial-fiduciary management product (2015) notes that: there is a potential conflict in that the firm is advising on a service for which it would receive a fee, that this has been explained and that the firm considers that trustees have adequately considered alternatives.[429]

[426] [✂] 2015.
[427] [✂] 2016.
[428] [✂] 2017.
[429] [✂] 2015.

7.127 Based on the documents that we reviewed, we note that where IC-FM firms did provide written descriptions of specific conflicts and raise the issue of considering alternative providers, this generally took place in later stage advisory letters, at which point trustees were already proposing to appoint the firm as a fiduciary management service provider.

7.128 We recognise that firms may disclose conflicts of interest through various means, including documents that we have not reviewed and through verbal exchanges.

7.129 Several parties said that they did not 'steer' customers towards fiduciary management services. For example, WTW submitted that 'if a client decides to move to fiduciary management, it enters an entirely new contractual relationship, so the ability to 'steer' is very limited, it is very obvious that such a change has taken place and lawyers and the trustees would be engaged in the negotiation of the new contract'.[430] However, at the trustee round table, several trustees said that their experience was that trustee boards sometimes purchased delegated products, not appreciating that these were fiduciary management solutions. They said this can cause trustees to 'slip' into using fiduciary management services.[431]

7.130 In our view, even if trustees are aware that they are purchasing a firm's fiduciary management service, this does not mean that they have not been steered towards this purchase.

7.131 Overall, our assessment is that some of the ways that IC-FM firms introduce and advise on fiduciary management in documents steer trustees towards the firm's own service and make it less likely that trustees properly consider alternatives.

CMA survey

7.132 The CMA survey asked trustees a series of questions regarding what the incumbent investment consultant said and did in relation to fiduciary management.

7.133 Around a fifth of trustees (19%) said that their investment consultant had suggested that the scheme consider fiduciary management.[432] This

[430] WTW response to the fiduciary management working paper.
[431] Summary of roundtable with Pension Trustees held on 1 and 2 May 2018.
[432] Source: CMA survey, question P5. 'Has your current investment consultant ever suggested that you consider fiduciary management for your scheme?', question L1 'Thinking back to when you first bought fiduciary management for your scheme, who, if anyone prompted you to consider buying these services? We mean the first time ever that you bought fiduciary management, which was not necessarily from your current provider.', and question L2 'You didn't mention them, so can you please confirm that your investment consultant at the time was NOT amongst those who prompted the board of trustees to first consider buying fiduciary management?'.

increases to around a third of trustees (30%) when only considering those trustees currently buying investment consultancy services from IC-FM firms.[433]

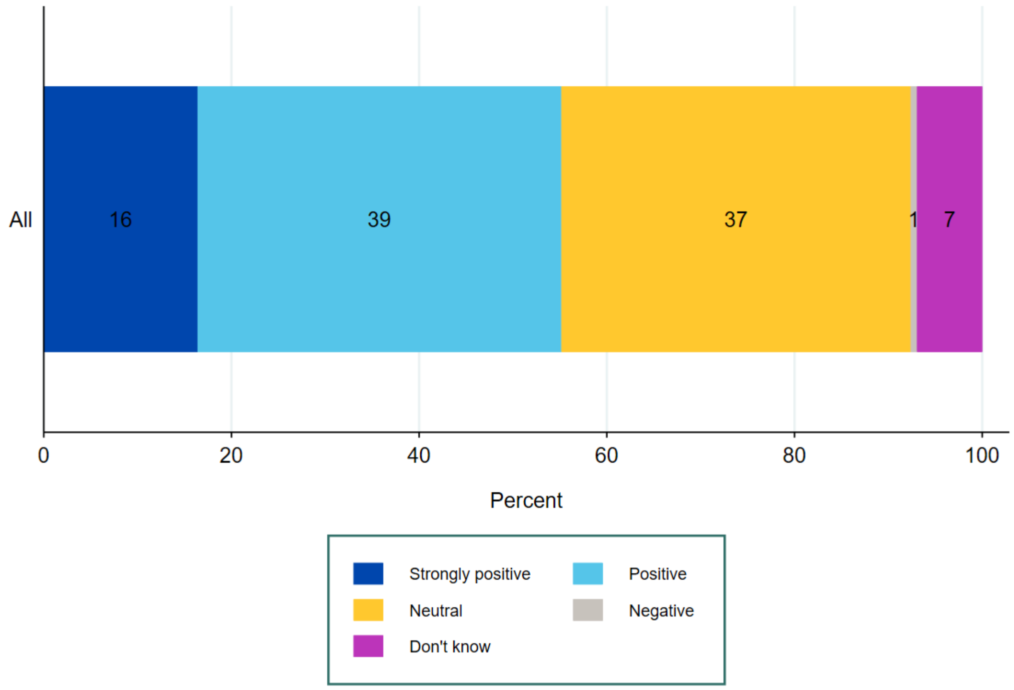
7.134 This implies that investment consultancy firms that have a fiduciary management business are more likely to raise it than those that do not. We consider that firms may have legitimately different views as to whether fiduciary management is a beneficial service for pension schemes in general, and/or for particular pension schemes.

7.135 Related to this, many IC-FM firms submitted that investment consultants that do not offer fiduciary management may be subject to a conflict, in that they may fail to introduce or recommend fiduciary management to their advisory clients in order to avoid losing advisory work. We cover this point in chapter 8.

7.136 As shown in Figure 17 below, in discussions about whether fiduciary management was right for the scheme, over half of trustees either said the investment consultant was positive (39%) or strongly positive (16%). 37% said that the investment consultant was neutral and less than 1% said that the investment consultant was negative. Therefore, based on the CMA survey, investment consultants appear to have very rarely been negative about fiduciary management services.

[433] Ibid.

Figure 17: Attitudes of investment consultants towards fiduciary management in discussions with trustees



All schemes where IC provider suggested using FM: All (150)

Source: CMA survey, question L4 'And in discussions with your investment consultant, at the time about whether fiduciary management was right for your scheme, would you say they were …?' and P7. 'And in discussions with them about whether fiduciary management was right for your scheme, would you say they were …'

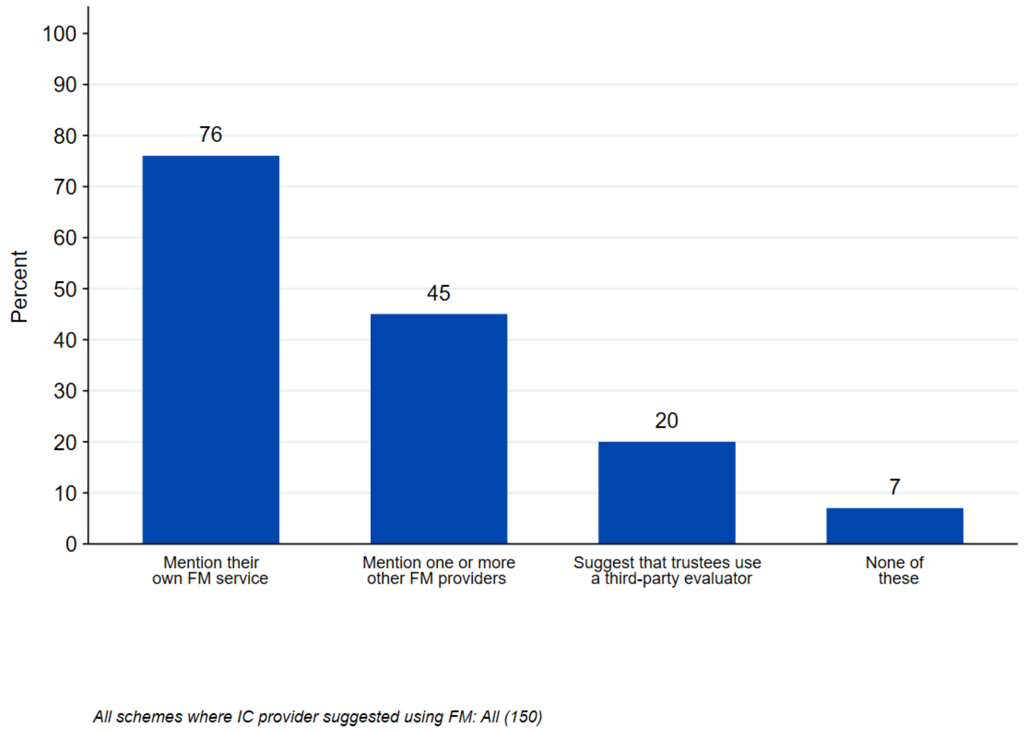
7.137 Where the investment consultant had suggested fiduciary management, we asked trustees what else the investment consultant did. Figure 18 below shows that:

(a) in the majority of cases the investment consultant also mentioned its own fiduciary management service (76%);

(b) in just under half of cases, the investment consultant also mentioned one or more other fiduciary management providers (45%), and

(c) in a fifth of cases, the investment consultant suggested that trustees use a third-party evaluator (20%).

Figure 18: Behaviours of investment consultants in discussions with trustees about fiduciary management



Source: CMA survey, question L3 'Which of the following things, if any, did your investment consultant do at the time you first bought fiduciary management?' and question P6 'In addition to suggesting fiduciary management, which of the following things, if any, did they also do?'.

7.138 We note that the CMA survey evidence above shows a higher incidence of investment consultants mentioning other fiduciary management providers, compared to the document review at paragraphs 7.103 to 7.132 above (which did not identify any examples of IC-FM firms mentioning alternative providers). One reason for this difference could be that some investment consultants mention other fiduciary management firms verbally, but not in documents.

7.139 Hymans said that fewer than half of investment consultants mentioning one or more other fiduciary management providers was 'not necessarily surprising, as it is perfectly understandable that an investment consultancy firm should consider that its own fiduciary management services reflect the ideal implementation of its best ideas'.[434]

7.140 We recognise that IC-FM firms may view their own fiduciary management service as the best option for clients. However, as noted above, where firms have a 'trusted advisor' role in relation to investment consultancy services, mention an in-house service to existing clients, and do not prompt them to

[434] Hymans response to the fiduciary management working paper.

also consider other providers of that service, we consider that trustees would be less likely to test the market properly and end up with the best deal.

Summary of findings on firm conduct when introducing and advising on fiduciary management

7.141 Incumbent IC-FM firms have a strong position with existing advisory clients; these firms often present a variety of documents to their clients that relate to fiduciary management over the months or years before they take a decision to buy fiduciary management.

7.142 We have not identified any evidence that firms are seeking to introduce fiduciary management services that they believe to be against their clients' interests.

7.143 However, some of the ways that IC-FM firms introduce and advise on fiduciary management steer trustees towards the firm's own fiduciary management service and make it less likely that trustees properly consider alternatives. We consider that these practices contribute to an incumbency advantage for IC-FM firms compared to other providers of FM services. For example:

(a) Introducing in-house fiduciary management services in the course of giving strategic advice: In some documents, IC-FM firms provide strategic advice to trustees, mention their own fiduciary management service as a way of implementing the advice, and are unclear about whether the material is advisory or marketing in nature. Our concern is that this may cause trustees to conflate the strategic decision with the choice of service provider and develop a bias towards the provider's own fiduciary management product.

(b) Comparing in-house fiduciary management services to other products/services: In some documents, IC-FM firms compare their own fiduciary management service to alternative, non-fiduciary products or services. The documents that we reviewed were not always clear about the nature and scope of these comparisons. We consider that trustees receiving documents of this nature may overestimate the extent to which the advice covers other options in the market and be less likely also to consider alternative fiduciary management providers.

(c) The timing and clarity of disclosures on conflicts of interest: We reviewed many documents that introduce in-house fiduciary management services or compare these to other (non-fiduciary management) solutions and do not mention conflicts of interest, or only mention these in a general

sense. Where we found good examples of conflict statements, these were generally in later stage advisory letters, at which point trustees were already proposing to appoint the firm as a fiduciary management provider. Clearer and more timely statements about conflicts of interest could mean that trustees are more likely to test the market properly and end up with the best deal for their scheme.

Provisional conclusion

7.144 The fiduciary management market has grown significantly in recent years. Integrated IC-FM firms have accounted for a large part of this growth; around half of pension schemes buying fiduciary management have appointed an IC-FM firm that was already acting as their investment consultant.

7.145 Decisions on whether to buy fiduciary management and which provider to appoint are very important decisions for trustee boards; buying fiduciary management services means handing over more control, receiving more services and paying more compared to only buying investment consultancy services. In addition, switching fiduciary management provider can be expensive, costing pension schemes the equivalent of one year of fiduciary management fees.

7.146 The CMA survey found that a substantial proportion of trustee boards have concerns about investment consultants steering clients into their own fiduciary management services: 30% think that it is ‘a problem, and more should be done to address it’ and a further 30% consider it to be ‘a problem, but generally well managed’. These concerns are even greater amongst professional trustees and larger pension schemes.

7.147 Therefore, it is particularly important that trustees are willing and able to access, assess and act upon good information about the options that they face when considering and buying fiduciary management.

7.148 In light of the provisional findings above, we were concerned to find low levels of customer engagement at the point of first buying fiduciary management. For example, our analysis indicates that only 34% of fiduciary management appointments followed a formal tender process.

7.149 Based on a range of evidence including documents produced by firms, we have found that IC-FM firms have strategies and financial incentives to sell fiduciary management to their existing advisory clients.

7.150 We have not found any evidence that firms are seeking to introduce fiduciary management services that they believe to be against their clients' interests and therefore we have not found this to be a concern.

7.151 However, we have found that some of the ways in which these firms introduce and advise on fiduciary management (for example, comparing their own fiduciary management service to other options and not being clear about the limited scope of the comparison), steer trustees towards the firm's own fiduciary management service and make it less likely that they properly consider alternatives.

7.152 Overall, we have provisionally found that IC-FM firms steering customers towards their own fiduciary management service and low engagement by trustees when first buying fiduciary management contribute to an incumbency advantage for IC-FM firms, such that pension schemes are less likely to get best value deals when buying these services.

8. Conflicts of interest

Our provisional findings:

- Conflicts of interest between suppliers and customers are common in many industries.
- We considered several potential conflicts of interest in relation to investment consultancy and fiduciary management services.
- Overall, we did not find evidence that any of these gave rise to a competition problem.

Introduction

8.1 Chapter 7 analysed whether there are competition problems arising from the sale of fiduciary management services by IC-FM firms. As part of this analysis, we also considered whether IC-FM firms are failing to manage conflicts of interest effectively when introducing and selling fiduciary management services to existing clients.

8.2 In this section, we consider a number of other potential conflicts of interest in relation to investment consultancy and fiduciary management services and whether these are impacting competition, namely:

(a) fiduciary management firms investing in their own asset management or investment products;

(b) business relationships that investment consultants have with asset managers that might affect the independence of the consultants' manager ratings;

(c) the receipt of gifts and hospitality by investment consultants that might affect the independence of the consultants' manager ratings;

(d) the sale of master trusts by investment consultants who are also supplying employee benefit consultancy, which may steer customers towards their own master trust products;

(e) Other potential conflicts of interest relating to fiduciary management, including investment consultants failing to introduce or recommend fiduciary management services to their advisory customers.

8.3 Some of the activities of investment consultancy and fiduciary management providers are subject to FCA and MiFID II regulation, which contain extensive and detailed provisions in respect of conflicts of interest. For example, among other matters, regulated firms must take appropriate steps to identify and prevent or manage conflicts of interest arising in the course of providing a regulated service and which may damage the interests of a client.[435]

Fiduciary management providers investing in their own asset management or investment products

8.4 Some fiduciary management firms offer asset management products and do not offer investment consultancy services; we refer to these as 'AM-FM firms'. Firms with this business model together account for around [10 - 20%] of the fiduciary management market.

8.5 IC-FM firms also offer fiduciary management services. Most of these firms do not invest directly in assets, but some offer 'fund of funds' that combine several underlying asset management products.

8.6 This section considers whether fiduciary management providers have incentives to invest in their own asset management products or funds, even when this could reduce overall value-for-money for customers. Our focus is on AM-FM firms, but we also consider IC-FM firms.

8.7 Fiduciary management firms could have incentives to invest in this way, if the potential for increased profit margins outweighed the potential for lost revenue, in the event that trustees choose not to buy fiduciary management from the firm as a result of this concern. This depends in turn on whether trustees are aware of how fiduciary managers use in-house products and whether trustees are able to understand the overall value-for-money of these fiduciary managers.

8.8 We start by considering the views of trustees and other stakeholders, we then consider firms' approaches to in-house managers and funds, and finally we review a sample of information that prospective customers have requested and received in relation to this issue.

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[435] See, for example, SYSC 10 (Senior Management Arrangements, Systems and Controls) of the FCA Handbook, Article 23 MiFID II Directive 2014/65 and Articles 33 to 43 MiFID II Delegated Regulation 2017/565.

Trustee and stakeholder views

8.9 The CMA survey found that trustees recognise this as a potential problem:

(a) in total 59% of trustees perceived that this was a problem;

(b) of those trustees saying there was a problem, just under half said that more should be done to address it (26% of trustees) whereas just over half (33% of trustees) thought that it was generally well managed;

(c) compared to other trustees, professional trustees were notably more likely to say that this was a problem and that more should be done to address it (47% of professional trustees versus 26% of all trustees[436]).

8.10 Several IC-FM firms highlighted potential issues where fiduciary management services are provided by an AM-FM firm. For example: WTW said that, compared to integration between advisory and fiduciary management services, 'a more substantive vertical integration issue arises in relation to asset managers offering fiduciary management, but only using their own fund solutions (or very limited alternatives) to implement the mandate'.[437]

8.11 AM-FM firms submitted that they were transparent with customers in relation to their usage of in-house products.[438] For example, LGIM said that 'it is clear in all our presentation materials that we do not sub-delegate to other asset managers, and indeed we champion this as one if the key differentiators of LGIM's offering'.[439]

8.12 At the asset manager round table, asset managers said that investment consultancy firms with in-house funds or products may have incentives to select their own in-house funds or products, when other products would offer better value-for-money for the client.[440] JLT expressed an opinion that in-house funds have the greatest potential for conflicts of interest. It said it has an in-house fund but this is now of insignificant size and is no longer being marketed.[441]

[436] Statistically significant.
[437] WTW Issues Statement response
[438] Market information request responses.
[439] LGIM market information request response.
[440] Summary of roundtable with Asset Managers held on 12 February 2018.
[441] JLT hearing summary.

Firms' approaches to investing in in-house products

8.13 We asked AM-FM firms whether they invest in in-house products.

(a) SEI and [✂] said that they do not distinguish between internal and external products and simply choose the best option for the client.[442]

(b) BlackRock said that it subjects in-house and external products to the same due diligence.[443]

(c) Charles Stanley said that it generally only invests in external products.[444]

(d) LGIM said it only invests in internal products.[445]

(e) Schroders 'building blocks' use internally managed solutions and externally managed solutions where there is no internal solution or it is not the most appropriate. They emphasised that they are clear about their approach in their pitch documents and other materials.[446]

8.14 Our assessment is that AM-FMs investing in their own products is unlikely to be a problem where customers are aware of this. However, there could be concerns if prospective clients are unaware of the firms' approach to this and the fees charged for in-house products. We consider evidence on this below.

> **As long as customers are aware of it, the fact that fiduciary managers invest in their own financial products is unlikely to be a problem.**

Review of information provided to prospective customers

8.15 We reviewed a sample of tenders in order to see how the issue of AM-FMs investing in their own products was being handled in practice and whether customers were being made aware of the firms' approach on this.

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[442] SEI and [✂] market information request responses.
[443] BlackRock market information request response.
[444] Charles Stanley market information request response.
[445] LGIM market information request response.
[446] Schroders market information request response.

8.16 We reviewed seven invitations to tender (ITT) documents in which one or more AM-FM firms had participated and 38 proposals that had been submitted in response.[447]

8.17 As part of this review we considered:

(a) whether the tender had requested information from participants in relation to their approach to investing in in-house products;

(b) how participants had responded to this request or otherwise addressed this point.

8.18 We found that each of the seven ITTs included a specific question about the fiduciary management providers' approach to using internal and external funds and that fiduciary managers had complied with this request. We note that:

(a) Two AM-FM firms said that they used a mix of internal and external funds. and that some of the funds used included internal managers,[448] whereas another AM-FM firm said that all security-level investment decisions were made by external underlying managers.[449]

(b) One AM-FM firm said that only one fiduciary client used its internal fund and that this would not be used unless the client expressed a particular interest in it.[450]

(c) Two IC-FM firms said that they used a mix of internal and external funds. However, these funds tended to be 'wrappers' or 'fund of funds', that were only populated with external underlying managers[451]. Another IC-FM firm said that it used funds that were mostly populated with external underlying managers [452].

(d) Two IC-FM firms said that they invested in external third-party managers/funds only.[453]

(e) Several of the firms that used internal 'fund-of-funds' or 'wrappers' said that they did so as an efficient means of accessing external funds or

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447 These documents were submitted in response to our market information request. [✂]. Of these seven ITTs, four had been issued by a TPE on behalf of a pension scheme and three had been issued directly by the scheme.
448 [✂], Schroders.
449 SEI.
450 Charles Stanley.
451 Aon, WTW.
452 R&M.
453 Cambridge Associates, Mercer.

managers, but that they did not benefit financially where these vehicles were used.[454]

8.19 Each of the seven ITTs also asked respondents to provide some form of breakdown between headline fiduciary management fees and underlying asset manager or fund fees.

8.20 We found that respondents generally complied with these requests, in varying levels of detail. In a minority of cases firms said that they couldn't estimate underlying asset manager fees at this stage, as these would depend on the portfolio selected for the client.[455]

8.21 We reviewed some ITTs that included specific questions about how fund choices would impact the fiduciary management provider financially. For example, one ITT asked whether the fiduciary management provider would benefit financially from placing assets with particular managers.[456] Another ITT asked about the fee implications of a provider investing in its own funds and how disclosure would be made to the client.[457]

Provisional conclusions

8.22 Based on the CMA survey, trustees have some concerns about fiduciary management providers investing in their own products.

8.23 We found that some fiduciary management providers do have a policy of investing in in-house products, but we consider that this is unlikely to be a problem unless customers are unaware of this and the implications for fees.

8.24 However, in our fiduciary management tender review, we found that trustees had in each case requested and received information regarding how each bidder used in-house products. Each ITT had also requested information on underlying fees as well as headline fiduciary management fees. These requests were generally complied with.

8.25 In addition, we note that several AM-FM firms (including BlackRock and Legal & General Investment Management) belong to well-known asset management groups.

8.26 Overall, the evidence does not indicate that the potential conflict of interest from fiduciary management providers investing in in-house products is

[454] Aon, WTW, SEI.
[455] For example: [✂] and [✂] responded in this way to tenders for [✂] and [✂] respectively
[456] [✂].
[457] [✂].

leading to competition problems. This is because the evidence indicates that trustees would generally be aware of the firm's policy with regard to investing in their own products, and should therefore be able to factor this into their decision on which fiduciary manager to appoint.

Business relationships between investment consultants and asset managers

8.27 Asset managers regularly purchase services from investment consultants, such as tickets for investment conferences, data and consulting services, or advisory services for their firm's pension scheme. Therefore, investment consultancy firms can generate potentially significant revenues from asset management firms whilst also advising pension schemes whether to invest in products or funds offered by these asset management firms.

8.28 This section considers whether the business relationships that investment consultants have with asset managers affect the independence of investment consultants' asset manager ratings.

8.29 Investment consultancy firms may lack incentives to maintain objective asset manager ratings, if the potential benefits from building goodwill with asset management firms (and selling more services to them and earning more revenue) outweigh the potential costs from fewer trustees buying their asset manager ratings services or wider investment consultancy services.

8.30 In the section below, we first consider the views of trustees and other stakeholders, we then assess the nature and size of relationships between investment consultancy firms and asset management firms, and finally we review processes and controls for making asset manager ratings.

Trustee and stakeholder views

8.31 In the CMA survey, a total of 54% of trustees perceived that business relationships with asset managers affecting the independence of investment consultants or fiduciary managers was a problem. Of those, around two-thirds thought it was generally well managed and a third thought that more should be done to address it.

8.32 We received only a limited number of submissions that there were problems in this area. For example, River & Mercantile submitted that 'where manager recommendations could be perceived to be coloured by other direct services or fees from such asset management firms, there are significant risks to the perception of impartiality'.[458] In addition, the Local Government Association said that they would welcome requirements for consultants to fully disclose business interests.[459]

8.33 We heard from many investment consultants that revenues received from asset management firms would not lead to conflicts in practice and several emphasised that their ratings processes are robust and independent. For example: Aon said 'the rating which Aon awards to asset managers is not connected either explicitly or implicitly to the levels of revenue that the Aon Group as a whole earns from them. Aon's manager research staff are subject to a number of controls to prevent any bias or undue influence from impacting their recommendations'.[460]

8.34 In addition, some investment consultants said that they did not directly offer services to the asset managers within asset management firms. For example, LCP said 'We do not offer services to asset managers in their capacity as an asset manager – we do have asset manager clients to whom we provide advice on their pension scheme or other areas not directly related to the products offered to pension scheme clients'.[461]

8.35 At the asset manager round table, asset managers said that they do not consider that any business relationships that exist between themselves and investment consultants (such as an investment consultant advising an asset management firm's own pension scheme) would have influenced ratings given by investment consultants.[462]

Nature of business relationships

8.36 We consider that business relationships between investment consultancy and asset management firms are more likely to influence manager ratings where they are sizeable and where they involve parts of investment consultancy and asset management firms with a direct interest in asset manager ratings.

8.37 We asked investment consultancy firms about their relationships with asset managers. We found that investment consultancy firms received payments for a range of services, including investment advice to asset managers'

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458 River and Mercantile response to issues statement.
459 Local Government Association response to issues statement.
460 Aon response to issues statement.
461 LCP response to issues statement.
462 Summary of roundtable with Asset Managers held on 12 February 2018.

pension schemes, employee benefit consultancy, actuarial services and pension administration services.

8.38 We focus below on two types of relationship that involve divisions within investment consultancy and asset management firms that have a more direct interest in asset manager ratings. These business relationships are ‘pay-to-play’ payments and payments for conferences.

Asset managers paying investment consultants in return for manager ratings (pay-to-play)

8.39 Under a pay-to-play model, an advisor (for example, an investment consultant) charges a product supplier (for example, an asset manager) a fee in return for being considered for recommendation. This model creates a direct financial link between asset managers and investment consultants.

8.40 Each of the ten largest investment consultancy firms[463] said that they do not take pay-to-play payments from the asset managers that they rate.[464] In addition, each of the smaller investment consultancy firms that we questioned said that they did not use a pay-to-play model. However, one of these firms said that in some asset manager selection exercises, it included an option where the winning manager would pay a fee.[465] Overall, however it is clear that this model is not commonly used amongst investment consultants.

Asset managers paying investment consultants for conference attendance

8.41 Each of the ten largest investment consultancy firms that we questioned had organised one or more conferences in the last three years that was attended by asset managers.

8.42 Three of these firms had charged asset managers for attendance: Hymans, JLT, and Mercer.

(a) Hymans said that they charged £350+VAT per asset manager representative for their Investment Manager Conference in 2016. The revenues received amounted to £33,000 (+VAT) and did not fully cover

[463] In alphabetical order: Aon, Barnett Waddingham, Capita, Hymans, JLT, KPMG, LCP, Mercer, Redington, and WTW.
[464] Market information request responses from the above ten firms.
[465] [✂] market information request response.

the conference cost. Hymans say that they have no plans to organise similar conferences in the future.[466]

(b) JLT said that it organises investment conferences, to which managers are invited at a nominal fee.[467]

(c) Mercer organise a number of Global Investment Forums each year. Two of them have been hosted in London. The charge for attending the latest London conference in 2017 was $[✂] USD per asset manager representative. Mercer say that the total revenue received amounted to around £[✂]. Mercer said that the event was [✂].[468]

8.43 Capita has not charged asset managers to attend conferences. It received a financial contribution of £[✂] from life assurers to organise some conferences related to its employee benefit consultancy business in 2017.[469]

8.44 At our asset manager roundtable, asset managers said that attending investment consultants' conferences helps them better to understand investment consultants' thinking and indicated that strong relationships with investment consultants benefit their clients. They did not see this as affecting the independence of decision-making on either side.[470]

8.45 We found that some investment consultants are charging asset managers to attend conferences and that the fees charged varied significantly.

Size of business relationships

8.46 We asked investment consultancy firms to submit the total revenues that they had earned from asset management firms.

8.47 Table 19 compares total UK revenues earned by investment consultancy firms from asset management firms to the total investment consultancy and fiduciary management revenues earned by these firms.

[466] Hymans' response to follow up information request on outside business relationships.
[467] Summary of hearing with JLT held on 20 November 2017.
[468] Mercer response to follow-up information request on outside business relationships.
[469] Capita response to follow-up information request on outside business relationships.
[470] Summary of roundtable with Asset Managers held on 12 February 2018.

Table 19. Comparison of total revenues from asset management firms (for all services) to total investment consultancy and fiduciary management revenues

	(A) Total revenues from asset management firms (for all services)	*(B) Total investment consultancy and fiduciary management revenues*	*Ratio of (A) to (B)*
[✂]	[✂]	[✂]	22%
[✂]	[✂]	[✂]	12%
[✂]	[✂]	[✂]	37%
[✂]	[✂]	[✂]	57%
[✂]	[✂]	[✂]	18%
[✂]	[✂]	[✂]	34%
[✂]	[✂]	[✂]	9%
[✂]	[✂]	[✂]	0%
[✂]	[✂]	[✂]	3%
[✂]	[✂]	[✂]	117%
Average	**£11,430,823**	**£33,130,060**	**20%***

Source: CMA Analysis, Parties' Data. All revenues are UK-only, for 2016 or the most recent available year if 2016 data was unavailable.
Note: * indicates median rather than mean
Note: One firm earns UK revenues from asset management groups that are higher than their total UK revenues for investment consultancy and fiduciary management services. This firm earns substantial revenues from services that are not related to investment consultancy and fiduciary management.

8.48 Table 19 shows that total revenues from asset management firms do appear to be material for some investment consultancy firms when compared to the revenues from their investment consultancy and fiduciary management practices. However, it should be noted that the revenues from asset management firms in Table 19 include payments for a range of services not directly related to investment consultancy or fiduciary management, such as payments for employee benefit consultancy and actuarial services.

8.49 Table 20 compares total UK revenues earned by investment consultancy firms from asset management firms for investment consultancy and fiduciary management services to the total investment consultancy and fiduciary management revenues earned by these firms.[471] Therefore, Table 20 focuses only on revenues earned by parts of investment consultancy firms that are more directly involved in manager ratings. For example, it includes payments for investment advice to asset management firms' pension schemes and attending conferences, but does not include payments for wider services between these corporate groups such as employee benefit consultancy or actuarial services.

[471] In this analysis, we use revenues earned by investment consultants from the ten asset management firms from which they had earned the most revenues.

Table 20. Comparison of total revenues from asset management firms (paid to investment consultancy and fiduciary management practices) to total investment consultancy and fiduciary management revenues

	(A) Revenues from asset management firms (for IC and FM services only)	*(B) Total investment consultancy and fiduciary management revenues*	*Ratio of (A) to (B)*
[✂]	[✂]	[✂]	2%
[✂]	[✂]	[✂]	5%
[✂]	[✂]	[✂]	13%
[✂]	[✂]	[✂]	9%
[✂]	[✂]	[✂]	1%
[✂]	[✂]	[✂]	1%
[✂]	[✂]	[✂]	1%
[✂]	[✂]	[✂]	0%
[✂]	[✂]	[✂]	1%
[✂]	[✂]	[✂]	0%
Average	**£2,057,042**	**£33,130,060**	**1%***

Source: CMA Analysis, Parties' Data. All revenues are UK-only, for 2016 or the most recent available year if 2016 was unavailable.
Note: * indicates median rather than mean.

8.50 Table 20 shows that revenues from asset management firms for parts of investment consultancy firms that are more directly involved in manager ratings, generally account for only a small part of the total investment consultancy and fiduciary management revenues earned by these firms.

Manager ratings processes and controls

Conflicts of interest management

8.51 Some investment consultants have conflicts of interest management policies that specifically mention business relationships with asset managers as an example of a situation in which conflicts of interest may arise. These firms have established management strategies to handle the conflicts. Such management strategies include having separate manager research and investment consultancy divisions and ensuring that manager ratings are subject to appropriate procedures and peer reviews.[472]

8.52 As noted at paragraph 8.3 regulated firms are subject to extensive and detailed requirements in respect of conflicts of interest.

[472] Based on responses to the market information request and the follow-up request on outside business relationships.

8.53 In the following sections we consider some of the processes and controls that investment consultants use when making manager ratings.[473]

Separation of manager research and investment consultancy activity

8.54 We found that manager research activities are generally undertaken by staff that sit within the investment consultancy division of investment consultancy firms.

8.55 Of the ten investment consultancy firms we looked at, six have dedicated manager research teams that are separate from the wider investment consultancy business,[474] whereas four have a model where the same staff undertake both manager research and wider investment consultancy work.[475]

Challenge and approval of manager ratings

8.56 Once research staff have developed proposed ratings for asset managers, we found that these proposals are generally submitted to a committee or panel for challenge and/or approval.

8.57 Six of the investment consultancy firms in our sample have rating review committees or their equivalents.[476]

8.58 Four investment consultancy firms said that they do not have a rating review committee and instead use alternative procedures to oversee and approve ratings.[477]

8.59 Overall, we found that investment consultancy firms have processes and controls in place that have the potential to help guard against the risk that manager ratings are not independent. We have not examined the effectiveness of these processes and controls.

Provisional conclusions

8.60 Some trustees have concerns about business relationships, but fewer think that this is a problem compared to other conflicts that we asked about.

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[473] Based on responses to the market information request and the follow-up request on outside business relationships.
[474] Aon, Barnett Waddingham, Hymans, Mercer, Redington, and WTW.
[475] Capita, JLT, KPMG, and LCP.
[476] Barnett Waddingham, Capita, Hymans, JLT, Mercer, and Redington.
[477] Aon, KPMG, LCP, and WTW.

8.61 Of the two most direct revenue streams between asset managers and investments consultants, we found that none of the larger investment consultants receive pay-to-play payments in return for ratings, whereas several investment consultants charge asset managers to attend conferences. Asset management firms also make payments to investment consultancy firms for a range of other services.

8.62 We found that the total revenues from asset management firms are material, however revenues earned by parts of investment consultancy firms that are more directly involved in manager ratings appear to account for a relatively limited part of total investment consultancy and fiduciary management revenues.

8.63 Investment consultancy firms seek to maintain objective and independent manager ratings through a range of processes and controls.

8.64 Overall, we have not found evidence to indicate that ratings are influenced by business relationships with asset managers; investment consultancy firms generally have safeguards in place to seek to maintain objective and independent ratings, and overall revenues earned by investment consultancy and fiduciary management divisions from asset management firms account for a relatively limited proportion of total revenues.

Gifts and hospitality provided by asset managers to investment consultants

8.65 This section considers whether gifts and hospitality provided by asset managers to investment consultants affect the independence of investment consultancy firms' asset manager ratings.

8.66 Conceptually, this issue is similar to the business relationships issue that we assessed above.

8.67 In the section below, we first consider the views of trustees and other stakeholders, we then consider relevant regulations and conflict management policies, and finally we assess the level of gifts and hospitality that are provided by asset managers to investment consultants.

Trustee and stakeholder views

8.68 In the CMA survey, a total of 35% of trustees perceived that gifts and hospitality from asset management firms affecting the independence of investment consultancy or fiduciary management firms was a problem. Of those that perceived a problem, less than half thought that more should be done to address it.

8.69 Trustees found this issue to be the least concerning of the four conflicts that they were asked about.

8.70 Many investment consultancy firms said that gifts and hospitality levels have declined in recent years.[478] Some said that they have had clear gifts and hospitality policies in place for many years[479], others indicated that they had updated or tightened their practices over time.[480]

8.71 Some investment consultants also indicated that the way that they determine manager ratings prevents gifts and hospitality from leading to concerns in practice. For example, [✂] said that ratings are conducted by a dedicated team and are subject to challenge and review.[481] As discussed at paragraphs 8.51 to 8.59 above, investment consultants use various processes and controls when making their manager ratings, however we have not examined the effectiveness of these.

8.72 [✂].[482]

8.73 Asset managers who participated in our asset manager roundtable stated that they did not believe that gifts and hospitality played a significant role in their relationships with investment consultants. They drew a distinction between gifts on the one hand and hospitality on the other. They indicated that gifts are not prevalent and have long been restricted. More generally, asset managers considered that changes to the regulatory environment and increased competition in the asset management industry have led to a decline in the level of gifts and hospitality across the industry.[483]

Regulation and guidance

8.74 As noted in paragraph 3.48, some of the activities of investment consultancy and fiduciary management providers are subject to FCA regulation and MiFID II requirements. We briefly note below some of the rules and guidance that are relevant to gifts and hospitality, including giving or receiving monetary and non-monetary benefits.

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[478] For example, summary of hearing with Redington held on 13 November 2017, LCP issues statement response.
[479] For example, summary of hearing with WTW held on 21 November 2017.
[480] For example, summary of hearing with Aon held on 22 November 2017, summary of hearing with Mercer held on 22 November 2017.
[481] [✂] issues statement response.
[482] Summary of hearing with Cardano held on 15 November 2017,
[483] Summary of roundtable with Asset Managers held on 12 February 2018

8.75 MiFID II makes specific provision in respect of inducements (that is, commissions, fees or any monetary or non-monetary benefits). The provisions include restrictions on firms which provide independent investment advice and portfolio management accepting and retaining inducements, except where a limited exception applies. This exception is expressed in terms of minor, non-monetary benefits that are capable of enhancing the quality of service provided to a client and are of a scale and nature such that they could not be judged to impair compliance with the investment firm's duty to act in the best interests of the client.[484]

8.76 We would note also that previously in March 2016, the FCA published key findings from its thematic review of the benefits provided and received by firms conducting MiFID I business,[485] and those carrying out regulated activities in relation to a retail investment product. One of the findings was that hospitality given or received such as attending or participating in sporting or social events (eg golf, tennis, concerts) did not appear capable of enhancing the quality of service to clients. The review concluded that these types of events were either not conducive to business discussions or the discussions could better take place without these activities.

Firms' gift and hospitality policies

8.77 We found that each of the ten largest investment consultants in our sample[486] has a specific gifts and hospitality policy, as well as a general conflicts of interest policy.[487] Several firms had updated their policy during 2017.

8.78 We found some common ground in how these policies are specified. For example:

(a) All but one of these policies explicitly prohibits cash gifts;[488] and

(b) All of these policies place some further prohibitions on the type and/or value of gifts and hospitality that could be accepted.

8.79 We also found some variation across these policies:

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[484] Article 24(7) and (8) MiFID II Directive 2014/65.
[485] FCA (2016), Inducements and conflicts of interest thematic review: key findings.
[486] Aon, Barnett Waddingham, Capita, Hymans, JLT, KPMG, LCP, Mercer, Redington, and WTW.
[487] Market information request responses from these ten firms.
[488] [✂].

(a) Only a minority of policies explicitly prohibit the receipt of any non-business (ie sporting/cultural/leisure) hospitality from asset managers;[489]

(b) Other policies set limits on the value of gifts and hospitality that can be accepted;[490]

(c) Other policies contain no explicit value limits, but use reporting and approval processes.[491]

8.80 Some value limits operate on a cumulative basis over a period of time, whereas others operate on an item-by-item basis. By way of example, one policy prohibits receiving or offering any gift item worth over £30 and any hospitality item worth over £50, without prior approval.[492] Another policy requires pre-approval for any gifts or hospitality over £150 and prohibits any staff member from receiving more than one gift or hospitality item with a total value of over £250 in a one-year period.[493]

8.81 We also reviewed the policies of some additional firms outside of the sample of ten larger investment consultants that we refer to above. We found:

(a) One example of an investment consultancy firm that had no formal conflicts of interest policy;[494]

(b) Two further examples of gifts and hospitality policies that did not explicitly prohibit cash gifts.[495]

8.82 Each of the investment consultancy firms in our sample also told us that they maintain a gift and hospitality register. In some cases, this is used to facilitate approvals or to facilitate periodic review by a compliance team. We found that some firms do not record minor items that fall below a *de minimis* threshold.

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[489] Aon, Barnett Waddingham, Cambridge Associates, Hymans, Mercer, and WTW.
[490] For example: JLT, KPMG.
[491] For example: Capita.
[492] Hymans.
[493] Redington.
[494] [✂]. In July 2018, the firm said that it did have a formal conflicts of interest policy at the overall business level that it had updated recently.
[495] [✂] and [✂]. [✂] subsequently submitted an updated policy document in July 2018 which does explicitly prohibit the offering or accepting of cash gifts. In July 2018, [✂] said that a recent internal policy review had recommended that accepting cash should be explicitly prohibited.

The level and nature of gifts and hospitality

8.83 Figure 21 below shows the value of benefits that investment consultancy and/or fiduciary management staff[496] received from asset managers. Some of these figures understate the total value of gifts and hospitality received, as some of these firms do not record minor gifts below a de-minimis threshold.[497] The outlier firm that received the highest gifts and hospitality levels does not use a de-minimis threshold.[498]

Figure 21. Value of gifts and hospitality received by investment consultancy and/or fiduciary management staff

Source: CMA Analysis, Parties' Data.

The value of gifts and hospitality has decreased since 2012.

8.84 This analysis shows that the total value of gifts and hospitality has followed a downward trend, with levels going down by 25% from 2015 to 2016 and decreasing even further by 39% from 2016 to 2017.[499]

[496] The firms included are Aon, Barnett Waddingham, Cambridge Associates, Capita, Cardano, Hymans, JLT, KPMG, LCP, Mercer, Redington, River & Mercantile, Russell Investments, WTW, and Xafinity.
[497] For example, Aon has a £25 de-minimis threshold.
[498] [✂].
[499] This is the mean of the annual changes in gifts and hospitality levels for the firms in the sample.

8.85 Total levels of gifts and hospitality now appear to be relatively modest for most firms; the median firm in our sample reported gifts and hospitality of £2,700 in 2017.[500]

Provisional conclusions

8.86 Regulated investment consultancy firms are subject to specific rules and guidance relating to gifts and hospitality, for example MiFiD II requirements.

8.87 We found that nearly all investment consultants have written gifts and hospitality policies, with several having updated these policies recently. Each of the ten larger investment consultancy firms in our sample keeps a gifts and hospitality register and nine of these firms have a policy that explicitly prohibits cash gifts. Some of these firms have policies that specifically define and prohibit the receipt of all non-business hospitality from asset managers. Each of these firms has processes and controls that seek to ensure objective ratings.

8.88 The data that we have reviewed indicate a downward trend in gifts and hospitality; the average decrease across firms was 25% from 2015 to 2016 and decreasing and a further 39% from 2016 to 2017.

8.89 Overall, we have not found evidence to indicate that ratings are influenced by gifts and hospitality; investment consultancy firms generally have safeguards in place to constrain gifts and hospitality and to seek to maintain objective and independent ratings, and the total value of gifts and hospitality appears to be relatively modest for most firms.

The sale of master trusts by investment consultants supplying employee benefit consultancy

8.90 Some investment consultants offer employee benefit consultancy services, including advising employers that are seeking to design or set-up pension schemes. As well as giving advice, some consultants also sell master trust pension products to employers.

8.91 This section considers whether there are competition problems arising from the sale of master trusts by investment consultants that also provide employee benefit consultancy services. For example, a potential concern here is that employers may be steered towards the master trust of their

[500] Rounded to two significant figures.

existing employee benefit consultant and as result may not get best value deals.

8.92 In the section below, we first provide background on employee benefit consultancy and master trust pensions, we then review investment consultants' positions for both of these services, and finally we draw some provisional conclusions.

Background

Stakeholder views

8.93 The submissions that we received in response to our issues statement contained relatively little in relation to the supply of master trusts by employee benefit consultants.

8.94 Some parties indicated that this issue was not a problem and/or questioned whether it should be an area of focus for our investigation. For example:

(a) Mercer said that 'switching to a master trust solution is not a decision that companies take lightly and tenders are absolutely standard around these decisions, often with the support of a third party'[501].

(b) WTW said that its Master Trust 'is a new offering by our firm [✂], which has been launched into a market with a wide range of existing offerings'.[502]

(c) JLT said that the focus of our investigation should be on investment services and that consideration of all conflicts and vertical integration which exist throughout the wider employee benefits businesses would seriously distract from the main focus.[503]

8.95 Others indicated that these issues should be considered. For example:

(a) The PLSA said that 'some scheme members have raised concerns about the potential misalignment of interests where consultants offering investment advice also have an in-house fiduciary management or master trust offering'.[504]

[501] Mercer Issues statement response.
[502] WTW Issues statement response.
[503] JLT Issues statement response.
[504] PLSA Issues statement response.

(b) Hymans said that master trusts should be in scope of our investigation.[505]

(c) LCP said that it sees barriers to clients switching master trusts, as these products generally bundle administration and investment management services.[506]

8.96 We did not receive any submissions from employers or pension scheme members in relation to master trusts or employee benefit consultancy.

Buyers of employee benefit consultancy services and master trusts

8.97 The vast majority of employers are now required to offer workplace pensions to their employees under auto-enrolment rules. [507]

8.98 Employee benefit consultants provide advice to employers on the design and set up of pension schemes, including whether to choose a master trust pension[508] and they may help employers select a pension product provider. This can involve running an evaluation exercise to compare different contract-based providers and/or different master trusts.

8.99 While employers are the buyers of employee benefit consultancy services and master trusts, the members of the employer's pension scheme are the ultimate beneficiaries.

Master trusts

8.100 Master trusts are a relatively new form of trust-based DC pension scheme.

8.101 As of 2017, there were more than 80 master trusts operating in the UK.[509] Master trust providers include those that are:

(a) **Insurance providers:** including AEGON, Fidelity, Legal & General, SEI, Standard Life and Zurich;

(b) **Investment consultancy:** including Aon, Capita, Mercer and WTW;

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505 Hymans Issues statement response.
506 LCP Issues statement response.
507 From October 2012, UK employers have had a duty to enrol eligible employees automatically into a qualifying pension scheme. See the Pensions Act 2008, section 3.
508 Contract-based schemes are individual contracts between members and a pension provider. Trust-based schemes include single-employer trusts, which are sponsored by an employer, and Master Trusts, which serve multiple employers at once.
509 The Pensions Regulator (2017), *DC trust: presentation of scheme return data 2016 – 2017.*

(c) **Auto-enrolment focused**: including NEST, NOW and the People's Pension.

8.102 Investment consultancy firms' and insurance providers' master trusts target larger employers (broadly speaking, those with several thousand employees). [510] Insurance providers' master trusts also target medium employers (broadly speaking, those with more than one hundred employees).[511] Whereas auto-enrolment focused master trusts target medium employers and smaller employers (broadly speaking, those with fewer than one hundred employees).[512]

8.103 [✂], [✂]and [✂] told us that their master trusts are generally targeted towards employers that have previously offered workplace pensions, rather than smaller employers who are engaging with pensions for the first time as a result of auto-enrolment rules.[513]

8.104 At present, master trusts represent a relatively small part of the UK pensions sector. At the end of 2016, there were around £2.2 trillion of assets[514] in UK work place pension funds, of which around £10 billion was in master trusts[515] and around £400 billion was in other DC schemes.[516] Therefore, master trusts accounted for less than 1% of total workplace assets and around 2% of workplace DC assets.

8.105 Master trusts and other DC pension products are widely expected to grow over the coming years in terms of both assets and members.

Regulation

8.106 Under the Pension Schemes Act 2017, the Pensions Regulator will be responsible for authorising and supervising all master trusts against criteria relating to systems and processes, financial sustainability and that people running the schemes are fit and proper.[517]

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[510] Spence Johnson (2016) *UK Defined Contribution, Looking beyond the passive approach*, p53.
[511] Spence Johnson (2016) *UK Defined Contribution, Looking beyond the passive approach*, p53.
[512] Spence Johnson (2016) *UK Defined Contribution, Looking beyond the passive approach*, p53.
[513] Market information request responses from these firms.
[514] Investment Association (September 2017), *Asset Management in the UK 2016-2017, The Investment Association Annual Survey*, p12.
[515] The Pensions Regulator (2017), *DC trust: presentation of scheme return data 2016 – 2017*.
[516] Investment Association (September 2017), *Asset Management in the UK 2016-2017, The Investment Association Annual Survey*, p51.
[517] House of Commons Library (March 2018), *Master Trust regulation,* p3.

Investment consultants' employee benefit consulting businesses

8.107 Aon, Mercer and WTW are the largest suppliers of employee benefit consultancy to customers with DC trust-based schemes.[518] These parties told us that they supply various types of employee benefit consultancy to employers that are looking to design or set up DC pension schemes. In some cases, they advise on the type of pension model to be adopted or retained (for example, whether to use a contract-based or master trust model). In some cases, this includes advice on product selection (for example, advice on which contract-based or master trust product to select).[519]

8.108 Aon and Mercer said that they do not advise on their own master trusts or run selection processes involving their own products.[520] WTW said that it would not typically carry out a selection/advice process where its master trust was on the shortlist, unless expressly requested to do so by the client.[521]

Investment consultants' master trust businesses

8.109 Investment consultants' master trusts currently account for a small part of the overall provision of master trust pensions. As of 2017, we found that Aon, Capita, Mercer and WTW were supplying their master trusts to only 36 employers in total. Two of these firms started serving their first master trust client in 2017.[522]

8.110 Through these arrangements, Aon, Capita, Mercer and WTW are serving around 100,000 members[523] (around 1.4% of all members of UK master trusts[524]) and managing around £3.2 billion of assets[525] (around a third of assets in UK master trusts, or less than 1% of assets in workplace DC schemes[526]).

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[518] Spence Johnson (2016) *UK Defined Contribution, Looking beyond the passive approach*, p56.
[519] Market information request responses from these firms.
[520] Market information request responses from these firms.
[521] WTW market information request response.
[522] CMA analysis of parties' market information request responses.
[523] CMA analysis of parties' market information request responses.
[524] Based on 6,999,000 total master trust memberships taken from The Pensions Regulator (2017), *DC trust: presentation of scheme return data 2016 – 2017*.
[525] CMA analysis of parties' market information request responses.
[526] Based on around £10 billion total master trust assets according to the Pensions Regulator (2017), *DC trust: presentation of scheme return data 2016 – 2017* and around £410 billion assets in DC schemes according to Investment Association (September 2017), *Asset Management in the UK 2016-2017, The Investment Association Annual Survey*, p51.

Provisional conclusions

8.111 Master trusts are a relatively recent and growing part of the UK pensions sector.

8.112 Some investment consultancy firms supply employee benefit consultancy services to employers and also sell master trust pension products.

8.113 However, given the limited penetration that these firms currently have in the master trust and wider DC sectors, we consider it unlikely that any potential steering by these firms towards their own master trusts has had a material impact on competition to date.

8.114 Therefore, our provisional view is that the potential conflict of interest for investment consultancy firms which offer master trust pensions and act as employee benefit consultants is unlikely to be leading to a competition problem at present.

Other conflicts of interest relating to fiduciary management

8.115 In the course of our investigation, we have received submissions highlighting a range of other conflicts of interest that may apply to some investment consultants and/or fiduciary managers. We consider some of these below.

Investment consultants not introducing or recommending fiduciary management

8.116 One of the most widely raised issues was that investment consultants that do not offer fiduciary management have incentives not to introduce or recommend the fiduciary management model, in order to avoid losing advisory business. This was raised by parties including Aon, Cardano, Mercer and WTW.[527]

8.117 At our roundtable event, asset managers agreed that firms which only provide advisory investment consultancy services may have incentives not to recommend fiduciary management services.[528]

8.118 We found that some trustee boards continue to buy separate investment consultancy services upon moving to fiduciary management, but the majority

[527] See for example: Mercer issues statement response, summary of hearing with Aon held on 22 November 2017, summary of hearing with Cardano held on 15 November 2017, summary of hearing with WTW held on 21 November 2017.
[528] Summary of roundtable with Asset Managers held on 12 February 2018.

do not. This implies that advisory-only investment consultancy firms may lose revenues where their clients move to a fiduciary model.

8.119 The CMA survey indicates that IC-FM firms introduce fiduciary management services more than other investment consultants: overall 19% of trustee boards said their investment consultant had suggested fiduciary management, whereas 30% of those buying from an IC-FM firm said that their investment consultant had done so. As discussed in chapter 7, our assessment is that firms may legitimately have different views as to whether fiduciary management is a beneficial service for their pension scheme clients.

8.120 In addition, as noted in chapter 7, fiduciary management has grown strongly in recent years; the value of assets under fiduciary management was over ten times higher in 2017 compared to a decade earlier.

8.121 Where schemes were not buying fiduciary management services, the most common reasons given in the CMA survey were that trustee boards felt it was not appropriate for the scheme circumstances (20%); would not lead to better outcomes (17%); or that trustees did not want to delegate decisions (15%). Only 11% of trustee boards said that the reason was that they had not even considered buying the service. Finally, we note that asset managers told us that sponsoring employers have played an important role in the growth of fiduciary management.[529]

8.122 Overall, the evidence that we have reviewed does not indicate that investment consultants not introducing or not recommending fiduciary management gives rise to a competition problem.

Other potential fiduciary management related conflicts of interest

8.123 Other potential conflicts of interest raised by parties included:

(a) Fiduciary managers may have incentives to discourage trustees from considering liability and asset transfers;

(b) Fiduciary managers which do not offer advisory services may have incentives to discourage fiduciary management clients from considering switching to an advisory-only approach;

(c) Fiduciary managers may have incentives to create complex or less liquid portfolios, in order to increase switching costs;

[529] Summary of roundtable with Asset Managers held on 12 February 2018.

(d) IC-FM firms may have incentives to prioritise their fiduciary management clients over their investment consultancy clients, when allocating assets to preferred funds;

(e) IC-FM firms which provide fiduciary management and advisory services to the same client may have incentives to moderate their advice so as to favour their fiduciary management division. This could mean recommending that more assets are added to the fiduciary mandate; setting soft objectives for the fiduciary manager; or failing to highlight poor performance by the fiduciary manager.

8.124 These examples further illustrate the range of potential conflicts of interest that can exist for investment consultancy firms and fiduciary managers. However, we did not find widespread concerns in relation to these issues, nor did we receive evidence to indicate that these were giving rise to competition problems.

9. Barriers to entry and expansion

Our main findings

- There are a wide range of firms providing investment consultancy and fiduciary management; and a number of firms that provide both services.
- Firms have used a range of entry strategies including vertical and horizontal expansion, expansion into the UK from overseas, or by focussing on particular client types or asset classes.
- There may be some greater barriers to entry for fiduciary management firms; there are likely to be both higher costs and greater economies of scale.
- Overall, we have not found high barriers to entry in investment consultancy or fiduciary management.
- We found that barriers to expansion are higher than those of entry particularly in fiduciary management;
  - The importance of reputation means that while new entrants can and do win clients, increasing a firm's client base may take time.
  - IC-FM firms with an established investment consultancy client base have an incumbency advantage in winning new fiduciary management clients.
  - There are material barriers to switching fiduciary manager.

9.1 This chapter sets out the evidence we have received and our assessment of potential barriers to entry and expansion in the investment consultancy and fiduciary management markets. This assessment focuses on the financial and other costs of entry and expansion.

9.2 We first set out our approach, before then assessing barriers to entry and then barriers to expansion. Lastly, we set out our provisional conclusions.

Our approach to assessing barriers to entry and expansion.

9.3 CMA guidelines[530] state that entry or expansion by firms, or the prospect of entry or expansion by firms within a short time, will often stimulate

[530] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3 (Revised)), paragraphs 205 – 236.

competition and can sometimes countervail against features which might otherwise give rise to an adverse effect on competition. A significant source of competitive discipline may therefore be eliminated or reduced if there is any barrier to market entry and/or expansion, whether an absolute barrier or some other form of restriction such as aspects of the market that deter entry.

9.4 There are three broad categories of entry barrier: natural or intrinsic barriers; strategic advantages of incumbents or 'first-mover' advantages; and regulatory barriers. We discuss aspects of each of these in the relevant section below.

9.5 Our guidelines explain that to assess the impact of barriers to entry and expansion, we will consider how the competitive climate within a market affects the decisions of individual firms to enter or invest in that market, taking into account the advantages of established firms.[531]

9.6 We have considered entry and expansion in investment consultancy and fiduciary management services through two assessments – first, the barriers to setting-up a new business (either a new firm or service line), and second, the barriers to growing that business through winning clients.

9.7 Within each of these we assess investment consultancy and fiduciary management together. Although we note that parties disagreed on whether it is helpful to compare investment consultancy and fiduciary management when assessing barriers to entry and expansion.

9.8 For example, Mercer said that investment consultancy and fiduciary management were different service models and that there was no reason to think that they are a useful comparison for each other.[532] Other firms, however, said there was merit in considering the barriers to entry for investment consultancy and fiduciary management in parallel. JLT for example told us that fiduciary management is an extension of investment consultancy and Redington said that there was an interrelation between the two.[533]

[531] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3 (Revised)), paragraphs 2227 – 234.
[532] Mercer response to the Competitive landscape & Barriers to entry and expansion working papers
[533] JLT and Redington response to the barriers to entry and expansion working paper

Recent entry and expansion

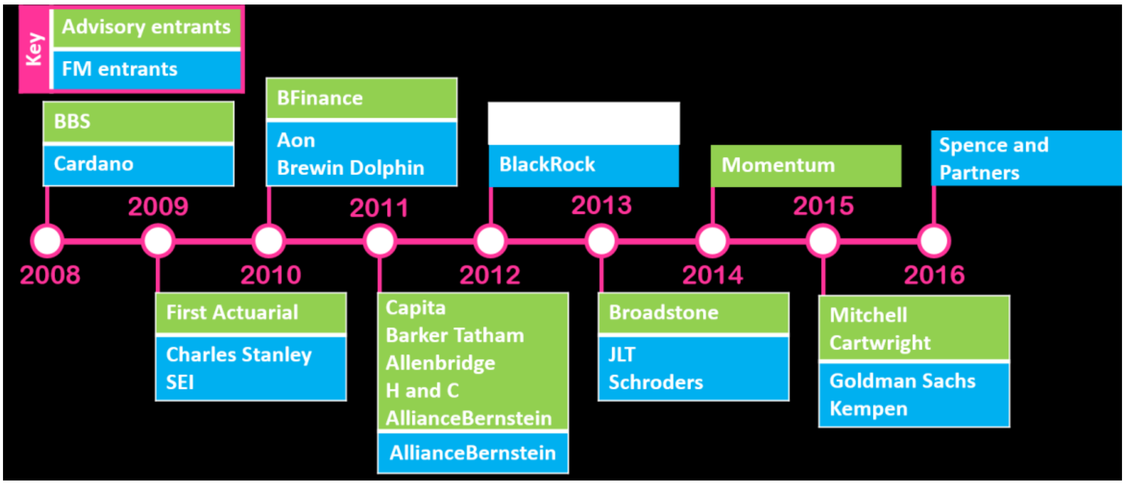
9.9 We have examined the number of firms providing fiduciary management and investment consultancy services and the scale of entry over the past ten years.

9.10 We have identified over 37 firms that offer investment consultancy services and at least 17 firms that offer fiduciary management services.

Over 37 firms offer investment consultancy and 17 offer fiduciary management services.

9.11 Figure 22 shows those firms that we are aware of that have started providing either investment consultancy or fiduciary management services since 2007. The number of firms active in providing investment consultancy and fiduciary management services appears to be growing and we have not noted firms exiting. It appears that 12 of the 17 fiduciary management firms currently operating in the UK have entered the market since 2007.

Figure 22: Timeline of market entry since 2007



Source: CMA Analysis
Note: Based on first year that revenues for relevant service recognised. CMA analysis of responses to CMA data requests and may not include all firms. Firms which first offered investment consultancy services before 2007 are not shown.

9.12 Fiduciary management is a relatively new service compared to investment consultancy and this has led to opportunities for entry over the last 10 to 15 years.[534] There has been sustained growth in the use of fiduciary management over the last ten years. KPMG's survey indicates that there

[534] See further analysis in chapter 4.

were 61 fiduciary management mandates (£12 billion AUM) in 2007 and 805 fiduciary management mandates (£135 billion AUM) by 2017.[535]

Barriers to entry – setting up a new business

9.13 In this section we focus on the barriers to setting up a new business up to the point of competing for and winning the first client. This may be in the context of setting up a new firm, or the expansion into investment consultancy and fiduciary management service lines by a firm providing other existing services.

Natural or intrinsic barriers

9.14 We define natural or intrinsic barriers to entry as the costs that firms unavoidably incur when entering a market (ie the sunk costs of entry). These costs include setting up functions such as human resources, financial systems and payroll. In the following subsections we discuss the costs of developing a research function and operating a regulatory compliance function.

9.15 We have not identified any natural or intrinsic barriers that have acted as a significant barrier to entry. We note however, that where such barriers do exist, multi-disciplinary firms may be able to take advantage of economies of scale or reduced entry costs. Any such barriers would be common to both investment consultancy and fiduciary management firms but are likely to be greater for fiduciary management, as a result of the broader range of services provided.

9.16 Firms with existing relationships in adjacent or vertical markets may have a competitive advantage in entry.[536] Some firms, for example, have entered the investment consultancy or fiduciary management sectors through expansion from existing actuarial or asset management services (and from investment consultancy in the case of fiduciary management). This could reduce the cost of entry, as the firms will already have the necessary support functions.

[535] KPMG's 2017 UK Fiduciary Management Survey https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/11/CRT086217_KPMG_FM_Survey_2017.pdf.
[536] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3 (Revised)), paragraphs 217 - 221.

Firms have entered through expansion from actuarial services or asset management.

9.17 The CMA survey of trustees found that 77% of schemes which bought investment consultancy services receive other services from the same provider, the most common service being actuarial services (55%) or scheme administration (52%). However, this in part may reflect the number of investment consultants that offer other associated services and that schemes may purchase services from multiple providers.

9.18 Aon said that 17 of 18 fiduciary management firms offer services in a number of adjacent markets which allowed those firms to develop commercial relationships with schemes regardless of investment consultancy provision.[537]

9.19 We have identified at least two firms which have entered the UK fiduciary management sector by expanding from overseas:

- Cardano was an established business in the Netherlands, with Cardano UK set up as a purpose built fiduciary manager. It did not inherit any client relationships from its parent firm.

- Kempen also entered the fiduciary management sector from the Netherlands. However, it did not act as an investment consultant there, instead offering advice on pension fund strategies as an integral of Kempen fiduciary management services.[538]

9.20 A non-solicitation clause in employment contracts of many investment consultancy staff can prevent them from performing revenue-generating activities in the first year or so of moving to a new or competing firm. However, these individuals are then able to benefit from the reputation and relationships they had built up at their former firm. One entrant which had been subject to these restrictions said it was not an unreasonable imposition.[539]

[537] Aon response to the Competitive landscape & Barriers to entry and expansion working papers, paragraph 2.7
[538] Summary of hearing with Kempen held on Friday 24 November 2017.
[539] Summary of hearing with Momentum held on 12 January 2018.

Momentum – entry with a small established team[540]

Momentum has provided investment and asset management services in the UK since 1998. Momentum entered the investment consultancy sector in 2014 by recruiting a small established team of investment consultants from Mercer. Several of these staff were subject to restrictive covenants preventing them from soliciting clients for a year after they left Mercer.

Momentum acted as a sponsor for the investment consultant team when it entered the sector, providing it with business support in areas such as compliance, legal, admin and payroll to help the investment consultant team enter the sector.

When it launched, the investment consultant team already had knowledge of a wide range of relevant asset managers and products. Momentum told us that this asset management research would be difficult for a new firm to replicate without extensive prior experience.

Research costs

9.21 To provide investment consultancy and fiduciary management services, firms need to have access to appropriate asset manager research to make recommendations to clients. The evidence submitted by parties indicates that developing research capability can be expensive but that firms have overcome this barrier in a number of ways.

9.22 We have been told that potentially significant resources are required for manager research in both investment consultancy and fiduciary management firms. Parties[541] have commented on the constraint that the lack of a research function poses on their firms. KPMG said however that research was critical to generate strategies for clients, determine which ones are likely to be successful and which fund managers would be best at implementing them. Research was therefore seen as imperative in order to serve client needs. It was also seen as needed to demonstrate credibility in the market. Costs of that research were therefore necessarily incurred.[542]

9.23 Spence & Partners said that the costs of undertaking extensive manager research are high and constitute a barrier for smaller firms entering the investment consultancy market as they would find it difficult to recoup across

[540] Summary of hearing with Momentum held on 12 January 2018.
[541] Momentum and Spence & Partners.
[542] KPMG response to the Competitive landscape & Barriers to entry and expansion working papers.

a small number of clients. However, they noted that some outsourced options are available and they could constitute effective solutions.

9.24 Different firms have taken a range of approaches. For example, new entrants or small firms can choose to buy research services or data from a third party initially but may develop a dedicated research function as they expand. Some firms such as KPMG and Momentum have chosen to embed their research function within the investment consultant team, with staff both conducting research and providing services to clients.

KPMG UK – expansion from pensions and professional services[543]

KPMG entered the investment consultancy sector in 2005 as an expansion of its pensions practice. KPMG said that it was not considering offering fiduciary management services to clients as it did not see fiduciary management having any fit with KPMG as an advisory firm. KPMG thought its independence as an advisor was important, especially as KPMG is the auditor of some fiduciary management firms.

KPMG told us that its approach to research was that it did not have a separate manager research team, instead all members of the investment advisory team spent 20 to 25 per cent of their time on research. KPMG believed this model meant that it was better able to communicate the advice it gives to clients. KPMG said that it did not seek to research all asset classes and did not, for example, conduct significant research on hedge funds. Its approach to research was to place more emphasis on finding the right asset class and having the right strategy in place for clients first, before helping clients through the process of selecting a fund manager to manage those assets.

9.25 Examples of the strategies that parties have adopted to develop research capabilities have included:

(a) Momentum told us that it started without a dedicated research team, instead using its consultants to conduct research.[544]

(b) Cardano commented that it needed to make considerable investment in manager research as this is resource-intensive.[545]

[543] Summary of hearing with KPMG held on 14 November 2017.
[544] Summary of hearing with Momentum held on 12 January 2018.
[545] Summary of hearing with Cardano held on 15 November 2017.

9.26 Several parties referred to the ability to buy in data or research services; although this was considered expensive, it was not considered prohibitively so.

> **Redington – focusing research efforts**[546]
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> Redington told us that not offering manager research was a significant barrier to its expansion and as a result it introduced its manager research offering during 2013.[547]
>
> Redington's manager research was provided by a team of 15, which it said was one-tenth the size of some large investment consultants. It had consciously adopted this approach to manage the cost of research.
>
> In developing its research function, Redington had chosen not to research the whole universe of managers. It instead developed criteria that would allow it to identify and focus on a smaller set of managers for each asset class. It would then issue a questionnaire to a long-list of firms before choosing those on which it wanted to conduct more detailed due diligence. This approach gave it sufficient breadth of coverage across asset classes whilst allowing it to spend sufficient time on the assessment of each of those managers.

9.27 In response to our working paper, WTW said that a full fiduciary management service needs to be capable of making informed decisions about a wide spectrum of investment opportunities, and needs to be supported by a full research function. Under an investment consultancy model, by contrast, providers have the option of offering 'niche' services that provide advice on certain types of investment, and so do not necessarily need to offer a complete spectrum of research.[548]

9.28 WTW noted that a number of new asset manager entrants in the fiduciary management sector have developed offerings focused on index tracking implementation which requires very low levels of investment.

Regulatory barriers

9.29 FCA regulation applies to the principal activities which are undertaken in the course of providing fiduciary management services, but covers only a more

[546] Summary of Hearing with Redington held on 13 November 2017.
[547] Redington response to the barriers to entry and expansion working paper.
[548] WTW response to the barriers to entry and expansion working paper, paragraph 1.6(a).

limited scope of the activities undertaken in the course of providing investment consultancy services.

9.30 The need to comply with regulation and to maintain a compliance function, are likely to impose some cost on firms. Russell Investments, for example, told us that regulatory costs are the biggest barrier to entry for a new fiduciary management firm.[549] However, other firms have not stated that regulatory costs are significant. Aon said that regulatory costs may be greater for fiduciary management operations than investment consultant operations but that many firms which enter the fiduciary management market will already be well-used to regulatory compliance.[550]

Economies of scale

9.31 Our guidelines state that economies of scale in combination with sunk investment costs can constitute a barrier if these relate to the cost of entering or expanding in the market.[551]

9.32 The costs of providing advice (whether by an investment consultancy or fiduciary management firm) appear to be largely scalable as having more clients will generally require additional advisory support. However, fiduciary management provision appears to require a larger fixed cost base for a research function and this does not appear to grow in proportion to the number of clients. We note the cost of research, both in terms of establishing a sizeable research function to cover a suitable range of assets and keeping that research current. Increasing the assets under management for a fiduciary management firm will lead to higher revenue, but not necessarily proportionately higher costs.

9.33 In response to our working paper Russell Investments said its experience was that higher costs and greater economies of scale are achievable for fiduciary management versus investment consultancy but that the current barriers to entry in either market need not be cause for concern.[552]

9.34 Our provisional view is that there are likely to be both higher costs and greater economies of scale in fiduciary management than in investment consultancy, and so greater barriers to a new entrant.

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[549] Summary of hearing with Russell Investments held on 3 November 2017.
[550] Aon response to the Competitive landscape & Barriers to entry and expansion working papers, paragraph 1.8.2.
[551] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3 (Revised)), paragraphs 211 – 216.
[552] Russell Investments response to the barriers to entry and expansion working paper, paragraph 2.1-2.2.

Barriers to expansion – winning clients

9.35 In this section we consider the barriers that firms may experience in winning new clients to expand their business. The extent to which these barriers affect firms may vary, particularly in relation to any existing client relationship acquired through the provision of other services.

Customer acquisition costs

9.36 Firms will need to incur various costs when competing to win new clients. These will include the cost of marketing and promotional materials, the time cost of staff preparing for and participating in tender processes and potentially a dedicated business development or bid support team.

9.37 The relative cost and importance of these activities will vary by firm and by client. We would expect that where a firm wins a new fiduciary management mandate from an existing investment consultancy client and where no formal tender process has been held, the marginal cost of winning that client would be lower than for other firms. In contrast, a smaller, less-well known firm might need to spend a greater amount of resource in developing a client's awareness of its services and reputation before being invited to participate in a tender process.

9.38 Although there are clearly costs to acquiring a customer, we received no evidence that these costs would be prohibitive in either investment consultancy or fiduciary management.

Brand recognition and reputation

9.39 Brand and reputation appear to be important factors in the ability of an investment consultancy or fiduciary management firm to expand.

9.40 Our analysis of information on fees and quality in chapter 5 identifies barriers that prevent customers from accessing the necessary information to assess value for money in investment consultancy and fiduciary management services. We consider that, as a result of these difficulties, brand and reputation may play an increasingly important role in choice of firm.

9.41 In the investment consultancy and fiduciary management sectors, larger firms are perceived to be more experienced and have greater brand recognition. We have heard from several parties that a pension trustee will often prefer to choose a large, well-recognised brand on the grounds that 'no-one ever got fired for choosing IBM'.[553]

9.42 Russell Investments said that this can sometimes result in customers choosing deals which are not necessarily in their best interests or missing opportunities to obtain a better deal elsewhere.[554] Aon said that the IBM effect should not be overplayed and that there are many well-established fiduciary management firms and many more asset managers or investment consultancy providers that have solid reputations and are well-known to trustees. Aon further said that larger, better-resourced schemes may opt for the 'IBM' option but they do that as sophisticated purchasers with demanding requirements and strong countervailing buyer power.[555]

9.43 The extent to which brand recognition acts as a barrier will be determined by the behaviour of trustees when conducting tender processes. The CMA survey found that the median number of fiduciary management providers invited to submit a tender or proposal was three; as was the median number of fiduciary management providers who responded to the invitation.[556]

9.44 Barnett Waddingham told us that for them, the greatest challenge is getting invited to bid for, and subsequently to be awarded, larger contracts. They also said that trustees at the larger pension schemes appear to be more comfortable working with larger investment consultant firms.[557]

9.45 Momentum stated that they recognise that - as a small firm[558] - in order to be awarded new mandates, they had to convince potential clients that size didn't matter, and that the attributes of a smaller firm can sometimes be an advantage. It found that feedback from potential clients who did not award them the mandate was, most often, that the successful firm was a bigger or more experienced firm – and therefore perceived to be a safer option.[559]

[553] Summary of hearing with Momentum.
[554] Russell Investments response to the barriers to entry and expansion working paper, paragraph 3.2
[555] Aon response to the Competitive landscape & Barriers to entry and expansion working papers, paragraphs 1.10-1.12
[556] Source: CMA survey, questions L6. '*In total, how many providers did you invite to submit a tender or proposal?' and L8: 'How many tenders or proposals did you receive?'. Estimations are based on the sample of 119 fiduciary management clients who knew the number of fiduciary management providers they invited to submit proposals and the sample of 116 fiduciary management clients who invited proposals and knew how many fiduciary management providers submitted them.*
[557] Summary of Hearing with Barnett Waddingham held on 12 December 2017.
[558] Momentum considered that: a small firm would have less than 50 investment staff; a medium sized firm would have between 50 and 200 and a large firm would have over 200 investment staff.
[559] Summary of hearing with Momentum.

9.46 Hymans said that a large brand name can also be associated with more generic less tailored advice, which does not suit all investment consultant advisory customers.[560]

9.47 Russell Investments agreed with the view expressed in our working paper that there was less scope to demonstrate reputation in fiduciary management relative to investment consultancy given the lower number of discrete projects available for fiduciary management.[561]

9.48 Firms in adjacent sectors, such as asset management may be credible alternatives in future as a result of strong brand recognition and investment knowledge and expertise. As some parties have noted (paragraph 9.42 above) fiduciary management firms may have developed strong reputations in adjacent markets.

9.49 Our provisional view is however that the ability to translate this reputation in one market into success in another will vary by the nature of that service and any pre-existing knowledge and commercial relationships of the trustees.

9.50 Recognition in the market place can also have a compounding effect. Once a large tender opportunity is won, a firm is likely to be able to attract further larger schemes to its client base. Redington, whose founding members specialised in risks to pension funds, established itself in 2006 and by 2010 had managed to secure some very large pension schemes as clients.[562]

Redington (pt. 2) – niche advice expanding over time

Redington was established just over ten years ago by two individuals working in the field of pensions risk management in an investment bank.

They established Redington having devised a framework for the intensive management of risk for pension schemes, with a specific focus on inflation and interest rate hedging. The founders felt that inflation and interest rates were the two largest inherent risks to pension funds but had not to that point received sufficient attention.

As a result of its clients being relatively well-hedged Redington believed its clients' performance through the financial crisis of 2008 had strengthened its reputation, allowing it to win larger clients than initially anticipated.

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[560] Hymans response to the barriers to entry and expansion working paper
[561] Russell Investments response to the barriers to entry and expansion working paper, paragraph 3.2.
[562] Large Clients would typically be those with over £1 billion AUA/M.

Its core client type was UK defined benefit pension scheme trusts. It initially worked with sponsoring employers, often looking at schemes in parallel to a scheme's own consultant. As the investment consultancy services grew in breadth, it began to tender for pension schemes.

Redington did not begin to fully expand its research function until some years after it had been established. As the firm developed its research capability to cover the full spectrum of asset classes, it was able to expand into a full-service investment consultancy. Redington told us this expansion allowed it to participate in a wider range of tender processes.

Redington told us that it had successfully won a range of business and believed that brand and trust are both important factors for successful firms in the investment consultancy sector. Redington's view was that, although there are some benefits arising from having scale, being a pure investment consultant firm gives it objectivity and independence.

Incumbency advantage

9.51 In addition to the general importance of reputation, incumbent firms (that is those currently providing any of a range of services to a given client) may experience a particular competitive advantage which potentially acts as a barrier to expansion for other firms.

9.52 In chapter 7, we found that IC-FM firms have a stronger competitive position with their existing advisory clients, compared to other prospective providers of fiduciary management, contributing to an incumbency advantage for IC-FM firms.

9.53 Russell Investments said that they have much less interaction with clients who have an existing relationship with an investment consultant which also provides fiduciary management services.[563] They believed that the most significant barrier to expansion of their fiduciary management activities is that access to clients is restricted due to the presence of IC-FM firms who have a 'trusted adviser' status.[564]

Cardano – international entry with experienced UK individuals

Cardano was established in the Netherlands in 2000 offering a combined investment consultancy and fiduciary management service before it

[563] Summary of hearing with Russell Investments held on 3 November 2017.
[564] Summary of hearing with Russell Investments held on 3 November 2017.

entered the UK in 2007, at which point fiduciary management services were not widely offered by the larger firms. The firm has targeted its services exclusively to pension funds, and typically those schemes which had assets of at least £150 million in fiduciary management and £2 billion in investment consultancy.

The UK firm was established by several experienced investment consultants, each with around 10 to 15 years of experience in the market. Cardano told us this experience brought credibility with it and that personal relationships, developed with prospective clients while working at previous firms, had helped Cardano to be invited to participate in tender processes.

It had however taken Cardano around two years before it tendered for its first full fiduciary management mandate. Cardano had won clients but had not to date replaced an incumbent fiduciary management provider.

9.54 In response to our working paper on barriers to entry and expansion, Redington raised concerns about the frequency with which an investment consultancy mandate held by an IC-FM firm may be replaced with a fiduciary management mandate without consideration being given to opening the existing mandate up to other investment consultancy firms.[565]

9.55 WTW said that an incumbent IC-FM firm may have an advantage for good reason. For example, the features that made a firm's investment consultancy services attractive to the client will also make its fiduciary management features attractive. WTW gave the example of a client that originally chose WTW to provide its investment consultancy services because of the strength of its research base is also likely to see this as an attractive feature in WTW when selecting a fiduciary management provider.[566]

9.56 Overall, as set out in chapter 7, we provisionally found that IC-FM firms steering customers towards their own fiduciary management service and low engagement by trustees when first buying fiduciary management contribute to an incumbency advantage for IC-FM firms. This is likely to increase barriers to expansion in fiduciary management.

IC-FM firms have an incumbency advantage which is likely to increase barriers to expansion in fiduciary management.

[565] Redington response to the barriers to entry and expansion working paper
[566] WTW response to the barriers to entry and expansion working paper, para 1.11(b)

Opportunities to participate in tender processes

9.57 The opportunity for investment consultancy and fiduciary management providers to bid for a tender can arise in two ways;

- firms may tender for services to 'test' the market against the incumbent investment consultancy or fiduciary management provider, with a view to potentially switching provider; or

- when procuring a service for the first time. The duration of any mandate is not usually fixed. It will vary from client to client, though Russell Investments and BBS told us that fiduciary management and investment consultancy appointments last for at least three to five years.[567,568] This is of particular relevance for fiduciary management.

9.58 As set out in chapter 6 switching rates are higher in investment consultancy than fiduciary management. But it is difficult to assess switching in fiduciary management as this is a relatively new market and so it may in practice be too soon for many schemes to have switched.

9.59 Table 7 below sets out the combined number of fiduciary management and investment consultancy tender processes that firms have participated in in the last three years. For the 21 firms for which we hold data, there is significant variation in the number of tender processes that the firms participated in. These ranged from fewer than ten to over 400.

Table 7: Fiduciary management and investment consultancy tender process participation in the last three years (in alphabetical order)

Firm	*Number of tenders*	*Firm*	*Number of tenders*
Aon	[✂]	KPMG	[✂]
Barnett Waddingham	[✂]	LCP	[✂]
BlackRock	[✂]	Mercer	[✂]
Cambridge Associates	[✂]	Redington	[✂]
Capita	[✂]	River & Mercantile	[✂]
Cardano	[✂]	Schroders	[✂]
Charles Stanley	[✂]	SEI Investments	[✂]
First Actuarial	[✂]	Spence & Partners	[✂]
Hymans	[✂]	WTW	[✂]
JLT	[✂]	Xafinity	[✂]
Kempen	[✂]		

Source: CMA Analysis, Parties' Data, listed in alphabetical order.

[567] Summary of hearing with Russell Investments. Russell Investments referred to fiduciary management.
[568] Summary of hearing with BBS held on 7 November 2017, BBS referred to investment consultancy contracts 'New contracts tend to be for a for a three to five-year timeframe. BBS stated that they had a duty to remind clients that they should regularly review their performance'.

9.60 Our dataset does not allow us to identify whether a given tender process related to investment consultancy or fiduciary management services, nor the scale or scope of the engagement. It does however indicate that although firms may have opportunity to participate, it is the largest firms that participate most frequently.

9.61 The cost of bidding for tenders is not seen to be prohibitive to entry by parties but a firm's rate of expansion may be affected by its ability to finance and afford staff time in participating in multiple tenders. For fiduciary management mandates, the selection process could take up to a year and therefore the costs incurred may be considerable.[569] For smaller firms there will necessarily be greater restrictions on the number of tender processes that firms have the capacity to engage in.

9.62 Hymans said that the cost of participating in a tender is high relative to the revenues earned. Therefore, Hymans sought to participate in those which were driven by a need for change and the prospect of a long-term relationship, rather than simply for due diligence purposes where the client is entirely satisfied with the incumbent.[570]

9.63 Russell Investments said that the number of fiduciary management contracts being tendered had been growing in recent years.[571]

9.64 As more firms choose to adopt fiduciary management services, the number of opportunities to win a contract and the associated revenues available may also increase.

9.65 Our provisional view is that the number of tenders that firms have participated in varies significantly. We are not in a position to ascertain the success rate in tenders for a given service. However, the number of tenders and the fact that the largest firms participate most frequently, are broadly consistent with our understanding of market shares.

9.66 WTW said in response to our working paper that tender success rates should be the focus of our analysis instead of the rate of participation in tenders.[572] We agree with WTW that the success rate is an important aspect of competition but consider that understanding the ability of firms to compete requires analysis of the opportunity to tender. WTW also said that there are stronger opportunities for new entrants to establish themselves and grow

[569] Summary of hearing with Punter Southall held on 23 November 2017.
[570] Summary of hearing with Hymans held on 15 November 2017.
[571] Summary of hearing with Russell Investments.
[572] WTW response to the barriers to entry and expansion working paper, paragraph 1.12.

their client base in fiduciary management as a result of the growth of the market.[573]

Switching rates and costs

9.67 A further potential barrier to expansion is the rate of switching by clients with incumbent providers and the costs incurred in switching. The impact of this will, however, depend on the overall level of uptake of a given service in a market. Chapter 6 on trustee engagement sets out relevant evidence and indicators of engagement and switching costs in more detail.

9.68 In investment consultancy we found that average switching rates of 27% do not raise major concerns, although levels of switching vary considerably by type and size of scheme. Equally we do not consider that there are material costs or barriers to switching investment consultant.

9.69 In fiduciary management it is difficult to assess switching rates as this is a relatively new market, however we have found that there are material barriers to switching fiduciary manager (due to the time it takes and significant costs which can be incurred).

9.70 Hymans said that switching costs in fiduciary management will increasingly be a barrier in future for large DC schemes and especially if they have different DC admin providers.[574] Within DC, it said that there would be additional barriers to switching relating to any pre-retirement strategy developed by a fiduciary management provider.[575]

Perceptions of conflicts of interest and benefits of bundling

9.71 There are some potential barriers which may act in opposite directions depending on client preference. We note the potential tension between the perception of any potential conflict of interest arising from offering both investment consultancy and fiduciary management and the potential benefits of offering multiple, possibly bundled, services.

9.72 For example, some parties[576] believe that their clients prefer that they do not offer fiduciary management in addition to their investment consultancy service, as this reduces the conflict of interest possibility. This could then

[573] WTW response to the barriers to entry and expansion working paper, paragraph 1.3(b)
[574] Hymans response to the barriers to entry and expansion working paper.
[575] Should a scheme decide to switch to another fiduciary management provider or back to an investment consultancy provider, [✄]. These types of challenges and decisions are likely to lead to fewer decisions to switch fiduciary management provider within DC.
[576] Momentum and Punter Southall.

limit a firm's willingness to expand into fiduciary management services, given the potential conflicts associated with offering both investment consultancy and fiduciary management services to a client.

9.73 KPMG said[577] that it was not considering offering fiduciary management services to clients as it did not see fiduciary management having any fit with KMPG as an advisory firm. KMPG said that its independence as an advisor was important, especially as KPMG is the auditor of some fiduciary management firms.

9.74 Several firms offer a range of service lines to clients which allow bundles of services to be purchased from the same provider, either incrementally or at the same time. Some firms, such as SEI offer an integrated IC-FM service whereas many firms providing both investment consultancy and fiduciary management to a client have separate agreements in place for each service.

9.75 Any client-perceived benefit of obtaining multiple services from the same firm could however act as a barrier to expansion. First, firms which do not offer multiple services may find themselves at a competitive disadvantage in tenders. Second, the costs of entry to multiple service lines will be greater and expansion may be slower than for established multi-service line firms. Third, where clients have a preference for buying multiple services from the same firm, the aggregate switching cost will likely be greater than the switching cost of any given services.

9.76 Parties provided views on the preferences of trustees in relation to bundling or the potential ability to purchase multiple services:

(a) Russell Investments said that the ability to provide multiple services or a 'one-stop shop' was not a particularly significant barrier to expansion. It found in many cases that clients prefer to keep separate providers in order to reduce the perceived conflict of interest. However, where providers have pre-existing relationships with clients, it can influence the client's decision to expand the relationship across other service lines.[578]

(b) LCP said that clients can value the independence of investment consultancy only providers but that this was not a barrier for IC-FM firms winning business.[579]

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[577] Summary of hearing with KPMG held on 14 November 2017.
[578] Russell Investments said that in its view the ability to provide multiple services under one roof was largely separate from the issue of incumbency in terms of competitive advantage. Russell Investments response to the barriers to entry and expansion working paper.
[579] LCP response to the barriers to entry and expansion working paper.

(c) Hymans noted that bundling would attract schemes according to size and position in their lifecycle. For example, smaller schemes and mature schemes and those in run-off would perceive greater benefit from bundling or overlap of service provision (including investment, actuarial and administration services).[580]

(d) Aon said that trustees value and encourage the additional options that are available to them by being able to purchase both investment consultancy and fiduciary management services from a single firm.[581]

(e) JLT said that its experience was that fiduciary management is often seen by clients as merely an extension of investment consultancy, enabling efficient implementation of the preferred investment managers, and for clients using trigger based de-risking strategies, the rapid implementation of pre-agreed strategic changes.[582]

Provisional conclusions

9.77 Our provisional finding is that barriers to market entry in investment consultancy or fiduciary management are not high.

(a) There are over 37 firms providing investment consultancy services and at least 17 providing fiduciary management services in the UK.

(b) Firms have used a range of entry strategies including vertical and horizontal expansion, and expansion into the UK from overseas.

(c) Firms can choose to enter by focusing on particular client types, asset classes or strategic advice.

9.78 There may be some greater barriers to entry in fiduciary management; in particular there are likely to be both higher costs and greater economies of scale. We have not however assessed these quantitatively.

9.79 We provisionally find that barriers to winning clients are greater than those of setting-up a new firm or service line, particularly in fiduciary management.

(a) The importance of reputation means that while new entrants can and do win clients, increasing a firm's client base may take time.

[580] Hymans response to the barriers to entry and expansion working paper
[581] Aon response to the Competitive landscape & Barriers to entry and expansion working papers, para 3.6
[582] JLT response to the barriers to entry and expansion working paper

(b) IC-FM firms with an established investment consultancy client base have an incumbency advantage in winning new fiduciary management clients, as explored further in chapter 7.

(c) There are material barriers to switching fiduciary manager.

10. Market outcomes

Our main findings

- Some outcomes indicate that aspects of the investment consultancy and fiduciary management markets function well. Trustees generally are satisfied with their providers, providers can achieve significant discounts from asset managers for their customers, and their asset allocation advice appears to be tailored and has added value in recent years through the hedging of interest rate risks.

- However, there is evidence that these markets do not function well in other ways, and that the issues of low customer engagement and difficulties accessing information we identified in previous sections are resulting in worse outcomes for some customers. In particular:

  - In fiduciary management, we found evidence that less engaged schemes pay significantly higher prices than more engaged schemes, when they remained with their existing investment consultant. There is some evidence that less engaged schemes in investment consultancy pay more too.

  - Less engaged schemes are likely to receive lower discounts from asset managers negotiated by their investment consultant.

  - Less engaged customers in some cases receive a lower quality of service, for example a less experienced team

  - Investment consultancy firms with above average quality have persistently lower market shares.

- Our quantitative analysis of investment consultants' recommended asset manager products found that these appear to outperform benchmarks net of fees, but not to a statistically significant extent. Therefore, the evidence hasn't clearly demonstrated, one way or the other, whether providers collectively add value through this service, though some individual firms may do so.

- We found that the aggregate net profit margin for investment consultancy and fiduciary management combined was [20% - 30%]. We have not undertaken an economic assessment of profitability.

10.1 In this chapter we consider whether customers are getting good outcomes from the investment consultancy and fiduciary management markets, both in terms of prices and several aspects of quality.

10.2 Assessing outcomes in these markets is complicated because there are many different aspects to quality, such as asset allocation and discounts obtained on asset manager fees, and several of these are difficult to measure. Investment consultancy services in particular are differentiated, with customers purchasing different ranges of services, meaning that it is difficult to compare outcomes across schemes.

10.3 As a result, a fully comprehensive assessment of market outcomes is not feasible. We have therefore considered a range of key indicators, with a particular focus on prices, though we have also examined various elements of quality.[583] In undertaking this assessment, we consider whether some of the issues identified in previous sections, in particular low trustee engagement, are leading to some customers receiving worse market outcomes than others.

10.4 This chapter is structured as follows.

(a) First, we present our assessment of prices, including a detailed analysis of whether more engaged schemes get lower prices than less engaged schemes.

(b) Second, we present our assessment of quality, which includes;

(i) providers' impact on schemes' asset management costs;

(ii) the quality of individual services, in particular asset allocation and manager recommendations;

(iii) evidence in relation to overall scheme-level performance; and

(iv) other broader parameters, such as satisfaction and quality of service.

(c) Third, we consider indicators of profitability for these markets.

(d) Finally, we present our provisional conclusions.

[583] A number of parties expressed concern that focussing on price, to the exclusion of other outcomes was not appropriate (see Appendix 6). As noted above we have also looked at other factors, however we have focussed on price as this is a meaningful metric and one which can be more easily measured than quality.

10.5 Further details of our analysis of each topic can be found in Appendices 2, 5, 6 and 7.

Price outcomes

10.6 Here, we set out our analysis of investment consultancy and fiduciary management fees and prices. By *fees*, we mean the total amounts paid by schemes. By *prices* we mean for fiduciary management the fee paid *per unit of asset under management*, and for investment consultancy the fee paid *per hour of the provider's time*.

10.7 We have focussed our analysis on the extent to which providers charge customers different prices for a similar level of service. Significant variation in prices could mean that some customers are receiving worse value for money than others. This could indicate that the market is not working well in terms of its outcomes, if the reason some customers receive worse value for money is linked to aspects of the market which prevent, restrict or distort competition.[584]

10.8 Indeed, we have provisionally concluded in chapters 5, 6 and 7 that there are various aspects of these markets which are impacting competition. In particular, we identified that some schemes have low levels of engagement in these markets. In this section we have therefore analysed whether customers who are less engaged pay more. As in earlier sections, we use the term 'engagement' to refer to customers' willingness and ability to access information, assess offers and act to secure the best value deals.[585]

10.9 Our analysis in this section is structured as follows.

(a) First, we set out some context on the importance of investment consultancy and fiduciary management fees, in particular by reference to asset management fees.

(b) Second, we outline our qualitative assessment on whether providers give some customers, particularly engaged customers, a better deal.

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[584] In its market investigation reports, the CMA uses the term 'a well-functioning market' in the sense, generally, of a market without features causing an AEC, rather than to dente an idealized, perfectly competitive market (CC3 (Revised), paragraph 30).

[585] The access, assess, act framework is set out in our guidance in reference to customers getting a better deal when they are willing and able to 'access information about the various offers available in the market; assess these offers to identify the …service that provides the best value for them; and act on this assessment [for example] by switching to purchasing the good or service from their preferred supplier'; CC3 Revised, paragraph 296.

(c) Third, we summarise our quantitative analysis on whether there is any variation in fees and links between the level of engagement and fees.

Context on fee levels

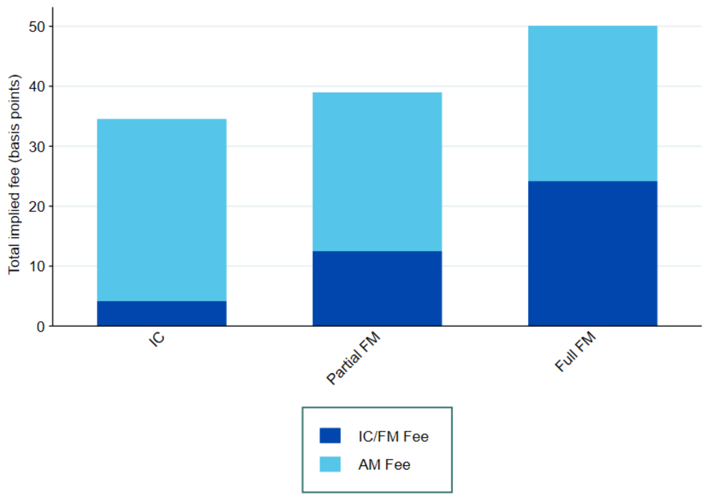
Fees for investment consultancy and fiduciary management together cost schemes up to £558 million every year.

10.10 In chapter 4, we found that investment consultancy and fiduciary management fees together cost pension schemes as a whole between £461 million and £558 million pounds every year. Together with asset manager fees, schemes pay well in excess of a billion pounds every year in investment-related fees.[586,587]

10.11 It is common practice to express fees in basis points, that is as a percentage of asset under management, multiplied by 100. We term these 'prices'. We show in the chart below an estimate of the average breakdown between investment consultancy/fiduciary management fees and asset management fees.[588]

[586] In our dataset which covers only a subset of schemes at a limited number of providers and drops potential outliers (which are mostly on the right tail of the distribution), we find that asset management fees exceed £669 million. This is likely to be a significant underestimate.
[587] According to a TPR survey conducted in 2013, investment costs constitute an average of about 20% of the running costs for most DB schemes (and constituting the highest cost category, except for administration). Source: TPR DB Scheme Costs Research 2013. We have not quoted the figure for 'very large' pension schemes as it is out of line with others and may not be representative.
[588] That is, as a percentage of schemes' assets multiplied by one hundred.

Figure 23: Median investment consultancy/fiduciary management fees and asset management fees by service



Source: CMA Analysis, Parties' data[589]

10.12 Figure 23 shows that investment consultancy fees are, on average, approximately one tenth of a pension scheme's combined investment consultancy and asset management costs. By contrast, fiduciary management fees constitute around half of combined fiduciary management and asset management costs.[590] Median fiduciary management fees are around five times higher than median investment consulting fees. Investment consultancy and in particular fiduciary management fees are therefore material.

10.13 Asset management fees are also significant, and are influenced by investment consultancy and fiduciary management firms through negotiation. Our analysis of asset management discounts is set out in our assessment of quality further below.

Qualitative analysis of pricing

10.14 We have analysed parties' responses and their internal documents to understand whether they monitor levels of customer engagement, whether

[589] In this chapter, we draw on Parties' data which contains information on the large majority of their pension scheme customers. Our primary dataset is described in Appendix 5 however for statistics relating to asset management pricing we also draw on a secondary dataset described in Appendix 6.
[590] Whilst schemes that use fiduciary management services appear to pay more overall, the data is not fully comparable because implementation costs (as well as potentially other bundled service costs) are included in the fiduciary management fee but not in the investment consultancy fee: these services would be purchased separately or at least split out from the investment consultancy fee. Further, we note that the average analysis above indicates that asset management costs are *lower* in fiduciary management, which may indicate an ability to offset these fees. We return to this point in our analysis beginning at paragraph 10.10.53..

price and service factors are personalised to individual schemes, and whether this is driven by customer engagement.

10.15 Providers generally told us that their fee levels varied between schemes. They also appeared prepared to negotiate on fees in order to secure appointments, and will revisit fees for existing schemes. In addition, one provider told us they monitored trustees' satisfaction at least in part to 'provide more pre-emptive action where a client appears at risk'.[591]

10.16 This is consistent with evidence from internal documents, which is set out in more detail in Appendix 6. It appears from these documents that several providers carefully monitor their existing customers, and record information on who they consider to be 'at risk' of switching provider.[592] This process also appears to be linked to firm-led negotiations on fees, targeted improvements in service quality, and other efforts to improve outcomes for such customers. There were references in the documents to concerns that otherwise these customers would switch.

10.17 In addition to improving customers' initial terms through more effective negotiations, engagement also appeared to be a key reason why schemes would be considered 'at risk' by firms. Improvements in terms appeared to be linked to the 'at risk' registers. This also implies that customers which are less engaged may receive comparatively less favourable outcomes.

10.18 Parties' disputed the inference we drew from the above documents. Aon and Mercer said that the small number of documents and firms involved raised doubts about their broader applicability.[593] Mercer told us, amongst other points, that the evidence was consistent with highly competitive markets, and that improvements driven by the most engaged clients are shared by a wider group.[594]

10.19 We have addressed these comments in full in Appendix 6. In summary, while this documentary evidence is not exhaustive we nonetheless consider that it is illustrative of market practices. It demonstrates that more engaged schemes can and do obtain better outcomes than less engaged schemes. Whilst this is not problematic in itself, as set out in chapters 5, 6 and 7 we have found that there are some issues in these markets that are inhibiting engagement and the ability for customers to assess value for money.

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591 [✂] response to the market information request, paragraph 56.
592 In a more general way, investment consultants and fiduciary managers told us that they undertake client surveys and interview processes in order to understand trustees' perceptions of the service qualities and value for money that they are receiving. Some parties conduct these anonymously, others in an attributable way.
593 Aon's response to the Gains from Engagement Working Paper, pages 9-10
594 Mercer's response to the Gains from Engagement Working Paper, paragraph 3.6.

Quantitative analysis of pricing

10.20 We have also conducted more detailed quantitative analysis to understand whether there is a link between customer engagement and price levels.

10.21 Specifically, for both investment consultancy and fiduciary management we examined data on the amount schemes paid for these services, and analysed whether this is related to three indicators of engagement: whether schemes tendered,[595] used a TPE, or have a professional trustee.[596] We consider that schemes which have at least one of these indicators are more likely to have higher engagement levels, than schemes which have none. For fiduciary management we also compared outcomes for those schemes who stayed with their existing investment consultant ('Internally Acquired') to schemes that moved to a different provider ('Externally Acquired').

10.22 We acknowledge that engagement is a matter of degree, and that our binary measurement will be an imperfect proxy as there are other indicators which we cannot measure. Nevertheless, we consider that schemes which have at least one of our indicators are more likely to have higher engagement levels, than schemes which have none. We therefore refer to schemes with at least one indicator as 'more engaged' in what follows.

10.23 Our analysis is set out in full in Appendix 5, and we summarise the key points here.

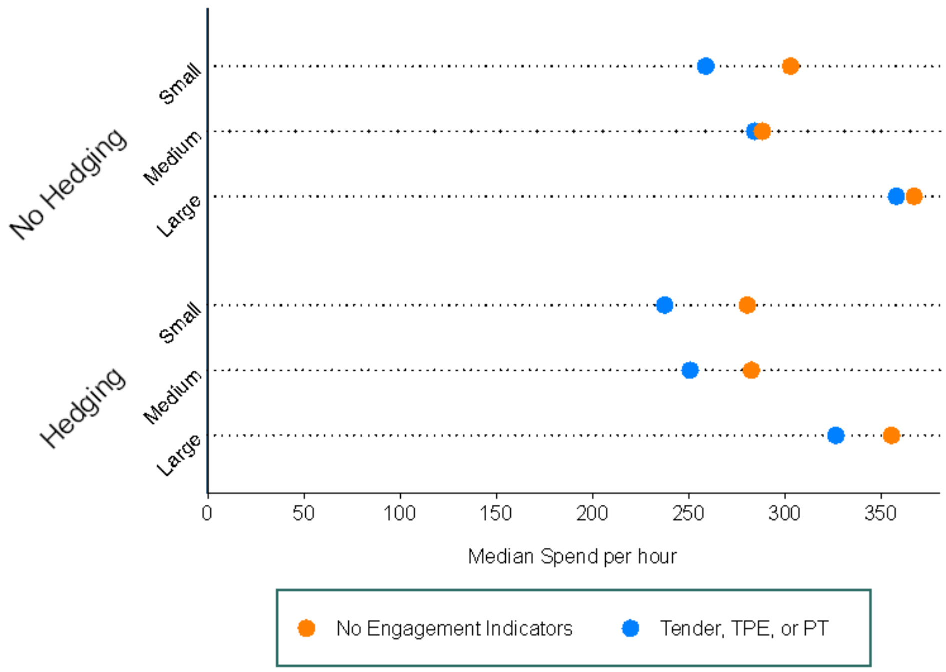
Investment consultancy analysis

10.24 We assessed the variation in 2016 investment consulting prices across clients. We compute 'price' as the total spend per hour of advice received from the investment consultancy provider, which reflects a very common charging structure.

10.25 To account in part for some key confounding factors, we split schemes into sub groups depending on their size[597] and whether they purchase the hedging service. Within each category we compared the median price between more engaged (blue) and less engaged (orange) schemes, this is shown in Figure 24 below.

[595] Specifically, whether they undertook a 'formal tender'
[596] See paragraph 6.53. We use slightly different indicators from the analysis in that section, due to different data sources: our analysis here relies on Parties' data rather than the CMA survey.
[597] The comparison for schemes with less than £100 million in AUM are categorised as 'Small' and shown in one group; schemes with AUM of £100 million to £1 billion are categorised as 'Medium' and shown in another; and schemes with AUM of over £1 billion are shown in a third group.

Figure 24: Investment consulting prices split by engagement



Source: CMA Analysis; Parties Data

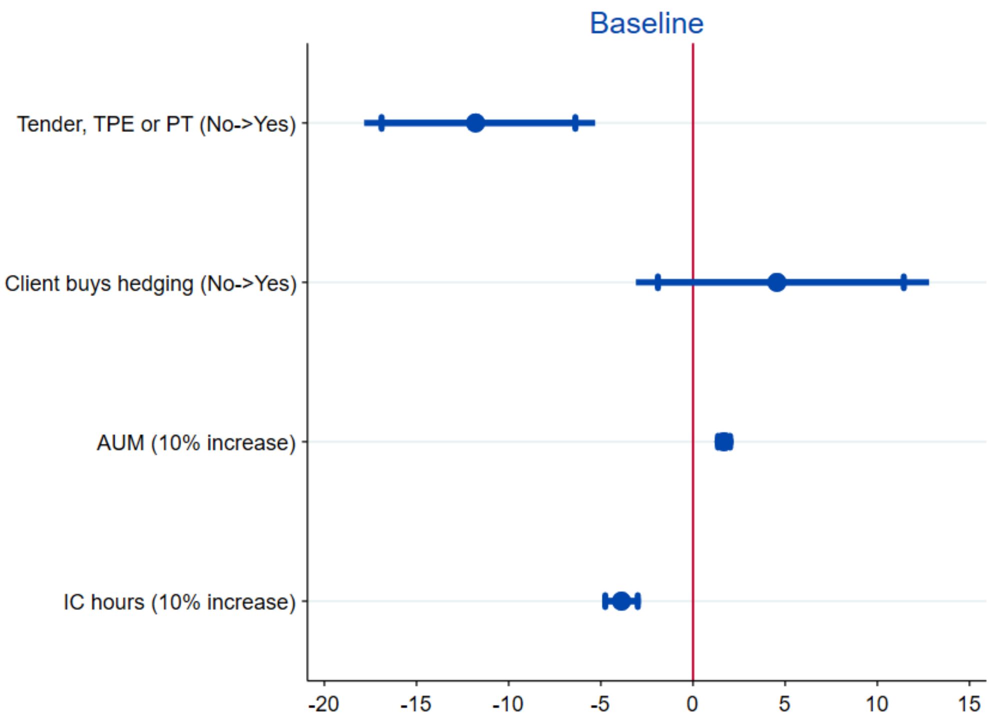
10.26 Figure 24 indicates that, in all six customer groups, more engaged schemes pay less than schemes which are less engaged.

10.27 However, this analysis does not account for all potentially confounding factors, or tell us whether the results are statistically significant. We therefore conducted a regression analysis.[598] Our baseline model controls for size;[599] the purchase of bespoke liability hedging which is an optional service which requires significant provider input and therefore adds cost; and the number of hours purchased.

10.28 In Figure 25, each horizontal line is a different variable we have entered into the model, and the horizontal position of the solid blue dot relative to the red vertical line indicates the magnitude and direction of the effect. The 95% confidence interval around each blue dot is shown by the solid blue lines, and the 90% interval by the blue tick-marks on that line.

[598] We further restrict our regression to only those who purchase strategic asset allocation and manager recommendations to rule out cases of project work from our analysis, which might be incomparable with retained work.
[599] Measured as the log of the scheme's assets under advice / management

Figure 25: Baseline investment consultancy regression specification



Source: CMA Analysis, Parties' data

10.29 Looking at the first line, the chart shows that more engaged schemes pay around 12% less per hour than less engaged schemes.

10.30 However, when we introduce some additional variables into the model to reflect the possibility of price differences between investment consultants this effect becomes statistically insignificant. We therefore place only limited weight on these results.

There is some evidence that less engaged schemes in investment consultancy pay higher prices than more engaged schemes.

Fiduciary management analysis

10.31 We have undertaken a more in-depth assessment of pricing in fiduciary management. Full details are provided in Appendix 5.

10.32 We have conducted two different assessments which we discuss in turn:

(a) a 'static' approach, which compares the *level* of prices across schemes depending on whether they are engaged, as we did above for investment consulting; and

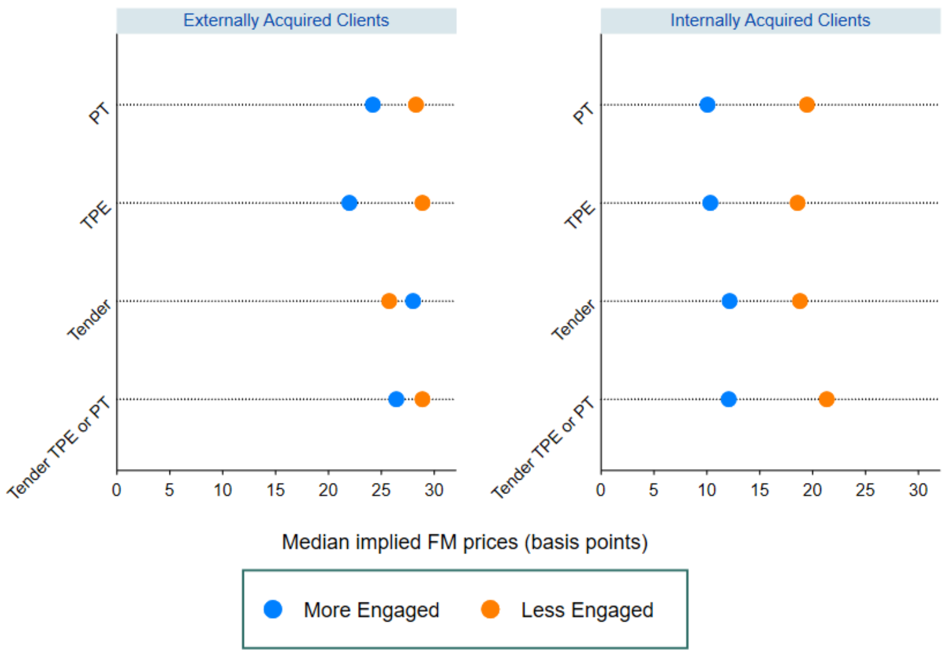
(b) a 'transition' approach, which assesses the *change* in prices when schemes moved into fiduciary management with their existing provider of investment consultancy, depending on whether they are engaged.

'Static' approach

10.33 We calculated prices as the spend of each client per unit of asset under management, which reflects the most common charging structure for fiduciary management clients.

10.34 We distinguished between Internally and Externally Acquired clients, and for both groups we again compared prices paid by more engaged (blue) and less engaged (orange) schemes. The results of this analysis are presented below.

Figure 26: Fiduciary management prices split by engagement



Each line cuts the data in a different way: they are not mutually exclusive

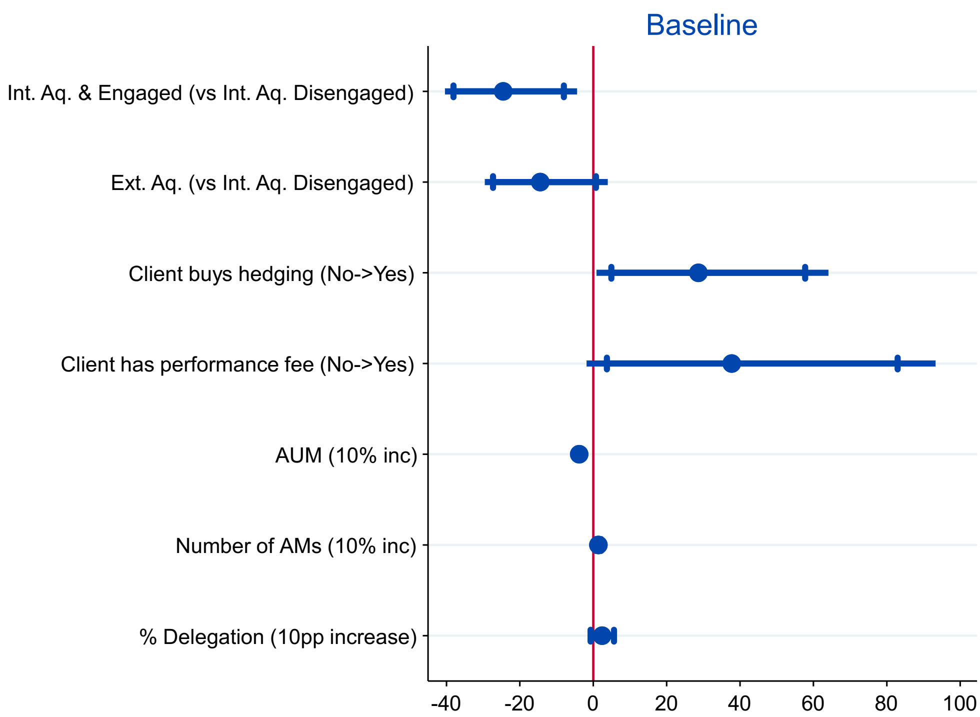
Source: CMA analysis, Parties' data

10.35 Figure 26 indicates that, amongst Internally Acquired clients, less engaged schemes pay much higher prices than more engaged schemes. Amongst Externally Acquired schemes the evidence is slightly more mixed, although this also indicates that less engaged schemes pay more than more engaged schemes.[600] We undertook further analysis breaking schemes down between different sizes and hedging decisions and found similar results.

10.36 We then undertook this analysis using a regression to control more thoroughly for other factors. Our key test is whether (i) engaged Internally Acquired schemes, and/or (ii) Externally Acquired schemes, pay less than Internally Acquired schemes than are less engaged. We control for a range of confounding factors including (but not limited to) whether the client buys hedging, whether the scheme has a performance fee, scheme AUM, the number of asset managers used by the client (as a proxy for complexity of investments), and the proportion of assets delegated to the fiduciary manager.

10.37 The results of our main specification are displayed in Figure 27 below. For each row the blue dot represents the percentage impact of this factor on prices, in measured on the horizontal axis. The blue lines represent the margin for error around these estimates at both the 90% (tick-marks) and 95% (full line) levels.

Figure 27: Fiduciary management pricing regression



Source: CMA Analysis, Parties' Data

[600] Externally acquired schemes appeared to pay less than internally acquired schemes, in this figure. We tested the robustness of this apparent result further in a regression and found no clear statistical evidence to support this. This analysis is summarised in paragraph 10.10.39.

10.38 Looking at the first row, the figure shows that Internally Acquired schemes who are more engaged pay about 24% less than those who are less engaged. The fact that this whole blue line is below zero demonstrates that this effect is statistically significant.[601]

> **In fiduciary management, less engaged schemes pay around 24% more than more engaged schemes, when they remained with their existing investment consultant.**

10.39 Looking at the second row, Externally Acquired schemes appear to pay about 14% less than less engaged Internally Acquired schemes,[602] but this effect is not statistically significant. This means that, although this analysis suggests that Externally Acquired schemes may pay less, it does not provide clear statistical evidence that this is the case. Therefore, we place only limited weight on this result.

10.40 The estimated impact on prices of all of the other control variables set out in the other rows match what we would expect. For example, customers who buy hedging services pay more, while larger schemes pay less per unit of AUM. This gives us additional confidence that the regression is capturing the main factors that affect pricing, and that the estimates it provides are reliable.

10.41 Some Parties said our econometric approach should undertake a different comparison; should introduce more control variables or was not robust to some specifications. We respond to these points in Appendix 5.

10.42 We have checked the robustness of these results to a large range of sensitivities in the control variables, data, and model specification. Whilst there was some variation in the exact effects shown across the sensitivities, the price difference between more engaged and less engaged schemes was fairly robust.

10.43 Overall this analysis shows that when schemes go into fiduciary management with their existing investment consultant, those that are less engaged pay a lot more than schemes who are more engaged. There is also some indicative evidence that less engaged schemes that move into

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[601] Note that we measure both Internally Acquired and Engaged schemes, and Externally Acquired schemes, relative to Internally Acquired, less engaged schemes.
[602] They appear to receive slightly higher prices than Internally Acquired but less engaged schemes, which might be indicative of efficiencies, although the difference is not statistically significant and it is therefore difficult to place weight on this observation.

fiduciary management with their existing investment consultant pay more than those who switch to a different provider, but we place only limited weight on this result.

'Transition' analysis

10.44 Fees for fiduciary management are higher than those for investment consultancy because the former involves more services being provided. Schemes in full fiduciary management on average spend about five times as much as those in investment consultancy.[603]

10.45 In light of this, we have undertaken an additional analysis of these price increases for schemes entering fiduciary management with their existing provider. We have analysed whether those which were less engaged saw their fees increase more than those which were more engaged.[604] The advantage of this approach is that it allows us to control implicitly for other factors that may affect the amount that schemes pay, such as the complexity of their investments. Whilst the sample size is smaller, this analysis therefore provides an important check on our static analysis.

10.46 We used a regression analysis to control for other factors. We found that more engaged schemes had prices increases which were 26% lower than the price increases of less engaged schemes. This demonstrates that more engaged schemes pay substantially less for fiduciary management.

10.47 We undertook a number of sensitivity checks of this analysis and this finding was again fairly robust.

Provisional conclusions on price outcomes

10.48 Our provisional conclusions from this work are that schemes of similar types pay very different fees in both investment consultancy and fiduciary management.

10.49 In investment consultancy, there is some evidence that less engaged schemes pay higher prices than more engaged schemes.

10.50 In fiduciary management, there is evidence that less engaged schemes pay significantly higher prices than more engaged schemes, when they remained with their existing investment consultant. There is also some evidence that less engaged schemes that move into fiduciary management with their

[603] For DB schemes only.
[604] Due to data limitations we were not able to analyse price changes for schemes which moved into fiduciary management with a provider other than their investment consultancy provider.

existing investment consultant may pay more than those who switch to a different provider.

Quality Outcomes

10.51 The CMA survey showed that quality is also an important aspect of investment consultancy and fiduciary management services. This ranges from the effectiveness of investment advice, to the extent to which firms aid trustees in executing their duties.[605]

10.52 In the rest of this section we therefore assess investment consultants and fiduciary managers in terms of:

(a) Their effectiveness in negotiating discounts from asset managers.

(b) The quality of their investment advice, including both asset allocation and manager recommendations.

(c) Their overall quality of service, including less tangible measures of quality such as satisfaction.

Investment consultancy and fiduciary management impact on asset management fees

10.53 In addition to investment consultancy and fiduciary management fees, another important cost for schemes is asset management fees.[606]

10.54 These costs are impacted by investment consultancy and fiduciary management providers in several ways, most importantly through negotiation of discounts with asset management firms on behalf of customers. This is often achieved in part by aggregating together their clients' assets, particularly in fiduciary management. Moreover, in some cases, investment consultancy or fiduciary management providers make claims to clients about the discounts they are able to achieve.

[605] CMA analysis of CMA survey questions C1 and K1

[606] Asset management costs are significant in the context of pension scheme investment costs. In monetary terms, we have found that the median pension scheme using investment consultancy pays just under £400,000 per year in asset management fees. The median full fiduciary management scheme pays just under half of this, at just under £200,000 per year. Based on data provided by investment consultancy and fiduciary management firms to the CMA, excluding DC schemes from this analysis given that the data contains only a small number of the highest paying schemes, which may not be representative. Of course, these are simple averages: for example, large schemes pay significantly more.

10.55 We have therefore assessed the impact of investment consultants and fiduciary managers on asset management discount and fees. This is structured as follows:

(a) First, we consider how important discounts are in general.

(b) Second, we assess how far investment consultancy and fiduciary management providers impact and reduce asset management costs for their clients.

(c) Third, and related to the above, we assess whether there is evidence that the outcomes they achieve are linked to the functioning of the market and the strength of engagement.

Importance of discounts and role of investment consultancy/fiduciary management providers

10.56 Our analysis in Figure 23 showed that asset management fees are generally much larger than investment consultancy fees, and are generally similar to full fiduciary management fees. Actual asset management prices paid by clients differ substantially from the rack rate asset management prices, particularly for fiduciary management clients. Therefore, the effectiveness of investment consultancy and fiduciary management providers in getting discounts could materially influence scheme outcomes.[607]

10.57 Investment consultancy and fiduciary management providers emphasised that discount negotiations were typically closely linked together with their manager recommendations services and teams.[608] Some providers said that clients are able to, and do, negotiate discounts on their own behalf. However, responses indicated that these represent a minority of cases and to be disproportionately those able to achieve good discounts anyway, such as larger schemes.

Investment consultancy and fiduciary management providers' impact on asset management fees

10.58 We compared discounts achieved by clients who use investment consultants' manager recommendations with those who don't, in order to

[607] Of course, the level of the discount also has other drivers. These include whether the fund is nearing a capacity limit, the newness of a fund; the prestige of an opportunity, whether there have been certain recent changes at the asset manager (eg underperformance, change of staff); and the level of investment in the fund.
[608] These services are purchased, potentially implicitly, by a large majority of schemes in fiduciary management as a consequence of delegating decision making to the fiduciary management provider.

understand whether investment consultancy and fiduciary management firms help their clients to obtain higher discounts.

10.59 We found that clients using manager recommendations have a higher overall discount rate of 17%, compared to 11% for those not using manager recommendations. We also find that they have a greater proportion of material discounts.[609] The median discount increases with the size of the provider's investments, both in investment consultancy and fiduciary management. This might imply that a strategy of aggregating together assets is effective in increasing discount rates.

10.60 However, there is a range of potentially confounding factors which could influence discount rates, such as the asset class and identity of the asset manager. We therefore used a regression approach to control for these factors, and also to test whether the level discounts is linked to customer engagement, in the same way we did for investment consultancy and fiduciary management pricing.

10.61 We find that investment consultancy clients which purchase manager recommendations obtain discounts which are around 2-5 percentage points higher than schemes which do not purchase this service, but only where these schemes are engaged. Less engaged schemes purchasing manager recommendations do not have higher discount rates than schemes which do not purchase this service.

10.62 Schemes in fiduciary management receive discount rates which are as much as 20-25 percentage points higher than schemes in investment consultancy which do not purchase manager recommendations. This effect does not appear to vary by whether the scheme is more engaged.

Engaged customers who use their investment consultants' asset manager recommendations service get a bigger discount on investment fees.

10.63 As described in Appendix 6, we conducted a range of sensitivities and alternative analyses to address potential limitations to this analysis. These did not alter our conclusions.

[609] Our analysis considered the proportion of investments with a discount rate of at least 10%.

Provisional conclusions on asset management fees

10.64 We found that investment consultancy and fiduciary management providers can achieve higher asset manager discounts than schemes would be able to achieve themselves. Discounts are substantially larger in fiduciary management, which is potentially related to the fact that aggregating assets across clients appears to be a key driver of higher discount rates.

10.65 We also found some evidence that asset manager discounts are lower for less engaged clients in investment consultancy.

The quality of asset allocation advice, manager recommendations, and other services focussed on investment returns.

10.66 There are several key investment services given by investment consultancy and fiduciary management firms, most notably asset allocation and asset manager recommendations. As set out in Appendix 6, our review of the academic literature and the CMA survey showed that both services play an important role in determining scheme outcomes. We therefore consider both of these in turn.

Asset allocation advice

10.67 Asset allocation advice is concerned with which types of assets schemes should purchase to meet their investment objectives.[610] Asset allocation is therefore a central aspect of any decision to invest.

10.68 Many parties told us that it is very difficult to precisely measure the impact of asset allocation decisions. We therefore conducted some more high-level analysis to assess the quality of these services.

10.69 First, we considered what asset allocation advice involves. A broad range of parties submitted evidence demonstrating that asset allocation advice often involves undertaking sophisticated analysis, and submitted examples of the modelling they have undertaken.

[610] At a high level, schemes will consider their risk and return objectives, and choose an appropriate mix of equities, bonds, alternative investments and investments in other asset classes to meet these objectives. Each of these could be broken down further, for example providers may advise on the merits of Global Equity, Sub Investment Grade Debt and Property investments. By contrast, manager (product) selection is concerned with selecting the asset manager and investment product in the chosen asset class to carry the investment. In practice, these two services feed into each other because finding no suitable managers in the chosen class may require a scheme and its investment consultancy or fiduciary management provider to revisit the asset class decision.

10.70 Parties told us that asset allocation advice is highly scheme specific, in that advice is tailored based on factors such as the strength of the employer covenant; investment risk appetite; funding position; scheme maturity; the level and profile of contributions; cash flow demands and liquidity; correlation of asset class returns with sponsor health; and schemes' appetite for and tolerance of complexity. Parties also told us that asset allocation is not formulaic, and is often arrived upon as part of a conversation with trustees.

10.71 To verify this, we first assessed whether advice is tailored to scheme characteristics by examining the bond/equity ratio of schemes receiving services from four large providers of IC and/or FM services.[611] We found significant variation in asset allocation across schemes, and there was a clear relationship between funding level and a tilt towards bonds.

10.72 We then sense-checked this analysis using data provided by TPR and the PFF. This analysis showed that several other factors also influenced asset allocation positions, and therefore likely asset allocation advice. These factors included scheme maturity and scheme size.

10.73 Our analysis suggests that asset allocation advice is not 'one-size-fits-all' but rather is tailored to reflect scheme-specific factors.

Asset allocation advice appears to be tailored to reflect the needs of the pension scheme.

10.74 We next considered whether there was qualitative evidence that parties' asset allocation advice had produced good market outcomes for their clients.

10.75 Advice in relation to hedging can be considered a form of asset allocation advice. Many investment consultancy and fiduciary management firms have recommended that schemes increase their levels of hedging. Our analysis found that schemes purchasing either fiduciary management or strategic asset allocation advice were much more likely to purchase liability hedging.[612]

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[611] We consider that asset allocation positions are a good proxy for the advice that schemes will have received, particularly for fiduciary management

[612] For example, Aon has stated that 'Aon Hewitt's analysis suggests that on average, closed and frozen schemes should be protecting against at least 70% of their interest rate risk. Instead, the average amount hedged is thought to be nearer 30% to 40%' Source: http://www.aon.com/unitedkingdom/retirement-investment/investment/hedging.jsp. In particular, a logistic regression of whether the scheme purchased hedging on whether the scheme purchases strategic asset allocation showed an extremely significant correlation.

10.76 Investment consultants and fiduciary managers[613] told us that hedging has been used to manage risk but has also significantly boosted pension schemes' returns. This view was supported by other evidence: the 2017 update to TPR's annual funding statistics for UK defined benefit (DB) and hybrid schemes stated that "schemes with hedged positions may have fared better overall".[614] Overall, we infer that providers' asset allocation advice with respect to hedging decisions has produced value for their clients in recent years.

Investment consultants' asset allocation advice on hedging has produced value for clients in recent years.

Manager recommendations

10.77 Investments are typically made with asset managers. Investment consultants often advise clients on the suitability of various asset management / investment products, and in the fiduciary management function they implement investment decisions in relation to such products.[615]

10.78 We have undertaken quantitative analysis to assess whether investment consultants improve schemes' investment returns by recommending asset management products which outperform their manager-selected benchmarks. In doing so we recognise that manager recommendations is only one of the services provided by investment consultants, however it is an area that can be measured and where firms commonly claim they add value by outperforming benchmarks.[616]

10.79 The full details of our analysis is set out in Appendix 2. We discuss a number of important caveats, in particular that the available data only covers a subset of firms' recommendations. In brief, we examined ratings from eight

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[613] For example, WTW told us that "It seems that many fiduciary managers have been able to hedge client interest rate risk to a more significant degree than the average UK pension fund which led to above average outcomes", Source: WTW's response to the Market Information Request, paragraph 22
[614] TPR: Scheme funding statistics: Valuations and recovery plans of UK defined benefit and hybrid pension schemes, June 2017, page 6
[615] When developing their lists of recommended products, investment consultancy and fiduciary management providers typically combine both quantitative and qualitative research considering, among other factors, 'investment organisation', 'investment staff', 'investment process', 'risk', 'performance' and 'terms and conditions'. It is also common for due diligence on asset managers to be carried out as part of this process.
[616] See paragraph 5.64.

investment consultant and fiduciary management firms over the period between 2006 and 2015.[617]

Gross of fees, investment consultants' 'buy-rated' products out-perform their respective benchmarks. But out-performance net of fees is not statistically significant.

10.80 The results of our quantitative analysis indicate that on a gross of asset manager fees basis 'buy-rated' products outperform their respective benchmarks by approximately 23 bps per quarter on average, and these results are highly statistically significant.

10.81 However, in our view it is appropriate to focus on an analysis net of asset management fees, as these are more representative of the overall impact of recommendations on schemes' funding levels. On this basis we found that 'buy-rated' products still outperform their respective benchmarks, but by the much smaller amount of 4 bps per quarter. However, this is no longer statistically significant, in other words this observed outperformance may be down to chance.

10.82 We have also performed a number of extensions and sensitivities, several of which were proposed by the Parties, to test whether our results were sensitive to the way the analysis was conducted. The large majority of these sensitivities produces results that were consistent with our main analysis. We did however find evidence that two individual providers of investment consultancy and/or fiduciary management services recommend net outperforming products.

10.83 Based on the subset of recommendations we have been able to examine, there is no clear statistical evidence that investment consultants collectively outperform benchmarks on a net of fees basis. However, there is evidence that some individual firms outperform benchmarks. As a result, this analysis has not clearly demonstrated one way or the other whether overall investment consultants collectively add value through their asset management product recommendations.

[617] We have not been able to incorporate Mercer into our aggregate analysis as it does not subscribe to eVestment and we could not match its ratings data to returns data from eVestment. We have therefore conducted a standalone analysis for Mercer, using Mercer's proprietary database (GIMD).

Analysis of overall investment performance

10.84 Asset allocation advice and manager recommendations are the two key sub-services which are offered by investment consultancy and fiduciary management providers. However, they are not the only services: in particular, implementation is a key aspect of fiduciary management.

10.85 Some parties, in particular Aon, Mercer and WTW, submitted statistics and analysis regarding the historical performance of their fiduciary management clients compared to a representative of the average pension scheme or other benchmarks. These parties told us that since full fiduciary management is not as susceptible to the difficulties around attributing performance between decisions made by the trustees and the provider, the performance of their fiduciary management schemes is representative of their investment consultancy abilities. They submitted that these analyses demonstrate that their fiduciary management services are adding substantial value to their clients.

10.86 As discussed above, we note that it is difficult to estimate the value added by providers' investment decisions because of the challenges of identifying an appropriate comparator; it is not clear that the comparators selected by the parties' approximate the returns schemes would have achieved, if they were not using these services. We have not sought to test their analysis.[618]

10.87 We also considered other evidence on overall outcomes. In the CMA survey, trustees were asked how important their investment consultancy and fiduciary management services were in helping them achieve the scheme's objectives.[619] Regarding investment consultancy services, three quarters of schemes thought buying these services was very important to achieving the scheme's objectives, and over 95% of schemes rated investment consultancy as either 'very important' or 'fairly important'. These statistics were very similar for trustees in fiduciary management.[620]

[618] We note that due to issues of comparability discussed in paragraph 5.67, this analysis does not demonstrate that the above providers have outperformed their peers. However, particularly since Aon, Mercer and WTW represent a material percentage of the fiduciary management market by revenue, we consider that these submissions can be interpreted as indicative evidence of outcomes in the fiduciary management market more generally.
[619] CMA analysis of CMA survey, question C1.
[620] CMA analysis of CMA survey, question K1.

Provisional conclusion on the quality of asset allocation advice, manager recommendations, and other services focussed on investment returns.

10.88 Our assessment has shown that both asset allocation advice and manager recommendations are important for schemes.

10.89 On asset allocation it appears to be tailored to individual clients. There is some evidence that this may have produced value for schemes in recent years, principally through the hedging of interest rates risks.

10.90 Our analysis of investment consultants' asset manager recommendations has not clearly demonstrated one way or the other whether they collectively add value through this service, though there is evidence that some individual firms have done so.

Analysis of broader quality factors

10.91 Beyond investment advice quality, there are other aspects of service quality which are important to customers of investment consultancy and fiduciary management providers, such as clarity of advice and the experience which providers and individual consultants bring to trustee decision making.

10.92 The importance of quality of service was highlighed at the trustee roundtable; where trust and credibility were found to be key aspects of service provision. Similar factors were also emphasised by attendees of our roundtable with pension scheme in house investment staff, who said that the investment consultant-client relationship was key and that investment consultants should understand the needs of the scheme.[621]

10.93 Our assessment of broader quality is structured as follows:

(a) First, we consider overall satisfaction rates.

(b) Second, we assess whether there is evidence that less engaged schemes receive lower quality of service.

(c) Third, we assess the link between providers' quality and their market shares.

[621] Summary of discussion with pension scheme in house investment staff: 16 May 2018, paragraphs 3 & 4

Indicators of overall quality of service

10.94 Given the weight that trustees place on quality of service factors, one informative measure to consider is satisfaction.[622] The CMA survey found that a substantial proportion (56%) of trustees who purchase investment consultancy were very satisfied with their investment consultant and 94% of trustees were either very satisfied or fairly satisfied.[623] These percentages were similar for schemes which purchase fiduciary management.

94% of investment consultancy customers are satisfied with their provider. *CMA survey*

10.95 Whilst there are challenges in interpreting these statistics (as discussed further in Appendix 6), these statistics indicate trustees consider that they are receiving positive outcomes.

Link between overall quality of service and engagement

10.96 We analysed whether there is likely to be a link between engagement and the quality of service received by trustees. To do this, we considered whether parties' submissions and documentary evidence indicated that more engaged schemes could be offered better terms.

10.97 Quality of service is monitored frequently by most consultants and they each focus on various aspects of service provision in monitoring their performance.

10.98 Parties' submissions highlight the following areas of quality that they monitor on an ongoing basis: overall satisfaction; relationships of the client team; market intelligence reports; communication; previous errors and omissions. This shows that firms monitor the quality of service perceived by their clients, often at client level.

10.99 In internal documents we found evidence that engagement could lead to improved service quality outcomes for customers. We found evidence that providers monitor client engagement. We also found evidence that providers have improved or assured their quality of service in response either to client pressure or their having identified clients as being 'at risk' of switching.

[622] Satisfaction will also be in part determined by returns, risk and other investment-relevant quality factors we have discussed above.
[623] CMA analysis of CMA survey, questions J1 (Investment Consulting) and O4 (Fiduciary Management)

10.100 Relevant quality of service parameters appeared to include team proactivity; innovation on risk management; investing more time or resources and the experience or consistency of consultants allocated to clients.

10.101 We therefore find that, at least in some cases, less engaged customers receive a lower quality of service.

Relationship between overall quality of service and market success

10.102 Within a well-functioning market, we would expect providers which have higher quality of service to have high or growing market shares, all else being equal. Evidence to the contrary could imply that the market does not function well.

10.103 We have analysed this using data on service quality provided by Greenwich Associates (GA). GA's quality of service research is based on in-depth interviews with the largest institutional funds in the UK[624,625] to produce the Greenwich Quality Index (GQI). The measure is widely used in the investment consulting market.

10.104 For market shares, we used our data gathered directly from investment consultants. Given the set of clients included in GA's data, we conducted this analysis for schemes in investment consultancy only.

10.105 In Figure 28 we show the average market share for schemes of above average quality, and separately the average market share for those of below average quality, in each year.[626]

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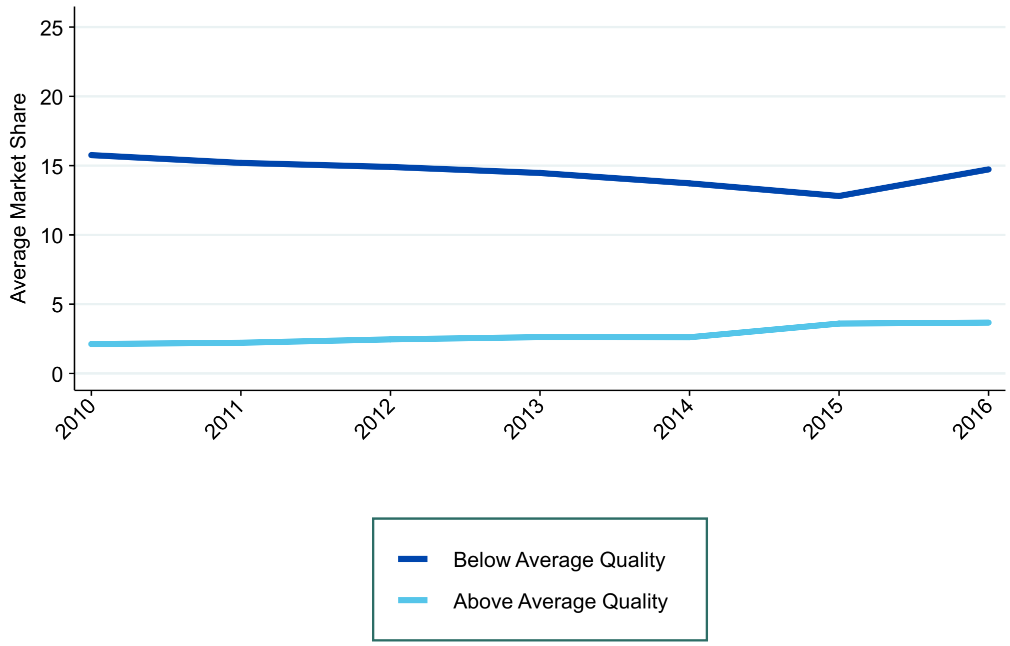
[624] Institutional investors with over £100 million in assets under management.
[625] Institutional funds include Corporate pension, Local Authority Pension and other institutional funds.
[626] Average quality is calculated as firm specific mean relative to the sample mean. Therefore, if a firm has below average quality in any single year but across the sample has above average quality, we treat them as an above average quality firm. We do not have data on all firms for all years, so some year-on-year differences in the analysis could be a result of a sample composition effect.

Figure 28: Average market share over time, split by quality levels,



Source: CMA Analysis; Parties Data; GA Data.

10.106 We find that for each year from 2010 to 2016, those who provided a higher quality service had persistently lower market shares. This can be seen because the light blue line is persistently lower than the dark blue line. The difference in shares ranges from 14 to 9 percentage points, and is therefore substantial. Using a regression framework, we found that the negative association between quality and market share is statistically significant.

Providers with above average quality had persistently lower market shares in investment consultancy.

10.107 Figure 28 above appears to show the market share differential is declining. However, again using a regression framework, we have found that this decline is not statistically significant. We again found that there was a significant negative relationship between quality of service and market shares.

10.108 A number of other sensitivities we undertook gave similar results. We provide further discussion of our econometric methodology and results in Appendix 6.

10.109 The evidence presented above implies that firms which have higher quality measured on this particular indicator, may not be able to grow their investment consultancy market share.

Provisional conclusion on overall quality of service

10.110 Broader service quality factors are important to trustees. We found that trustees generally appear to be satisfied. However, we also found evidence that, at least in some cases, less engaged customers receive a lower quality of service, such as the experience of the team and the amount of resources dedicated to that customer.

10.111 Furthermore, we found some evidence that firms with high quality have lower market shares, and that across time there is no relationship between quality and changes in market shares. This is not what we would expect in a well-functioning market and is consistent with the issues we have set out in the preceding sections, such as low trustee engagement, and insufficient or incomparable information on fees and quality

Profitability

10.112 We examined profit margins to inform our understanding of competition: an examination of relative profits may provide useful information in examining the firms' incentives, for example in seeking to sell fiduciary management services to their existing advisory clients (see our analysis from paragraph 7.66).

10.113 We examined the profitability of the three largest combined providers of investment consultancy and fiduciary management services in the UK (Aon, Mercer and WTW) as well as three smaller combined providers of investment consultancy and fiduciary management services who were also able to provide us with net profit margin figures for investment consultancy and fiduciary management ([✂], [✂] and [✂]). The three largest providers of investment consultancy and fiduciary management services combined are not the three largest providers of fiduciary management services.

10.114 We found the following:

(a) Overall, the aggregate net profit margin for investment consultancy and fiduciary management combined for the six providers in 2016 was [20% - 30%]

(b) For investment consultancy, the aggregate net profit margin for the six providers was [20% - 30%] and [20% - 30%] for fiduciary management.

The aggregate net profit margin for investment consultants and fiduciary management was [20 - 30%] in 2016.

10.115 These margins are lower than the margins the FCA found for asset managers, but higher than the average operating margins in the FTSE All Share sample created by the FCA. However, in our view, a comparison with the FTSE All Share index would not be meaningful because the index is an average of margins across a wide range of industries, subject to, among other things, different degrees of risk and capital requirements.

10.116 Our usual approach in market investigations would be to compare an economically meaningful measure of profitability, usually in terms of rates of return on capital, with the cost of capital of the firms involved.[627] In this market investigation we found a number of difficulties in calculating the capital base.

10.117 We considered that it was very resource intensive, and practically and conceptually difficult, to attempt to calculate the capital base relating to the investment consultancy and fiduciary management businesses. Even if we were able to calculate the capital base, it was unlikely to be robust enough for us to draw any conclusions from it. As a robust assessment of the capital base is essential to the return on capital employed (ROCE) calculation, we were not in a position to calculate ROCE and thereby to conclude whether profits were in excess of the cost of capital.

10.118 We set out the results of our analysis and our findings in Appendix 7.

Provisional conclusions

10.119 In some respects, outcomes indicate that the investment consultancy and fiduciary management markets function relatively well.

(a) Trustees generally are satisfied with the services they receive.

(b) Providers can achieve greater discounts from asset managers than schemes would be able to achieve themselves, particularly in fiduciary management.

[627] CC3 Revised, paragraph 114 - 126

(c) Asset allocation advice appears to be tailored to individual clients, and have produced value for clients through the hedging of interest rates risks.

10.120 However, there is evidence that the investment consultancy and fiduciary markets are not functioning well in other respects. In previous sections we have found that there are problems of low trustee engagement, and of trustees facing difficulties in accessing the information they need to select the best provider. We examined the impact of these on outcomes, and found evidence that less engaged schemes obtained worse prices and quality of service.

10.121 In terms of prices:

(a) In investment consultancy, we found some evidence that less engaged schemes pay higher prices than more engaged schemes.

(b) In fiduciary management, we found that less engaged schemes pay significantly higher prices than more engaged schemes, when they remain with their existing investment consultant.

10.122 Further, in relation to quality we found some evidence that:

(a) Asset manager discounts are lower for less engaged schemes, at least in investment consultancy.

(b) Less engaged customers in some cases receive a lower quality of service such as the experience of the team and amount of resources dedicated to that customer.

(c) Firms with higher quality have lower market shares, and that across time there is no relationship between quality and changes in market shares.

10.123 Our quantitative analysis of investment consultants' recommended asset manager products found that collectively these appear to outperform benchmarks net of fees, but not to a statistically significant extent. Therefore, the evidence hasn't clearly demonstrated one way or the other whether providers collectively add value through this service, though some individual firms may do so.

10.124 Overall, we provisionally conclude that whilst the investment consultancy and fiduciary management markets are meeting customers' expectations in some respects, there is evidence that the aspects of the markets identified in previous chapters are resulting in some customers receiving significantly worse outcomes in terms of price and quality, than they would in a well-functioning market.

11. Conclusions

Overview of our competition assessment

11.1 We provisionally find that there are AECs in both the investment consultancy and fiduciary management markets. This decision is set out below but first, we set out our general view of competition in these markets.

11.2 We find that both investment consultancy and fiduciary management are markets which are not highly concentrated and where barriers to entry and expansion are not high. We find that customers have access to a sufficient number of providers in both markets. Both markets are growing, although investment consultancy is already used by the vast majority of pension schemes, while fiduciary management is used by a fast-growing minority of them.

11.3 However, in both markets, we find there are weaknesses in the demand side based on a low level of engagement by some pension trustees with investment matters. In addition to this, for those who engage with the market, the information that trustees need in order to assess the value for money (by which we mean both fee levels and quality) of these services is difficult to access. These two factors reduce the competitive pressure on investment consultants and fiduciary managers.

11.4 We have identified additional, particular issues in the fiduciary management market which lead us to having stronger concerns about competition in that market, both overall and in particular at the point at which pension schemes first purchase fiduciary management. These are that:

(a) IC-FM firms have an incumbency advantage in selling fiduciary management to their advisory customers. This advantage derives from the demand-side weakness described above, IC-FM firms steering their advisory customers into their fiduciary management service and the lack of clear and comparable information for customers to assess value for money of alternative providers.

(b) Fiduciary management has higher ongoing and switching costs for pension schemes, and it represents a significant change in how those schemes govern their investments which can have lasting consequences. Therefore, the initial take-up of the service is a change which should be made with great care.

11.5 There has been a notable increase in fiduciary management market share by the three largest IC-FM providers in recent years. In this context, our further concern is that their incumbency advantage could contribute to further growth in their market share, which would result in greater market concentration in the future. This could increase barriers to expansion for non-integrated fiduciary management providers, weakening competitive pressure on IC-FM firms and making it more difficult for all fiduciary management customers to get a good deal.

Provisional decision on competition

Investment consultancy

11.6 We have provisionally found that the following features of the investment consultancy market, individually and in any combination, restrict or distort competition in connection with the supply and acquisition of investment consultancy services in the UK to and by pension schemes. Accordingly, there is an AEC in respect of investment consultancy services.[628] Those features are as follows:

(a) **Low levels of engagement by some customers**. Some pension trustees lack the necessary time and capabilities to monitor and scrutinise effectively the investment advice they receive. These issues are most prominent amongst small pension schemes and DC schemes, which are also less likely to switch, tender, or formally review their investment consultancy services.

(b) **Lack of clear information for customers to assess the quality of their existing investment consultant.** Customers do not set, and investment consultants do not agree, sufficiently clear objectives against which providers can demonstrate their performance. Furthermore, the information provided by investment consultants to pension trustees makes it difficult for trustees to evaluate the quality of service of their provider.

(c) **Lack of clear and comparable information for customers to assess the value for money of alternative investment consultants.** The nature of fee information provided by fiduciary managers in tenders is often limited and customers do not seek and obtain comparable information. It is also very difficult for customers to assess and compare the quality of the advice they would get from different providers. In particular, the ways used to calculate track records for consultants’

[628] EA02, sections 134(1) and (2).

recommended investment products makes it difficult to interpret and compare the quality of advice across providers.

11.7 These features make it difficult for many customers to access and assess the information needed to evaluate the quality of their existing investment consultant and/or identify if they would be better off using an alternative provider. This in turn reduces the ability of customers to drive competition between investment consultants. It also reduces the incentives for investment consultants to compete for customers on the basis of fees and/or quality of service.

Fiduciary management

11.8 We have provisionally found that the following features of the fiduciary management market, individually and in any combination, prevent, restrict or distort competition in connection with the supply and acquisition of fiduciary management services in the UK to and by pension schemes. Accordingly, there is an AEC in respect of fiduciary management services.[629] Those features are as follows:

(a) **IC-FM firms steering their advisory customers towards their own fiduciary management service.** IC-FM firms have strategies to sell fiduciary management to their existing advisory customers. Some of the ways that these incumbent firms introduce and advise on fiduciary management steer customers towards the firm's own service and make it less likely that those customers properly consider alternatives at the point of first moving into fiduciary management.

(b) **Low levels of customer engagement at the point of first moving into fiduciary management**. A substantial proportion of customers do not formally test the market prior to moving into fiduciary management. As a result, many take this service from their incumbent IC-FM firm without considering alternatives.

(c) **Lack of clear and comparable information for customers to assess the value for money of alternative fiduciary managers**. The nature of fee information provided by investment consultants in tenders is often limited and customers do not seek and obtain comparable information. Many providers also do not provide any information on the potentially high costs of transitioning into and out of their fiduciary management service. The nature and variety of the ways used by firms to calculate

[629] Section 134(1) and (2) EA02.

track records for their fiduciary management customers make it difficult for potential customers to compare quality across providers.

(d) **Lack of clear information for customers to assess the value for money of their existing fiduciary manager**. Many customers do not receive clear fee information from their provider, with fees for the fiduciary management service often bundled with the underlying investment fees. This limits customers' ability to assess the competitiveness of the fiduciary management service they are receiving, and the underlying funds that their fiduciary manager is investing in on their behalf.

(e) **Barriers to switching fiduciary manager.** The process of switching fiduciary manager generally requires substantial time and can incur high costs, which will deter some customers from changing provider.

11.9 Features (a) to (c) result in an incumbency advantage for the existing IC- FM firms; and they prevent, restrict or distort competition at the point of customers first moving into fiduciary management. This means that some customers remain with their incumbent investment consultancy provider even if a better deal on fiduciary management was available elsewhere. This in turn reduces the ability of customers to drive competition between fiduciary managers. It also reduces the incumbent provider's incentives to compete for customers on the basis of fees and/or quality of service.

11.10 Features (c) to (e) prevent, restrict or distort competition once customers have bought fiduciary management services. They make it difficult for many customers to access and assess the information needed to evaluate the fees of their existing fiduciary manager, to identify if they would be better off using an alternative provider, and to act on this information by switching. This in turn reduces the ability of customers to drive competition between fiduciary managers. It also reduces the incentives for fiduciary managers to compete for customers on the basis of fees and/or quality of service.

Customer detriment

11.11 We consider that the AECs we have provisionally found may be expected to result in material customer detriment in both the investment consultancy and fiduciary management markets.

11.12 This detriment may be expected to manifest itself in terms of customers paying higher prices for these services and receiving worse outcomes in terms of service quality.

11.13 In investment consultancy, the fact that customers face barriers in assessing the quality of their existing investment consultant and comparing this with alternative providers makes it difficult for them to select the best advisor for their scheme. This in turn means there are weaker incentives for firms to compete vigorously, as they may be less likely to lose customers if they offer a worse deal, and less likely to gain them if they offer lower prices or a higher quality service.

11.14 In fiduciary management the detriment will be even greater, as these information and trustee engagement features are compounded by two further features. First, the behaviour of the incumbent IC-FM firm can make it even less likely that customers properly shop around, which may further reduce firms' incentives to compete vigorously. Second, the greater switching costs in fiduciary management mean that customers may not be able to renegotiate or readily switch to a better alternative, so the detriment may persist for a longer period of time.

11.15 As a result of these competition problems, customers may be expected to pay higher prices for investment consultancy and fiduciary management than they otherwise would. The existence and significance of these price effects is demonstrated by our gains from engagement analysis, which found that engaged fiduciary management customers could pay around 24% less than disengaged customers.

11.16 In terms of the total detriment from higher prices, by way of illustration, even if fees are on average only 10% above those in a well-functioning market, this would in aggregate lead to investment consultancy customers paying around £250 million and fiduciary management customers paying around £200 million more over ten years.[630]

11.17 However, this impact on prices represents a lower bound for the total detriment, which may be significantly higher. This is because, in addition to the impact on prices, the problems we have identified may also be expected to result in customers receiving a lower quality service. The nature of these markets means that this will result in material detriment because:

(a) Investment consultants advise on, and fiduciary managers implement, decisions relating to the investment of at least £1.6 trillion of pension scheme assets affecting millions of pension scheme members and their dependents.

[630] Based on the lower bound estimates of the total revenues of each market, multiplied by 10% to represent the price increase, and then multiplied by 10 to represent the aggregation over ten years.

(b) These investment decisions can have a major impact on pension scheme outcomes through their influence on overall investment strategy, asset allocation and risk management, all of which are particularly important.

(c) Any negative impact on scheme outcomes will accumulate and compound over time, especially given the length of many investment consultant and fiduciary manager appointments, and the time horizon over which pension scheme investment decisions are made.

11.18 The precise magnitude of this detriment from reduced quality is particularly difficult to estimate. However, lower quality advice or implementation would be likely to result in an ongoing shortfall in investment performance which would be much greater in magnitude than the detriment from prices paid.

12. Our proposed remedies

Introduction

12.1 This chapter covers the package of remedies that we propose to introduce to remedy, mitigate or prevent the AECs and the customer detriment that may be expected to result from the AECs.

12.2 We set out the relevant framework, guidance and process we have followed before outlining the proposed remedies package. We then discuss remedies we are not proposing to develop before considering the overall effectiveness and proportionality of our package of remedies in chapter 13.

12.3 This is the CMA's first market investigation to adopt a revised approach to considering remedies.[631] In this investigation, we have consulted on potential remedies at an earlier stage and in greater detail than in previous CMA market investigations. For the first time we included a long list of potential remedies in our published issues statement and working papers and actively sought views from parties on them, in order to take these views into account in developing our thinking on proposed remedies.

12.4 This provisional decision includes only those remedies which we are proposing to implement to address the AECs and the resulting customer detriment we have provisionally found. Many of the remedies which were included in the issues statement and working papers would not be effective ways of addressing the AECs and underlying features we have provisionally found.[632]

12.5 In this document we have grouped our proposed remedies according to the relevant provisional AECs and features they seek to address and the nature of the remedy.

12.6 We outline key design issues we have considered, having had regard also to submissions from parties to date.

12.7 All of the proposed remedies relate to pension schemes which are the main customers of investment consultants and fiduciary managers.

[631] The CMA's revised approach was published in July 2017 https://www.gov.uk/government/publications/market-investigations-guidelines
[632] Previously, a less detailed notice of potential remedies was published alongside the provisional findings, and there was a separate, subsequent consultation on the provisional decision on remedies before the final report.

12.8 We welcome views from parties on the design, implementation, effectiveness and proportionality of our proposed remedies.

12.9 We will consider parties' submissions on our proposed remedies, and in the event that we find one or more AECs in our final report we will take these submissions into account in developing our final package of remedies. Should our final report include remedies to be introduced by order[633] (or undertakings)[634] there will be a further consultation during an implementation period of up to six months from the date of publication of our final report.[635]

Framework for assessment of remedies

12.10 In summary, where the CMA has decided that there is an AEC, it is required to decide whether it should take (or recommend that others take) remedial action and if so what action should be taken and what is to be remedied.[636]

12.11 In deciding those questions, the CMA must, in particular, have regard to the need 'to achieve as comprehensive a solution as is reasonable and practicable' to the AEC and any detrimental effects on customers so far as resulting from the AEC.[637] The CMA may, in particular, have regard to the effect of any remedial action on any relevant customer benefits of the feature(s) of the market(s) concerned.[638] We will consider how comprehensively any package of remedies will address the AEC and/or its detrimental effects and whether those remedies are effective and proportionate.[639]

12.12 CMA guidance sets out other factors that we consider when proposing a remedy package.[640]

[633] EA02, section 138 provides that, in relation to each AEC, the CMA must take such remedial action as it considers to be reasonable and practicable by making an order (EA02, section 161) or accepting undertakings (see footnote 5 below). An order is a legal instrument drafted by the CMA. Any person to whom an order relates is under a statutory duty to comply with it and compliance with an order is enforceable in the courts (EA02, section 167).
[634] The CMA may take remedial action by accepting undertakings from such persons as it considers appropriate (EA02, section 159) instead of making an order. In common with orders, persons to whom undertakings relate are under a statutory duty to comply with them and compliance is enforceable in the courts (EA02, section 167). Our provisional view is that, in the present case, proceeding by order would be more appropriate because of the number of parties present in the market.
[635] EA02, Section 138A. The CMA may extend the six-month period only once and by up to a further four months if it considers that there are special reasons why a final order cannot be made within the statutory deadline.
[636] EA02, section 134(4).
[637] EA02, section 134(4) and (6).
[638] EA02, section 134(7). We cover relevant customer benefits in paragraph 13.13.21
[639] CC3, (Revised), Part 4, paragraph 329.
[640] CC3, (Revised).

Developing remedies to the provisional AECs

12.13 In chapter 11, we set out our view on competition in these markets and our provisional decision on AECs. We consider that the nature of the AECs and the resultant detriment means that it is appropriate to remedy the AECs and that detriment. In this chapter, we set out our proposed remedies.

12.14 We have provisionally found that there are greater competition problems in fiduciary management than in investment consultancy. Therefore, in this section, we deal first with our proposed remedies which cover fiduciary management only, before turning to those which cover both fiduciary management and investment consultancy or only the latter.

12.15 In developing remedies, the preference of the CMA is to deal comprehensively with the cause(s) of the AECs wherever possible. We typically consider whether tackling some or all of the features identified will remedy, mitigate or prevent the AECs.[641] In the present case, we have focused on addressing the individual features giving rise to these AECs where possible.

12.16 In the following sections we group similar remedies together under the following themes:

- **Promoting greater trustee engagement when buying fiduciary management services** – measures that require all new mandates to be subject to a competitive tender process and supporting trustees to actively engage with the market when first considering fiduciary management services and subsequently choosing a fiduciary manager.

- **Fees and performance reporting** – remedies to help trustees access the information they need to understand, monitor and challenge the service, fees and overall performance of their existing or prospective providers. Our remedies package includes specific remedies for both fiduciary management and investment consultancy

- **Supporting remedies** – recommendations for others to deliver measures that empower trustees and improve the effectiveness of the package as a whole.

12.17 We propose to implement our remedies by CMA order as the most effective and comprehensive way of addressing the AECs and the resulting customer

[641] CC3, (Revised), paragraphs 330 and 332.

detriment we have provisionally found. We are also proposing supporting remedies in the form of recommendations to government, TPR and the FCA.

12.18 Our package of remedies is set out in Figure 29 showing the individual remedies we are proposing to introduce, the AEC they relate to and a high-level description of the remedy.

Figure 29: Remedies we propose to introduce

Fiduciary management AEC

Promoting trustee engagement when buying fiduciary management

1) Mandatory competitive tendering on first adoption of fiduciary management

2) Mandatory warnings when selling fiduciary management

3) Enhanced trustee guidance on competitive tender processes

Fiduciary management fees and performance reporting

4) Requirement to report disaggregated fees to existing customers

5) Minimum requirements for fee disclosures for prospective clients

6) Standardised methodology and template to report past performance

Investment consultancy AEC

Investment consultancy performance reporting

7) Trustees to set strategic objectives and firms to periodically report against them

8) Basic standards for reporting performance of recommended asset management 'products' and 'funds'

Supporting remedies

A) Extension of FCA regulatory perimeter

B) Enhanced TPR trustee guidance and oversight of remedy 1

C) Improving information on underlying asset manager fees and performance

Source: CMA

Promoting greater trustee engagement when first buying fiduciary management services

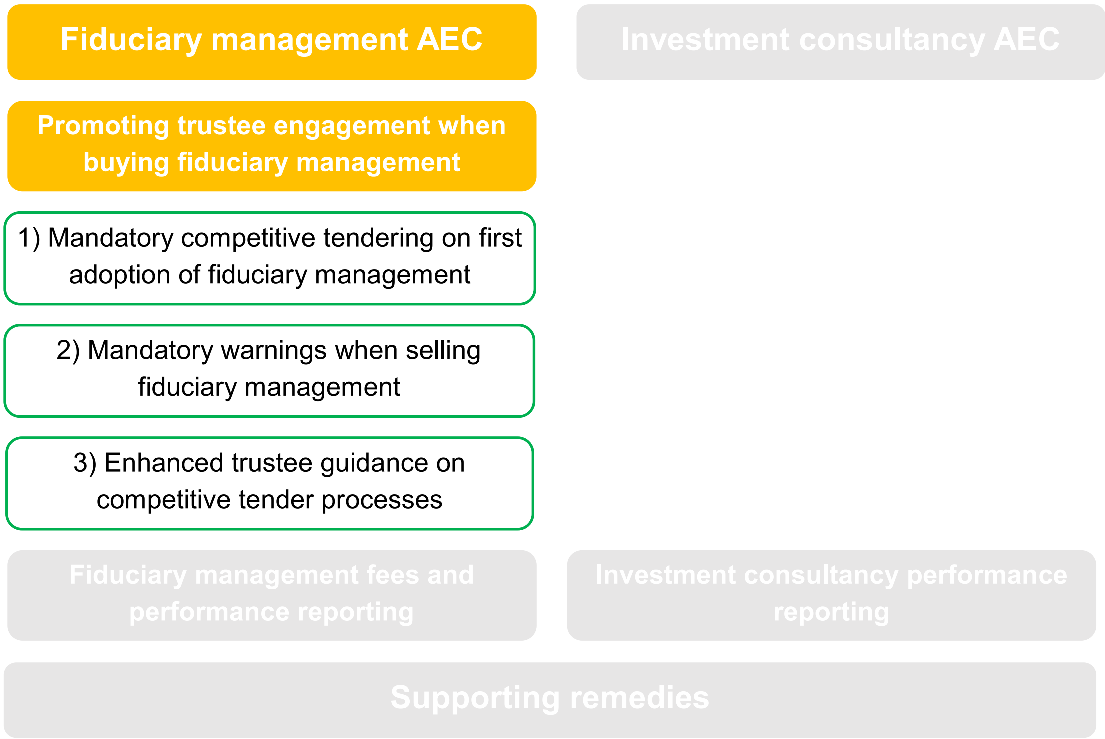
12.19 We have provisionally found an AEC in relation to fiduciary management. In this section we set out three proposed remedies:

- The first is the introduction of **mandatory use of a competitive tendering process on first appointment of a fiduciary manager**. This remedy addresses the low levels of customer engagement at the point of first moving into fiduciary management and the behaviour of IC-FM firms in steering their advisory customers towards their own fiduciary management service.

- The second is a requirement for IC-FM firms to include a clear **mandatory warning that alerts trustees to the nature of the information being provided** by the firm. This remedy addresses both the behaviour of IC-FM firms in steering their advisory customers towards their own fiduciary management service and low engagement by providing a prompt to act. This remedy also supports the first remedy by making trustees aware of guidance and resources available from The Pensions Regulator (TPR) and the mandatory tendering requirements.

- The third is a proposed recommendation to **TPR to develop enhanced guidance for trustees on conducting competitive tender processes**. This recommendation is intended to support trustee engagement, by enabling them to conduct effective tender processes.

Figure 30: Remedies we propose to introduce



Source: CMA

Remedy 1 – Mandatory competitive tendering on first adoption of fiduciary management

Objective
Trustees achieve the best outcomes for scheme members by making an informed, active choice when choosing a fiduciary management provider.

Description of the remedy

12.20 Our proposed remedy is that all fiduciary management mandates will be subject to a competitive tender process when a scheme first adopts fiduciary management:

- Trustees will be required to conduct a competitive tender process when first appointing a fiduciary management provider.

- Trustees of schemes which have previously appointed a provider without conducting a competitive tender process will be required to conduct a competitive tender process within five years after first appointment.

- Fiduciary management firms will be prohibited from accepting a new mandate if no competitive tender process has taken place.

How it addresses the AEC and resulting customer detriment

12.21 We have provisionally found that IC-FM firms may steer their advisory customers towards their own fiduciary management service and that there are low levels of customer engagement at the point of first moving into fiduciary management.

12.22 A requirement to hold a competitive tender process ensures that trustees test the market before first buying fiduciary management services by making an informed, active choice and thereby acting more effectively to drive competition between providers.

12.23 In our assessment of the detriment arising from the AEC we identified that the behaviour of the incumbent IC-FM firm can make it less likely that those customers properly consider alternatives at the point of first moving into fiduciary management, which reduces firms' incentives to compete for customers on the basis of fees and/or quality of service. We also found that switching barriers in fiduciary management mean that customers may not be able to renegotiate or switch to a better alternative once they are in fiduciary management, so any detriment will persist for a longer period of time.

12.24 By imposing a requirement on trustees to hold a competitive tender process before appointing a fiduciary management provider for the first time, or if previous appointments were not preceded by a competitive tender process, incumbent and rival providers are more likely to present a competitive offer. This would remedy or mitigate the customer detriment that may be expected to result from the AEC we have provisionally found. How good a deal is offered will depend on how well the tender requirements are specified and the tender process is managed. TPR guidance will ensure that this proposed remedies package is effective.

Key design and implementation issues

The specification of mandatory tendering

12.25 Our view is that an open invitation tender process is likely to have the greatest impact on competition and drive improved scheme outcomes. However, we recognise that a well-run, closed invitation tender may achieve similar outcomes with a potentially lower cost to schemes and providers. Our proposal is that trustees should hold an open invitation tender process but we welcome views on whether there are minimum standards for a closed invitation tender process that could be similarly effective.

12.26 We are not proposing to impose any minimum threshold for tendering, either by pension scheme size, or by size or scope of the mandate. Our view is that any move into fiduciary management should be subject to active competition. This approach ensures that incumbency advantages are addressed when the first move into fiduciary management is made, rather than becoming entrenched at this point.

12.27 We are not proposing to require additional tenders for increases in scope of the fiduciary management mandate. Our thinking is firstly that an initial tender will address competition problems arising from significant incumbency advantages and, secondly that if trustees get the best deal on initial appointment they will be in a better position in any subsequent negotiations. We have reached this view in part based on current behaviour (whereby trustees of 61% move 100% of their scheme assets into fiduciary management) and a design objective to avoid unnecessary financial or other costs where possible. We propose to include the costs and benefits of holding a tender process in anticipation of any change in scope of mandate as a relevant topic for TPR to include in best practice guidance.

12.28 We recognise that some schemes may currently be planning to move into fiduciary management or will be completing final contractual arrangements in the run up to this proposed remedy being implemented. We are currently minded to allow six months after any final remedy is agreed before any new mandate will be subject to the requirement of a competitive tender process.[642]

12.29 Trustees have the responsibility for deciding whether to conduct a tender process. Our proposed remedy therefore places the primary duty on trustees. But we also propose that firms will be prohibited from supplying fiduciary management services, where this is a first purchase of fiduciary management by trustees unless they have participated in a tender process.

12.30 We are considering how compliance with this remedy would be best monitored and enforced given that duties fall on both trustees and firms and we will liaise with TPR and the FCA on those matters.

[642] This period will follow implementation of the order which may take up to six months from the date of the final report, with a possible extension of 4 months.

Box 1: Consultation questions for mandatory tendering on first appointment

We are particularly keen to hear parties' views on the following points:

- Should trustees be required to hold a competitive tender process when first choosing fiduciary management?
- Should the tender process be open? In what circumstances would a closed tender process be an effective alternative and how should we define the minimum standard for a tender process?
- Should firms be prohibited from accepting new mandates if no such competitive tender process has not taken place?
- Should there be a minimum threshold either for size of schemes or scope or scale of the mandate?
- Should trustees be required to hold an additional tender process for any expansion in the scope of fiduciary management?
- How should trustee compliance be monitored?

We ask further common questions on our package of remedies in chapter 13.

Mandatory use of a competitive tendering process for existing mandates

12.31 Our remedy includes a second element which will require schemes which have not held a competitive tender previously to do so within five years from the start of their current mandate.

12.32 Based on analysis of client data from fiduciary management firms, we estimate that trustees of around 170 schemes currently use fiduciary management services which did not hold a competitive tender process.[643]

12.33 The competitive pressure of a tender process will help these trustees to achieve a better deal either with their existing or a new provider. We expect

[643] This is based on our dataset of some 498 schemes using fiduciary management.

this remedy to mitigate detriment in the market by reducing prices paid for fiduciary management services or improving value for money.

12.34 We propose that the scope of a competitive tender process for these schemes would be consistent with the requirements of any mandatory competitive tender process on first appointment, as set out above.

12.35 We propose to allow a grace period to ensure that all trustees whose mandate already exceeds the five-year period (or is approaching it) have the opportunity and sufficient time to organise an effective tender process. We propose that trustees will not be required to have completed a tender process earlier than two years from the date that any CMA order is made.

12.36 Table 8 illustrates the approximate number of pension schemes which will need to carry out a competitive tender process each year with a five-year time limit and a two-year grace period.

Table 8: Date by which trustees will be required to complete a competitive tender process according to age of existing fiduciary management mandate

Age of mandate at date that order made (years)	Latest date by which competitive tender process must be completed	Estimated number of schemes
~0	5 years from date of order	92
1	4 years from date of order	109
2	3 years from date of order	68
3		86
4	2 years from date of order	51
5+		92

12.37 By not requiring trustees with mandates less than five years old to immediately conduct a tender process, we think this will increase the likelihood that they would consider switching provider, and this will create stronger competitive pressure.

12.38 In setting a five-year time limit, we consider that the capacity of industry to submit competitive tenders should be adequate to ensure good participation in tender processes.

12.39 We would expect that guidance issued to trustees should recommend that trustees actively consider whether to hold a tender process at a given point irrespective of, and ahead of any requirement arising from any CMA order.

12.40 It will be necessary to identify which schemes this remedy applies to. We have identified around 170 schemes, from data supplied to us by fiduciary management firms. We welcome views on how the relevant schemes should be identified in order for this remedy to work, for example whether schemes should identify themselves or whether their fiduciary management provider should do so.

12.41 We do not propose that firms should cease providing fiduciary management services to trustees who have not held a competitive tender process, as this would lead to substantial switching costs to scheme members. Therefore, our view is that this should not become a requirement on fiduciary management firms. However, we propose introducing a requirement that firms notify their existing fiduciary management customers of their requirement to hold a competitive tender process if they did not do so already.

Box 2: Consultation questions on mandatory tendering for existing fiduciary management mandates

We are particularly keen to hear parties' views on the following points:

- Should trustees be required to hold a competitive tender process if they did not previously do so?
- Should the nature of the competitive tender process be the same as for those schemes adopting fiduciary management for the first time (eg should this be an open or closed tender process)?
- What should be the qualifying criteria of a previous competitive tender process, such that trustees are not required to hold an additional tender process?
- What should the maximum permissible tenure without holding a competitive tender process be?
- What should the grace period for schemes which have already reached the maximum permissible tenure be?

We ask further common questions on our package of remedies in chapter 13.

Remedy 2 – Mandatory warnings when selling fiduciary management services

> **Objective**
>
> Trustees understand whether information received from an investment consultant is advice or marketing.

Description of the remedy

12.42 This remedy requires IC-FM firms[644] to give timely, meaningful and prominent warnings to existing advisory customers when their written material relates to fiduciary management. These warnings will highlight the availability of any materials and guidance from TPR and the mandatory tendering requirement on trustees if they do choose to take a fiduciary management mandate.

12.43 Firms will be required to provide warnings to customers at different points when providing written advice or other materials:

- *(a)* When providing advice on fiduciary management in general;
- *(b)* When mentioning or providing information on their own fiduciary management service;
- *(c)* When advising on the suitability of their own fiduciary management service;
- *(d)* In advance of trustees entering into a binding agreement with the firm to be provided with fiduciary management services.

12.44 We propose that the warning will consist of the following elements:

- A statement on the nature of information included – whether advice, marketing or both and in either case stating clearly which part is advice and which part is marketing[645]
- A reminder to trustees that other providers are available;

[644] This remedy would cover both integrated IC-FM firms and any investment consultancy firm which has any kind of partnership or joint venture with a fiduciary management provider.
[645] We note that investment firms that are regulated in respect of their MiFID II business are subject to the requirement that all information, including marketing communications, addressed to customers or potential customers is fair, clear and not misleading and that marketing communications are clearly identifiable as such (Article 24(3) MiFID II Directive).

- A statement notifying trustees of their obligation to hold a competitive tender process if this is their first mandate or if they have not previously held a competitive tender process for an existing mandate;
- Signposting to TPR guidance and information.

How it addresses the AEC and resulting customer detriment

12.45 By making it clear whether firms are providing advice or marketing, and the context in which it is being provided, trustees should be better able to understand the nature of the information presented to them and whether the information would benefit from additional scrutiny. Improving this information will help drive greater trustee engagement and help to mitigate the incumbency advantage of IC-FM firms in winning fiduciary management business from existing advisory customers.

12.46 By requiring warnings whenever IC-FM firms provide information on fiduciary management, whether as advice or marketing, trustees will potentially have a series of prompts on their obligations. They will also be aware of any guidance which is available from TPR.[646]

12.47 This remedy is designed to increase engagement amongst trustees considering first adoption of fiduciary management. We expect this will support remedy 1 in addressing low customer engagement by reminding trustees of their obligations to hold a competitive tender process. By providing clear warnings on the nature of material being provided, the remedy also addresses potential behaviours of IC-FM firms in steering their advisory customers towards their own fiduciary management service.

12.48 As with remedy 1, driving informed customer engagement is likely to lead to strengthened competition and a reduction in detriment of choosing an IC-FM's fiduciary management service by default.

Key design and implementation issues

12.49 As set out in chapter 7, we found that paid-for advice on investment strategy is sometimes combined with information on the investment consultant's own fiduciary management products without comparable information on other products. To address the risk that trustees are influenced by this information or believe it to be objective advice on suitable products we have considered

[646] Subject to TPR developing this guidance, the scope of this could potentially include choosing fiduciary management and a suitable provider.

how to improve the clarity and avoid confusion about the context in which such information is provided.

12.50 We also recognise the potential benefits of directing trustees to supporting materials including TPR guidance. We set out the scope of our recommendation to TPR below.

How to help trustees understand the nature of information

12.51 In designing this remedy, we have considered how improvements can be made to the way that information is presented to trustees without adding excessive cost, complexity or confusion. We have considered some alternatives to a warning:

(a) the complete separation of marketing and advice into separate and clearly labelled documents could be an effective way to provide clarity and context to the information provided to trustees but could be difficult to implement consistently. We recognised that there is a further risk that multiple documents may be less useful or convenient to trustees.

(b) advice and marketing could be included in the same document but within separate sections. Our provisional view is that this would be effective in keeping the different types of information apart from each other, while retaining the benefit of a single presentation or document. However, it retains the need for every document to be reviewed in detail to ensure that no ‘advice’ or ‘marketing’ is included in the relevant sections. Additionally, there are risks of unintentional or deliberate inconsistencies in how different firms or individual advisers interpret what is ‘advice’ and what is marketing.

12.52 In our view, identifying whether a document is either advice or marketing is relatively simple and the warning would be more effective in the longer term, have fewer unintended consequences and be easier to implement.

Implementation

12.53 Our provisional thinking is that the main element of this remedy can be adopted by providers immediately and prior to any disclosure details being agreed or mandated via CMA order, or TPR guidance being available. We currently propose to allow a one-month period from the date that any order is made after which firms will have to ensure documents include the disclosure where appropriate.

12.54 We are considering whether the FCA could oversee this remedy, either alongside or as part of its other conduct requirements on these firms.

Presentation and wording of warnings

12.55 Our document review indicates that firms inform, introduce, suggest consideration of, or advise on the adoption of fiduciary management over a series of meetings or exchanges which can span a prolonged period. Our provisional finding on this is that such behaviour steers customers towards the incumbent's fiduciary management service.

12.56 We have provisionally concluded that different warnings may be required depending on the nature of communication and to ensure timeliness of declaration.

12.57 In Figure 31 we set out an illustration of how a warning might be presented when an IC-FM firm provides information about its own services in a document while not providing formal advice. We would expect different warnings on different types of document.

Figure 31: Example of possible wording of a mandatory warning

WARNING

This document contains marketing material about our fiduciary management service and should not be considered to be impartial advice.

Other providers of fiduciary management services are available.

You are required to conduct a tender process prior to appointing a fiduciary manager if you have not previously done so.

Guidance on running a tender process and how to get independent advice on choosing a fiduciary manager is available from The Pensions Regulator. Visit [URL of materials] for more information.

Source: CMA

12.58 Subject to responses to our proposals we will seek to test different formats and presentation of disclosures with parties.

Oral presentations

12.59 We recognise that there is a risk of accidental or deliberate conflation of marketing and advice when investment consultants are discussing fiduciary management with clients. We think any disclosure as part of an oral presentation is unlikely to be effective and demonstration of compliance would be difficult. We instead have provisionally concluded that suitable regulatory warnings in written documents and on purchasing fiduciary management should be sufficient.

Box 3: Consultation questions for warnings when selling fiduciary management

We are particularly keen to hear parties' views on the following points:

- Should this remedy apply only to IC-FM firms, or to other investment consultancy and fiduciary management providers?[647]
- What should the structure and form of the warning be? Should there be any separation of content?
- Should there be any requirement to give a warning on oral advice and marketing?
- Should firms have flexibility in changing the description of the service in the warning to a term other than 'fiduciary management' to reflect the description of the service being proposed?[648] Are any additional safeguards necessary?

We ask further common questions on our package of remedies in chapter 13.

Remedy 3 – Enhanced trustee guidance on competitive tender processes

Description of the remedy

12.60 In remedies 1 and 2 we have introduced trigger points for trustee engagement by requiring trustees to hold competitive tender processes and by providing prompts when an existing IC-FM firm advises on, or markets,

[647] As noted in footnote 644, we propose that for the purpose of this remedy we include investment consultancy firms with commercial relationships with fiduciary management firms within the term 'IC-FM'.
[648] We are aware that many firms do not use the term 'fiduciary management' when describing their service and are keen to ensure that any warning is clear and understandable to customers.

fiduciary management services. This remedy takes the form of a recommendation to TPR to develop guidance to help trustees run competitive tender processes. (we discuss the wider role that guidance can play in supporting trustees, including in relation to investment consultancy, in Recommendation B)

How it addresses the AEC and resulting customer detriment

12.61 We discuss the effectiveness of remedies 1 and 2 in addressing the AEC and the underlying features of the AEC above. This remedy is designed to increase the effectiveness of these remedies by helping trustees make decisions and manage tender processes.

Key design and implementation issues

12.62 In chapter 5 we have found that some tender processes have been of poor quality, while others were more effective in eliciting useful and comparable information from providers. We consider that, if more trustees adopt a broadly similar approach, costs for firms participating in tenders may be reduced and this may itself help drive competition by encouraging more to take part in competitive tender processes.

12.63 We are keen for TPR guidance to reduce the burden of running tender processes on trustees by clearly setting out best practice. We propose recommending that the guidance should include:

- Factors trustees should consider as part of fiduciary management strategy implementation and appointment
- Best practice in running a tender process, which could include, for example, issues such as:
  - The number and types of firms to be invited to participate
  - The possible use of third party advisers and evaluators
  - Factors to consider in interpreting providers’ fees and performance track records
- Factors to consider in preparing tender documentation, including fee schedules.

12.64 We expect that the enhanced guidance would also reflect new requirements for the quality of information provided as a result of our remedies below. We discuss the overall scope below at in our discussion of Recommendation B.

12.65 We have identified in our provisional findings that there is also scope for investment consultancy tender processes to be improved. We therefore suggest that TPR considers how best practice from running competitive tenders for fiduciary managers could also be used within its guidance for pension trustees tendering for investment consultancy.

12.66 We expect that smaller schemes will benefit most from the new materials while larger schemes will continue to run tender processes according to their available resources and in-house expertise. However, regardless of scheme size, TPR could signpost trustees to the guidance.

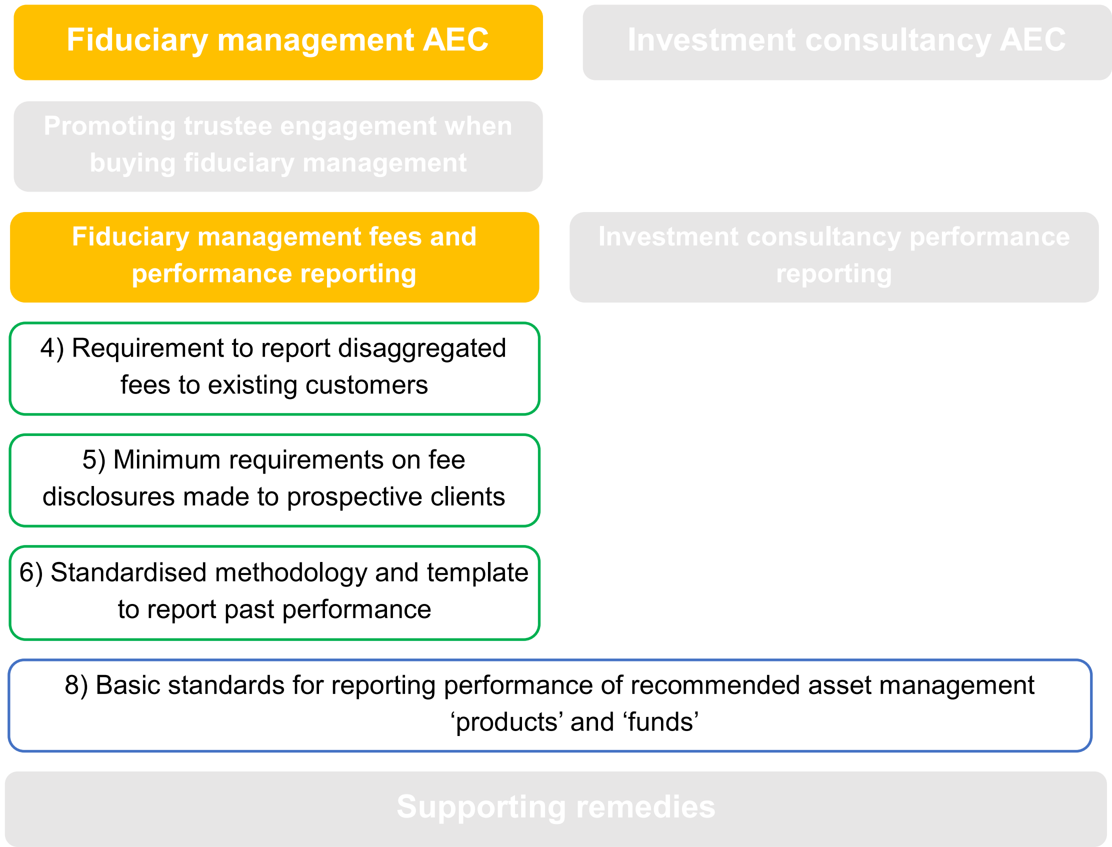
12.67 We would expect that the CMA will work with TPR on the development of guidance. TPR may also wish to work with other relevant parties including third party evaluators and trustees to develop these materials to capture real-world experience.

Fiduciary Management fees and performance reporting

12.68 In this section we set out the remedies we propose to adopt in relation to improving the quality, comparability and availability of information provided by fiduciary management firms to existing and prospective customers.

12.69 We set out the remedies we propose to introduce in Figure 32.

Figure 32: Fiduciary Management fees and performance remedies we propose to introduce



Source: CMA

12.70 The remedies outlined in this section would require fiduciary managers to provide disaggregated fee information to existing customers, as well as adopt a standardised methodology for reporting fees and past performance to prospective customers. Parties were generally supportive of our proposals to improve the standardisation of information on fiduciary management performance provided to prospective customers.

12.71 Remedy 8, which relates to how firms report performance of recommended asset manager products, is likely to have greatest relevance to the provision of investment consultancy but is also relevant to fiduciary management and we propose that providers of fiduciary management will also be subject to its requirements.

Remedy 4 – Requirement on firms to report disaggregated fiduciary management fees to existing customers

Objective
Trustees receive regular fee information which will be clear and comparable.

Description of the remedy

12.72 This remedy would require fiduciary managers to provide disaggregated fee information to their customers on a regular basis and at least annually.

12.73 This information would enable trustees to monitor both the overall fees paid for their fiduciary management service, and the fees paid for the distinct elements of the service. This break down would include the ‘core’ fiduciary management fee (including advice and implementation), asset management fees and other fees (such as custodian fees).

12.74 Moreover, this remedy would also require disaggregated asset manager fee information to be provided to trustees on a regular (at least annual) basis. This information must be included in the regular fee statement and we expect that this would be based on the FCA convened Institutional Disclosure Working Group (IDWG) developed template once this is in place.[649]

12.75 Parties have informed us that, in regard to reporting to customers on third party fees, significant progress has been made in this area following the coming into force of MiFID II requirements in January 2018.[650] However, some parties have acknowledged that more could be done.

12.76 We are proposing that fiduciary managers provide a regular (at least annual) fee statement to their customers that clearly sets out the following information:

[649] We discuss the IDWG in recommendation C.
[650] We note that investment firms that are regulated in respect of their MiFID II business are subject to various requirements in respect of information on fees provided to their customers. These include, for example, the requirement to provide information on all costs and associated charges and to provide an itemised breakdown in certain cases (see, for example, Article 24 MiFID II Directive and Articles 50 and 60 MiFID II Delegated Regulation). For the avoidance of doubt, our proposed remedy that firms must provide disaggregated fee information would operate alongside MiFID II requirements on firms to aggregate all costs and charges to enable customers to understand the overall cost (see, for example, Article 24 MiFID II Directive and Articles 50 and 60 MiFID II Delegated Regulation). Therefore, firms would continue to provide aggregated information in addition to our requirement to provide disaggregated information.

(a) An itemisation of the overall fee. The following fee elements should be clearly itemised:

(i) The fee for the core fiduciary management service, covering advice and implementation.

(ii) Asset management fees. This should cover products and funds provided by the fiduciary manager, and those provided by third party asset managers. This fee should include all transaction costs and any performance related payments.

(iii) All other investment fees. This should include custodian fees, administration charges and other miscellaneous fees incurred.

(b) The overall fee paid for the service over the period covered by the fee statement. This should cover all fees incurred as part of the service, including both those deducted directly from assets and those invoiced separately and those paid to the fiduciary manager and to third parties.

12.77 We propose that the overall fee and the itemised fees should be shown in both percentage (of assets under management) and cash terms.

How it addresses the AEC and resulting customer detriment

12.78 We have provisionally found that there is a lack of sufficiently clear information for customers to assess the value for money of their existing fiduciary manager. Many customers do not receive clear fee information from their provider, with fees for the fiduciary management service often bundled with the underlying investment fees. This limits customers' ability to assess the competitiveness of the fiduciary management service they are receiving, and the competitiveness of the underlying investment products.

12.79 With a minimum fee disclosure requirement, fiduciary managers will provide trustees with information in a format which will be clear. This information would allow trustees to understand the costs of their existing fiduciary management provider and those of the underlying products and so consider whether there may be any scope for lower costs in one or more fee categories.

12.80 Trustees will be better able to understand the fees charged by their existing fiduciary management provider and compare those to the trustees' internal objectives and budgets. If they choose to formally review their fiduciary management provider or go to tender for a new provider, an understanding of their current costs will help them drive competition between providers in a tender process. Therefore, this proposed remedy will help increase competition between fiduciary managers and incentivise providers to reduce component fees, as well as the overall fees customers pay for the service. This would also remedy or mitigate the customer detriment that may be expected to result from the AEC we have provisionally found.

Key design and implementation issues

12.81 As set out in chapter 5, it is also our view that trustees should have access to regular information on asset management fees that are disaggregated to a level that enables trustees to assess whether the various elements of their portfolio, such as the growth and matching assets, are competitive

12.82 Therefore, we are proposing that, in addition to the fee statement discussed above, fiduciary managers provide customers fund-by-fund (or product-by-product) information on the fees paid over the period covered by the fee statement and the impact of such fees on the return of underlying funds. This would ensure that clients have access to fund-by-fund information on both gross and net returns. We would expect the content of this information would be based on the IDWG user templates, available later in 2018. The aggregation of such charges should equal the overall asset management fees disclosed.

12.83 We welcome views on to the best way of ensuring that trustees have regular access to this disaggregated information on their asset management fees. We are mindful not to burden trustees with excessive information, and to avoid overly complex fee statements that distract from the headline fee.

12.84 Our provisional view is that this remedy will be implemented by CMA order. To allow system changes we propose that this requirement will be come into force from six months from the date that any order is made.

12.85 We propose that regular, at least annual, reporting to schemes should have commenced (ie schemes will have received their first report) within 18 months of any order being made.

Box 4: Consultation questions for fiduciary managers reporting disaggregated fees to existing customers

We are particularly keen to hear parties' views on the following points:

- Should fiduciary management firms be required to provide disaggregated fee information and how should they do this?

- Should asset manager fee information be based on the IDWG templates?
- What should the frequency of reporting such fee information to customers be?

We ask further common questions on our package of remedies in chapter 13.

Remedy 5 – Minimum requirements on firms for fee disclosure when selling fiduciary management

Objective

Prospective customers receive fee information that is consistent and comparable across fiduciary management bids when holding tender processes, or (if no tender process is run) prior to awarding the contract.

Description of the remedy

12.86 This remedy would require the information on fees provided by fiduciary managers to be consistent and comparable across bids in a tender process. In particular, the remedy would require firms to provide breakdowns of their proposed fees when competing for a new contract.[651]

12.87 Some parties have told us that customers looking to appoint a fiduciary manager may struggle to compare the offers of different providers. They support measures to improve the comparability of fees for fiduciary management services and the unbundling of these fees to allow for easier comparisons between providers.

12.88 We propose that providers must disclose and itemise all charges that will be incurred by the customer. This should be provided in both percentage and cash terms, and clearly present each of the following:

[651] We note that investment firms that are regulated in respect of their MiFID II business are subject to various requirements in respect of information on fees provided to their customers. These include, for example, the requirement to provide information on all costs and associated charges and to provide an itemised breakdown in certain cases (see, for example, Article 24 MiFID II Directive and Articles 50 and 60 MiFID II Delegated Regulation).

(a) The total fee to be charged for the service each year. This should cover all fees incurred as part of the service, including those deducted directly from assets and those invoiced separately, such as those above.

(b) An itemisation of the total fee, including the following elements:

(i) The fee for the core fiduciary management service, covering advice and implementation.

(ii) Asset management fees. This should cover products and funds (or fund-of-funds or related) provided by the fiduciary manager, and those provided by third party asset managers. This fee should include any potential transaction costs and performance related payments.

(iii) All other investment fees, such as custodian fees and administration charges and other miscellaneous fees likely to be incurred.

(c) Any one-off fees and charges that will be, or are likely to be, incurred by the customer. These include:

(i) Estimated transaction costs incurred in moving assets into the proposed portfolio. This should include both the implicit and explicit costs of transferring assets, even if these costs are paid to third parties (eg brokers).

(ii) Any one-off fees for advice, eg in refining the investment portfolio.

(iii) Any other one-off charges, eg legal fees, ‘onboarding’ services.

(d) Finally, we propose that providers should disclose the potential exit fees and costs that might be incurred if the customer were to switch at a future date to another fiduciary management provider for the services being tendered. These should include:

(i) Clear disclosure of any explicit exit fees that would be incurred from a change of provider (eg any exit charges or ‘lock-in’ fees in the contract).

(ii) A clear statement that transaction costs might be incurred in switching provider, and that such costs may be similar in magnitude to those disclosed. It should also be clearly disclosed whether there are any features of the proposed portfolio that might increase such transaction costs. This could include the use of proprietary funds or an increased exposure to illiquid assets.

12.89 Our provisional view is that this remedy will be implemented by CMA order. To allow system changes we therefore propose that this requirement will come into force from six months from the date that any order is made.

How it addresses the AEC and resulting customer detriment

12.90 We provisionally found that there is a lack of clear and comparable information for prospective customers to assess the value for money of alternative fiduciary managers. The nature of fee information provided by firms in tenders is often limited and customers do not seek to obtain comparable information. Many providers also do not provide any information on the potentially high costs of transitioning into and out of their fiduciary management service.

12.91 By following a minimum fee disclosure requirement when responding to a tender process, fiduciary managers will provide trustees with clear and comparable information.

12.92 In chapter 5, we provisionally found that fee information in fiduciary management tenders is generally more standardised and comparable across competing providers than in investment consultancy. However, we have also identified several factors that make comparison difficult for trustees when they attempt to assess and compare fees charged by each fiduciary management provider. We have also found that the level of details of the underlying asset management fees vary significantly across bids.

12.93 Trustees should be able to understand the fees charged by fiduciary managers prior to deciding to award the contract to a provider. Addressing this issue will help enhance transparency and comparability in competitive tender processes for prospective customers. It will also increase competition between fiduciary managers and may incentivise them to reduce fees, as well as the overall fees customers pay for the service. This would also remedy or mitigate the customer detriment that may be expected to result from the AEC we have provisionally found.

Key design and implementation issues

12.94 In designing this remedy, we sought to allow fiduciary managers the flexibility to use a variety of business and pricing models when submitting tenders for new contracts without restricting innovation.

Box 5: Consultation questions for fiduciary managers reporting disaggregated fees to new customers

We are particularly keen to hear parties' views on the following points:

- Should firms be required to provide a fee breakdown to prospective customers?
- Should any other fees or costs be disclosed in addition to those mentioned in this remedy?

We ask further common questions on our package of remedies in chapter 13.

Remedy 6 – Standardised methodology and template for reporting past performance of fiduciary management services to prospective clients

Objective

Prospective customers are better informed as to the fiduciary managers' historic performance.

Description of the remedy

12.95 This proposed remedy would support the development and implementation of a standardised methodology and require fiduciary managers to report their historic performance. The remedy covers the historic investment performance of the firm's full fiduciary management clients ('fiduciary management track records').[652]

12.96 Many parties have indicated their support for an industry standard for reporting fiduciary management track records, and there was broad support for such a standard at our trustee roundtables.

12.97 We note that a third-party evaluator, IC Select, has developed a reporting standard for fiduciary management track records which appears to have the

[652] We note that investment firms that are regulated in respect of their MiFID II business are subject to various requirements in respect of information provided to their customers or potential customers. These include, for example, the requirement that information must be fair, clear and not misleading and there are additional requirements when providing information on the past performance of a financial instrument (Article 24 MiFID II Directive and Article 44 MiFID II Delegated Regulation).

support of several providers. IC Select began using the standard in April 2018 and proposes that it will transfer to the CFA Institute. The CFA Institute has indicated that the standard will be integrated into its Global Investment Performance Standards by January 2020 and be adopted on a voluntary basis.

How it addresses the AEC and resulting customer detriment

12.98 We have identified that there are barriers to customers in assessing and comparing fiduciary management providers' quality in terms of their historic investment performance.

12.99 This remedy would enable trustees to better understand the historic performance of the fiduciary manager prior to deciding to award the contract to a particular provider. Addressing this issue will help enhance transparency and comparability between alternative fiduciary managers for prospective customers thereby enabling trustees to drive competition between providers. It would also enable trustees to achieve better value for money and thereby remedy or mitigate the customer detriment that may be expected to result from the AEC we have provisionally found.

Key design and implementation issues

12.100 Our provisional view is that a fiduciary management track record could help trustees compare providers. It is too early to assess whether the IC Select standard is the best approach and in any event our view is that a standard which would be used on a voluntary basis would not achieve the outcome we seek.

12.101 In our view, fiduciary managers, TPEs and other market participants are best placed to develop a performance standard which gives a fair reflection of performance. Therefore, we propose that an implementation group drawn from industry should develop and agree a standard and then maintain it. The implementation group may choose to outsource the development of a standard to a third party, implement the existing IC Select standard, or develop it themselves, for example. We discuss the formation and responsibilities of an implementation group in more detail in the paragraphs below.

Implementation group

12.102 Our proposal is that an implementation group should be formed by fiduciary management firms to develop and maintain a common standard for fiduciary management track records.

12.103 Our provisional view is that:

(a) It should be resourced and financed by fiduciary management firms on a fair basis reflecting the different sizes of firms;

(b) The group should set its terms of reference according to our final remedies and recommendations;

(c) Membership should be open to all fiduciary management firms;

(d) The group should include pension scheme trustees or groups representing their interests and independent advisers including professional trustees and third- party evaluators;

(e) The meetings should be open to the CMA to attend, and the FCA and TPR as appropriate;

(f) Meeting minutes should be published.

12.104 Our provisional view is that the group is unlikely to initially incur any significant costs beyond staff time though we invite views on this.

12.105 We would expect but would not mandate that the group should work with TPR to develop materials and tools to support trustees using the fiduciary management standard.

12.106 Our provisional view is that this remedy will be implemented by CMA order. We propose that the group should convene within two months of the publication of our final report and we propose that firms will have six months to put in place a standard. We therefore expect that this requirement will come into force from the date that any order is made.

12.107 In the event that the group is unable to develop and implement a standard that is acceptable to the CMA, then we will reserve the right to appoint an independent person to oversee its development, funded on a similar basis to the implementation group.

Box 6: Design questions for fiduciary management performance reporting

We are particularly keen to hear parties' views on the following points:

- Should there be a fiduciary management performance standard?

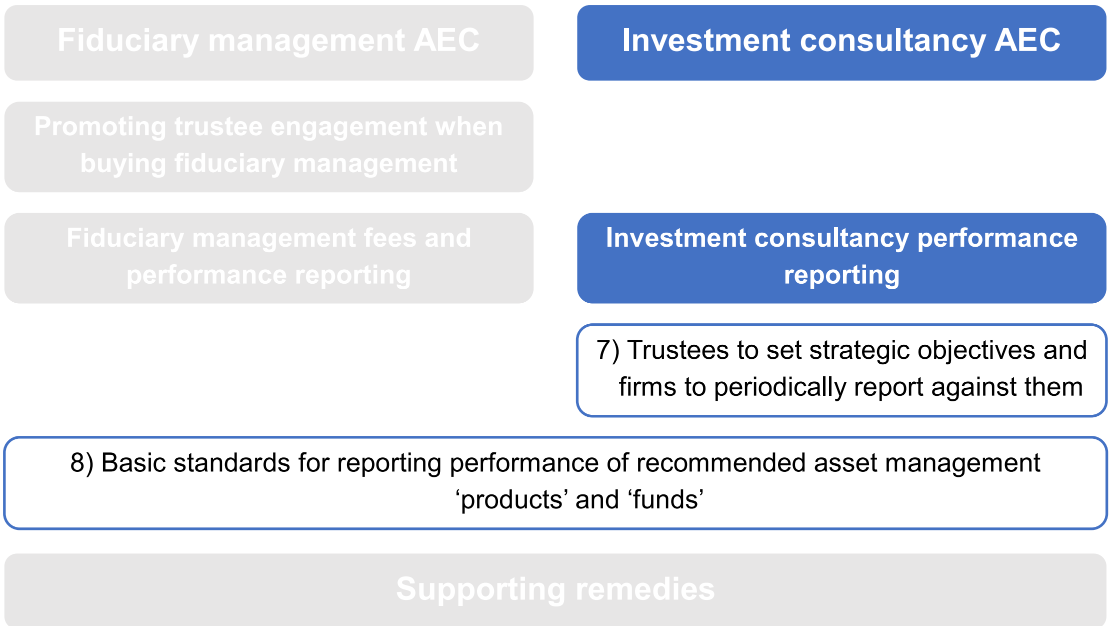
- Who would be best placed to develop and implement a fiduciary management performance standard?
- How do you envisage the implementation group working: how should it be funded, who should be part of it, etc?
- What backstop would be appropriate in the event that the group is unable to agree on the standard in the required period?

We ask further common questions on our package of remedies in chapter 13.

Investment consultancy fees and performance reporting

12.108 In this section we set out the remedies we propose to adopt in relation to improving the quality, comparability and availability of information provided by investment consultant firms to existing and prospective customers.

Figure 33: Investment consultancy fees and performance reporting remedies we propose to adopt



Source: CMA

12.109 The remedies outlined in this section would require trustees to set strategic objectives with their investment consultant. We also propose requiring investment consultants and fiduciary managers to establish basic standards for the reporting of performance of their recommended asset management 'products' and 'funds' using a standardised methodology.

12.110 In response to our working papers, parties were generally supportive of measures to improve the transparency of information on fees and quality. Some parties supported initiatives that will make it easier for trustees to process information on fees and quality and easier to assess and compare the offering of different providers.

12.111 Parties told us that any measures we plan to implement should not introduce unnecessary burden and complexity for trustees that may already be struggling with the information they currently have. Measures should be designed to ensure that unintended consequences do not arise, such as reducing trustees' ability to focus attention on aspects of investment consultants' service that are difficult to understand or compare (for example, cost compared to quality). We note these concerns and have taken these into account in considering our proposed remedies.

Remedy 7 – Duty on trustees to set their investment consultants strategic objectives

Objective
Trustees monitor the performance of their investment consultant by measuring it against an appropriate set of strategic objectives.

Description of the remedy

12.112 This remedy will require pension trustees to set their investment consultants a set of strategic objectives at least every three years, which should be clear and measurable, and for the consultants to report periodically their performance against these objectives.[653]

12.113 We propose that the setting and review of objectives must be completed at least every three years, potentially alongside the triennial scheme valuation or as part of the review of the Statement of Investment Principles, as appropriate.

[653] We note that investment firms that are regulated in respect of their MiFID II business are required to act in the best interests of their customers and all information addressed to customers or potential customers must be fair, clear and not misleading; investment firms must also provide their customers with adequate reports on the service provided (Articles 24 and 25 MiFID II Directive).

12.114 In ‘Supporting Recommendations’ below, we propose to recommend to TPR that it makes guidance available to trustees to help them to set these objectives.

How it addresses the AEC and resulting customer detriment

12.115 We have provisionally found that it is difficult for trustees to monitor the quality of their investment consultant, because there is a lack of information for them to do so. (See chapter 5.) Trustees do not set sufficiently clear objectives against which their providers can demonstrate their performance. Furthermore, the information provided by investment consultants to pension trustees makes it difficult for trustees to evaluate their quality of service.

12.116 This remedy would help trustees assess their investment consultant’s performance by measuring it against clearly defined objectives. We note that this is already standard practice in fiduciary management, in which the provider is set clear objectives at the start of the relationship.

12.117 The periodic evaluation of performance will also introduce a natural opportunity for trustee engagement on the performance of their investment consultant.

12.118 This remedy would therefore enable trustees to be better informed about their provider’s performance and thereby to drive competition between providers. It would also remedy or mitigate the customer detriment that may be expected to result from the AEC we have provisionally found

Key design and implementation issues

12.119 We have been conscious of the challenge of assessing investment consultancy performance in the context where the customer is responsible for choosing whether and when to execute that advice. It is not necessarily the case that scheme performance is a proxy for the performance of the investment consultant. This will vary across different pension schemes and the nature of objectives for the investment consultant should take account of this factor: if the scheme normally follows all investment advice, then the investment consultants’ objectives may be very close to the scheme’s objectives; if they do not, then it should have a different type of objective. The nature of the strategic objectives will vary on a case-by-case basis, reflecting the variation across schemes in the extent of a consultant’s remit.

12.120 This remedy particularly targets trustees and investment consultants that do not currently have such strategic objectives in place.

12.121 We considered whether all investment consultancy assignments and engagements should require strategic objectives to be agreed. We recognise for example that some investment consultancy firms may be engaged for very specific and discrete pieces of consultancy project work, whereas other customer relationships may last for a number of years. Our provisional view is that all investment consultancy customer relationships should be framed against clear objectives, regardless of length or scale of nature of engagement.

12.122 We propose that all investment consultancy engagements should be subject to having strategic objectives, other than existing engagements which are due to terminate within six months from the date any CMA order is made.

12.123 To support this remedy, we consider that guidance should be produced by TPR to help trustees in setting appropriate objectives for their scheme's investment consultants. This guidance should include reference to setting meaningful strategic objectives, which are clear, measurable and tailored to the scheme's characteristics. In particular, if the objective relates to underlying fund performance, the guidance should state that information on fees should be reported on either a net of fees basis or both a gross and net of fees basis.

12.124 TPR currently provides a range of guidance to trustees 'relations with advisers'. This could be expanded to include guidance on setting measurable strategic objectives for a particular scheme.

12.125 We have considered whether all schemes should be subject to setting strategic objectives, or whether there should be a minimum value of scheme assets below which an objective setting process is not required.

12.126 We have provisionally concluded that there should not be a minimum threshold based on the fact that all schemes should have clear strategic objectives prior to engaging with an investment consultancy provider. Furthermore, all DB schemes receive a triennial valuation and / or have a Statement of Investment Principles and therefore performance reporting against strategic objectives will not add further significant burden on investment consultants. We also consider that a minimum threshold might reduce the effectiveness of the remedy.

12.127 To allow TPR to develop guidance on how to set objectives, we propose that this remedy should come into force six months from the date any CMA order is made. However, to ensure that objectives are effective, implementation may need to be contingent on TPR guidance being published.

12.128 We propose that this remedy will also be implemented by CMA order on pension trustees.

Box 7: Consultation questions for setting strategic objectives for investment consultants

We are particularly keen to hear parties' views on the following points:

- Should pension trustees be responsible for setting objectives for their investment consultant?
- Is review and agreement of objectives every three years a suitable timeframe?
- Should there be a minimum threshold based on pension scheme size or the scale of the consultancy contract?
- When do you consider that the formal review of an investment consultant against the scheme's strategic objectives should take place?

We ask further common questions on our package of remedies in chapter 13.

Remedy 8 – Establish basic standards for how investment consultants and fiduciary managers report performance of recommended asset management 'products' and 'funds'.

Objective

Trustees can assess and compare historical performance of recommended asset management products.

Description of the remedy

12.129 This remedy would require information provided to customers regarding the performance of an investment consultant's or fiduciary manager's recommended asset management products and in-house investment products to adhere to a standardised set of rules and principles.[654]

12.130 This includes information provided in tender submissions and in marketing materials and any information of this type provided to existing customers.

12.131 Appendix 2 sets out the methodological and data issues that we have provisionally found have an effect on reported performance. On this basis, we propose that the following areas should be included in reporting standards:

(a) **Excess return vs benchmark**. Returns should be compared to an appropriate benchmark, and the benchmark should be clearly stated.

(b) **Net of fees**. Returns should be presented on either (i) a net of fees basis, or (ii) both a gross and net of fees basis. It should be clearly stated what fee basis is used. We invite views from interested parties as to what fees should be used to make the gross to net fees conversion

(c) **The inclusion of all relevant products and funds**. The firm should include information on the performance of all relevant products and funds. For example, if the firm is asked to demonstrate the performance of its recommended asset management products, it should include all recommended products across all asset classes.

(d) **Survivorship bias**. The firm should take reasonable steps to ensure that reported performance does not suffer from survivorship bias. [655] If there is a possibility that the methodology being used may suffer from survivorship bias, this should be clearly disclosed.

(e) **Data issues, including simulated returns and backfill bias**.[656] The firm should take reasonable steps to ensure that data relying on simulated returns and/or backfilled returns is removed from the analysis.

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[654] We note that investment firms that are regulated in respect of their MiFID II business are subject to various requirements in respect of information provided to their customers or potential customers. These include, for example, the requirement that information must be fair, clear and not misleading and there are additional requirements when providing information on the past performance of a financial instrument (Article 24 MiFID II Directive and Article 44 MiFID II Delegated Regulation).

[655] Survivorship bias is a form of selection bias that arises when the analysis of a variable (here investment performance) concentrates on products that made it past (ie survived) some selection process (here retaining their 'buy' rating) while not taking into account those that did not. As continuing to receive a 'buy' rating is contingent on investment performance, the observed performance of products that have retained their ratings over a reporting period will likely be inflated compared to the overall performance of the universe of 'buy-rated' products.

[656] Simulated returns occur when the (hypothetical) historical performance of products in a database are 'simulated' using statistical techniques. Such techniques might be used to produce strong historical returns in order to attract prospective investors. Backfill bias may occur if products are only added to a database after a certain period of time; those that perform well may be added, whilst those that perform poorly are unlisted. This may inflate the performance of products in the database.

The firm should clearly disclose any other data issues that could materially affect reported performance, and whether any steps have been taken to correct for these issues.

How it addresses the AEC and resulting customer detriment

12.132 We have provisionally found that there is a lack of clear and comparable information for customers to assess the value for money of alternative investment consultants and fiduciary managers. It is also very difficult for customers to assess and compare the quality of the advice they would get from different providers. In particular, the ways used to calculate track records for recommended investment products makes it difficult to interpret and compare the quality of advice across providers.

12.133 We have identified that there are barriers to customers in assessing and comparing different investment consultants' quality of advice. This includes reporting the investment performance of recommended asset management products.

12.134 We have provisionally found that the historical investment performance of recommended asset management products has been presented in an inconsistent way in responses to tender documents and in marketing materials. This can make it difficult for trustees to accurately assess the performance of each firm in identifying competitive products.

12.135 By requiring providers to adhere to basic standards on reporting performance, trustees would be better able to assess the value for money of alternative investment consultants and fiduciary managers and the quality of advice provided. This in turn would enable trustees to drive competition between providers. It would also enable them to achieve better value for money and thereby remedy or mitigate the customer detriment that may be expected to result from the AEC we have provisionally found.

12.136 In requiring that basic standards be agreed for use with prospective clients, we would expect that firms use these more widely with existing customers.

Key design and implementation issues

12.137 We envisage that this remedy would establish basic standards for the reporting of two types of information provided by investment consultants and / or fiduciary managers:

(a) The historical investment performance of recommended asset management products; and

(b) The historical investment performance of their own investment products (eg fund-of-funds, multi-client pooled funds etc).

12.138 Our provisional view is that this remedy will be implemented by CMA order. To allow appropriate changes to reporting systems and relevant marketing materials we propose that the remedy will come into force six months from the date that any CMA order is made.

Box 8: Consultation questions for performance reporting

We are particularly keen to hear parties' views on the following points:

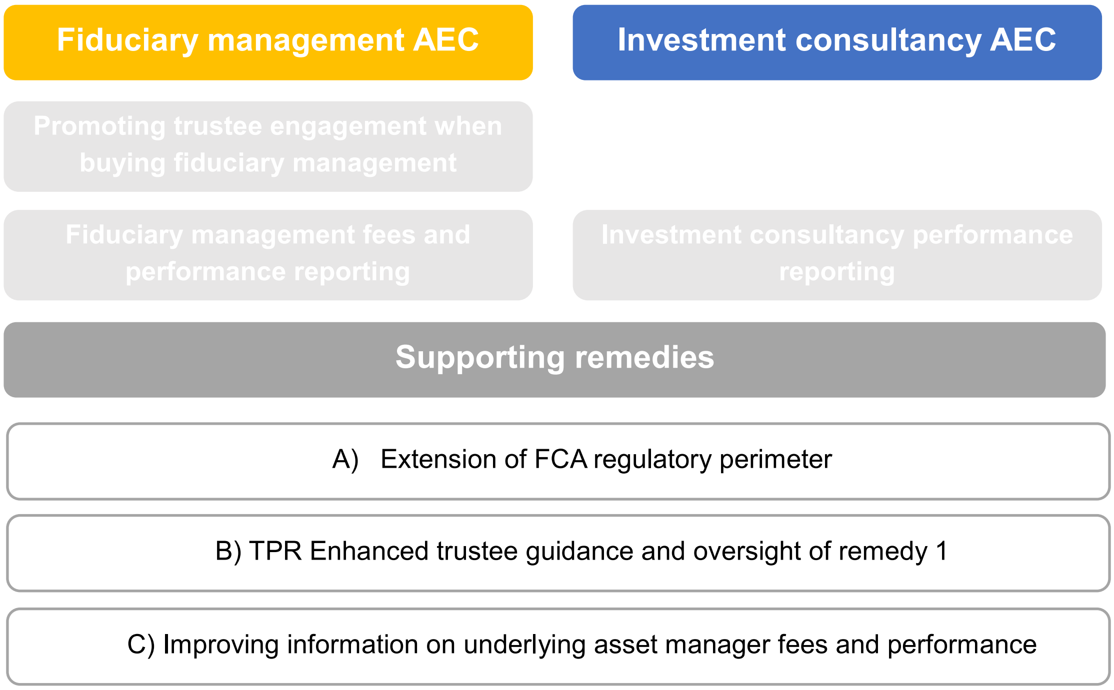
- Should basic standards apply to the reporting of recommended asset management 'products' and 'funds'.
- Are there any other areas that we should include in the reporting standards?
- Should standards be developed and agreed by an implementation committee similar to Remedy 6?
- What fees should be used to make the gross to net fees conversion?

We ask further common questions on our package of remedies in chapter 13.

Supporting remedies

12.139 Alongside the proposed remedies set out above we also propose to make three recommendations to government, TPR and the FCA respectively that will make our provisional package of remedies more effective.

Figure 34: Remedies we propose to adopt



Source: CMA

Recommendation A) Extension of FCA regulatory perimeter

Objective

Firms that provide investment consultancy and fiduciary management are subject to consistent, proportionate regulation that reflects market developments and addresses the competition findings of this investigation.

Description of the remedy

12.140 This remedy would take the form of a recommendation to government to extend the scope of the FCA's regulatory perimeter to include relevant services provided by investment consultancy and fiduciary management firms to the extent that they may not be presently regulated (for example, advice on strategic asset allocation, manager selection, fiduciary management).[657]

[657] We understand that elements of such activities (a) would be regulated to the extent that they form an integral part of a regulated activity (see, for example, FCA PERG 13.3, Q21 in relation to MiFID II investment services) or (b) may be subject to FCA conduct requirements in COBS if they are carried on in connection with a regulated activity. The aim of our recommendation would be to close the 'regulatory gap' in respect of key services, of which examples are outlined above.

12.141 It would enable the FCA to monitor remedies 2 and 4 to 8, and also potentially the aspect of remedy 1 that applies to fiduciary management firms. We intend that the relevant provisions of any CMA order to implement these remedies would terminate as soon as the regulatory perimeter is widened and to the extent that these remedies may be overseen by the FCA as conduct requirements on firms.

How it addresses the AEC and detriment

12.142 At present some but not all activities conducted by firms are subject to regulation by the FCA or designated professional bodies such as the Institute and Faculty of Actuaries. This may inhibit the ability of the relevant regulator to intervene in the market in certain situations.

12.143 Extending the FCA regulatory perimeter[658] would help to reinforce the effectiveness of the remedies outlined above that we propose to address the AECs and resulting customer detriment. In our view our proposed remedies would be best monitored by the FCA as the financial services sector regulator.

12.144 Extending the perimeter would also ensure greater consistency of conduct by investment consultancy and fiduciary management firms over the range of services provided to pension scheme trustees.

12.145 Finally, the FCA as the relevant sector regulator would be able to assess market developments across all relevant activities and take regulatory action as appropriate.

Key design and implementation issues

12.146 The key design issue for any extension of the FCA's regulatory perimeter is identifying a correct, comprehensive and appropriate definition of the relevant activities carried out by investment consultants and fiduciary managers which are not currently regulated.

12.147 We note that currently not all firms providing investment consultancy or fiduciary management services are authorised and regulated by the FCA. This is because they are regulated by a designated professional body (DPB), such as the Institute and Faculty of Actuaries.[659] This creates a potential further complexity.

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[658] Depending on its nature and degree, extension of the FCA's regulatory perimeter may catch firms in respect of activities that are currently only subject to regulation by designated professional bodies.
[659] See paragraph 3.49.

12.148 In making any final order and recommendation we will seek to address these issues and are keen to hear views on how best to create a consistent regulatory playing field.

12.149 In making a recommendation to extend the regulatory perimeter we are conscious of the risks of distorting competition and introducing additional regulatory burdens, particularly for smaller firms. However, our view is that the overall burden would be reduced by firms having a single regulatory relationship with the FCA or a DPB.

Box 9: Consultation questions on extension of the regulatory perimeter

We are particularly keen to hear parties' views on the following points:

- Should the FCA regulatory perimeter be extended and what activities should be included?
- Should specific rules or principles related to remedies 1-2 and 4-8 be included within the FCA's overall conduct requirements? If not, how should those remedies be best implemented in the regulatory regime?
- What is the anticipated cost of an extension of the regulatory perimeter to firms? What is the marginal cost to firms already subject to FCA or designated professional body regulation?
- How should any changes be implemented to ensure consistency between regulators (including designated professional bodies) and to reduce costs to firms?

We ask further common questions on our package of remedies in chapter 13.

Recommendation B) Enhanced trustee guidance and oversight of remedy 1

Objective

Trustees have access to free, comprehensive and impartial advice on how to choose and assess current and prospective advisers.

Proposed recommendation

12.150 In remedy 3 we have set out a proposed recommendation to TPR to develop enhanced guidance to trustees on running competitive tender processes. Alongside this, we are proposing to make a recommendation to TPR to develop broader guidance on engaging with investment consultants and fiduciary managers. In particular, our view is that this guidance could encompass the breadth of our package of remedies including how to set strategic objectives and request and interpret the information provided by firms.

12.151 Given TPR's role and its ability to develop materials over time and in response to trustee needs our view is that TPR is best placed to provide support to drive trustee engagement.

12.152 In addition to any requirements arising from our remedies for both trustees and schemes, our current view is that the following could be developed:

- Guidance on choosing and monitoring investment consultancy and fiduciary management providers including in relation to:
  - Remedy 7: How to set appropriate strategic objectives against which investment consultants can report on their performance
  - Remedies 4-8: Suggestions of what types of information to ask a provider for to monitor fees and performance
  - Remedy 1: How to get the most of a competitive tender process and how to ensure the scheme gets value for money on an ongoing basis
- Supporting materials (possibly in the form of templates or checklists)

Box 10: Consultation questions on enhanced trustee guidance

We are particularly keen to hear parties' views on the following points:

- Would trustees benefit from enhanced guidance?
- What should the scope of any guidance include?
- How detailed should guidance be and what form should it take?

We ask further common questions on our package of remedies in chapter 13.

Recommendation C) Improving information on underlying asset management fees and performance

Objective
Trustees and their advisers have access to accurate, consistent and comparable information on underlying asset manager fees and performance.

12.153 Following the conclusion of its Asset Management Market Study, the FCA convened an Institutional Disclosure Working Group (IDWG) with asset managers and other interested parties to improve disclosure of asset management fees and charges.[660] The IDWG is developing templates and underlying data hierarchies for asset managers to use that provide differing levels of granularity for investors. As a result, investors and their advisers should also be more easily able to aggregate cost data from across different funds and asset managers.

12.154 We have met the FCA and the IDWG over the course of this investigation to understand the development of the templates and their content. Our provisional view is that the templates will help investment consultants, fiduciary managers and trustees understand the underlying charges they pay.

12.155 The FCA has stated that it will reconsider the issue of disclosure to institutional investors in the future if it has any reason to be concerned about the effectiveness of how the IDWG recommendations play out in the market.

12.156 The IDWG has made recommendations to the FCA,[661] with its full report and templates due to be published in autumn 2018.[662]

12.157 We strongly support the work of the FCA and the IDWG and it is our provisional intention to recommend to the FCA that:

(a) it monitors the extent to which the IDWG template is used; and

(b) it takes steps to encourage whole of market adoption of the template.

[660] https://www.fca.org.uk/firms/institutional-disclosure-working-group
[661] https://www.fca.org.uk/firms/institutional-disclosure-working-group
[662] https://www.fca.org.uk/news/statements/christopher-woolard-statement-welcoming-idwg-recommendations

Remedies we are not taking forward

12.158 We consulted on a number of other potential remedies in our Issues Statement and working papers which we have provisionally decided not to take forward. We set out our reasons for this below in relation to a number of these potential remedies. These include:

(a) preventing investment consultants from offering fiduciary management;

(b) mandatory switching;

(c) the mandatory use of professional trustees;

(d) other information remedies.

12.159 We are not taking forward a large number of the remedies set out in our issues statement and working papers, as they are not relevant to the AECs and underlying features we have now provisionally found. We have limited our discussion below to those remedies which have received significant comment from parties in their submissions or where our remedies have developed from those outlined in working papers.

Preventing IC-FM providers from offering both services

12.160 We have considered whether preventing IC-FM providers from offering both investment consultancy and fiduciary management services would be an effective remedy to address the AECs we provisionally found, particularly in relation to the behaviour of incumbent investment consultants. This type of remedy can be used to create a new source of competition or strengthen an existing source of competition by increasing the quantity of non-vertically integrated firms in the market. For the reasons set out below, we have provisionally decided not to pursue this remedy.

12.161 This remedy would mean that providers would not be able to provide both investment consultancy and fiduciary management services. At the point that trustees were considering moving into fiduciary management, this remedy would have the effect of making trustees find a fiduciary management provider not associated with their existing investment consultancy provider.

12.162 In response to this remedy IC-FM providers may choose to divest one or other of their investment consultancy or fiduciary management businesses, or shut down one of their investment consultancy or fiduciary management businesses.

12.163 We also considered that IC-FM providers could implement an internal structural separation of their investment consultancy and fiduciary management businesses (a ‘firewall’ measure), or guarantee not to provide both investment consultancy and fiduciary management services to the same customer.

12.164 This remedy would be effective in preventing incumbent IC-FM firms from steering trustees towards their in-house fiduciary management services, because they would no longer be able to offer such services.

12.165 However, there are potential benefits for customers in IC-FM firms providing both services, which would be lost under this remedy, for example shared asset manager research costs. We considered that this remedy could have the following adverse consequences, leading to worse outcomes for trustees and scheme members:

(a) IC-FM providers would lose any economies of scale and scope from being active across both lines of business, for example by sharing the asset manager research function. Costs for providers, and prices for customers, could go up as a consequence;

(b) IC-FM firms might close, rather than divest, a line of business which would reduce choice for customers and increase market concentration;

(c) Pension schemes would no longer be able to buy fiduciary management services from a provider of investment consultancy services which already understands their scheme’s needs.

12.166 We note that, in the CMA survey, a minority of trustees (10%) supported the separation of companies providing investment consultancy and fiduciary management services. Support was higher amongst large schemes (18% of trustees), but this still represents a minority of potential customers.[663] IC-FM firms responding to our Issues Statement were largely against a remedy which would prevent them from also offering fiduciary management, although we note that some investment consultants supported this remedy.

12.167 We also doubted whether alternative ways of implementing this remedy, such as internal structural separation or guaranteeing not to provide both investment consultancy and fiduciary management services to the same

[663] Source: CMA survey, question Q6, ‘What, if anything, would you support to mitigate any of the potential conflicts of interest that you consider may be problematic?’.

customer, would be effective, because they would be difficult to monitor (and potentially easy to circumvent).

12.168 We considered the costs of this remedy and thought that:

(a) it would represent a major intervention in the investment consultancy and fiduciary management markets with at least nine IC-FM firms forced to divest or halt activities;

(b) there would be significant costs in implementation because IC-FM providers would incur transaction costs in selling or closing one or other of their investment consultancy or fiduciary management businesses.

12.169 We consider that the mandatory tendering remedy for fiduciary management services, combined with the information remedies, as set out above, would be at least as effective as this remedy, but importantly without the adverse consequences for trustees as set out above. We also consider that these proposed remedies are less intrusive and disruptive than this remedy. Our proposed remedies package is therefore the more proportionate solution to the AEC.

Mandatory switching of fiduciary management provider

12.170 We considered whether requiring firms to switch fiduciary management provider would be an effective remedy in addressing any historic incumbency advantage achieved by IC-FM firms.

12.171 While this remedy would be effective at addressing any historic incumbency advantage it would also potentially worsen competition by reducing the number of firms able to compete for fiduciary management mandates. Depending on its design it would also potentially distort incentives of providers.

12.172 Our provisional view is that a mandatory switching remedy would directly address issues of incumbency but would have potentially significant negative effects on scheme outcomes. Briefly these include:

(a) **Reduction of choice:** trustees would be unable to continue with their existing provider, even if their offer was the best value or most suitable. Furthermore, not only would there be one fewer firm taking part in any tender process, but the competitive pressure of an incumbent on other firms would be lost. Simply put, competition would be significantly reduced.

(b) **Switching costs:** as trustees would be required to switch fiduciary management provider regardless of any tender process, they would incur switching costs which may be high. Such costs would include both transaction costs of selling assets and purchasing new assets but also would give rise to possible disruption and an opportunity cost for the scheme Board in overseeing the transition. We acknowledge that our mandatory tendering remedies could also lead trustees to incur switching costs. However, importantly, in these circumstances, the trustee would be able to evaluate whether or not they would wish to incur these costs, taking into account the benefits available from changing suppliers. By contrast, mandatory switching would require these costs to be incurred in all circumstances, even when there was little to be gained from changing supplier.

(c) **Impact on long-term investment strategies:** if trustees were required to switch and anticipated the potentially high costs of this, then investment strategies might naturally move away from illiquid assets or other assets with high transaction costs. Schemes and members might experience worse investment outcomes as a result.

12.173 We propose instead to introduce remedy 1 which requires trustees to hold a competitive tender process either on appointment or subsequently. This remedy will ensure that all fiduciary management providers will need to compete for a mandate when a scheme first enters into a fiduciary management arrangement.

12.174 We consider that the mandatory tendering remedy for FM providers, combined with the information remedies, as set out above, would be at least as effective as the mandatory switching remedy but importantly without the adverse consequences for trustees as set out above. We also consider that that proposed remedies are less disruptive than the mandatory switching remedy.

12.175 Our proposed recommendation B to TPR will include reference to guidance on the potential benefits of periodic market testing.

Mandatory use of professional trustees

12.176 We have provisionally found that there are low levels of customer engagement, particularly amongst small and DC schemes, and that engagement is greater where a scheme has a professional trustee. In considering how to drive greater engagement we therefore considered the role of professional trustees. A number of parties said that mandatory use of professional trustees would improve scheme governance.

12.177 Some parties were concerned about both the availability of professional trustees to provide services and the burden that mandating their use would place on small schemes.

12.178 We recognised the experience that a professional trustee could bring to a scheme where that trustee had a range of experience with a number of schemes. However, we were conscious that having a professional trustee would result in a scheme incurring costs. We were in particular, concerned that the cost of a professional trustee would have greatest proportionate burden on the smallest schemes. We considered whether only schemes of a certain minimum size should be required to have a professional trustee, but considered that this might reduce the effectiveness of the remedy, particularly as the problems we found are most prominent amongst smaller schemes.

12.179 We note that there are no formal educational, regulatory or membership requirements to act as a professional trustee, and no agreed definition or qualifications. Therefore, anyone making themselves known as a professional trustee regardless of skillset would be able to discharge the requirement. We could not be certain that using a professional trustee would improve scheme governance or member outcomes. We considered this would reduce the confidence we could have in how effective mandating their use would be.

12.180 We further noted that many lay trustees are likely to have comparable skills and experience to professional trustees and a blanket requirement for the use of professional trustees would potentially be disproportionate.

12.181 Our provisional view is that professional trustees could play a significant role in supporting lay trustees. However, we have provisionally decided that their use should be voluntary. We consider enhanced trustee guidance in recommendation B.

Information remedies we are not proposing to introduce

12.182 To enable like-for-like comparisons between firms, some parties have proposed the development of standardised investment consultancy 'track records'. Redington for example submitted that investment track records could provide a useful counterfactual to the investment outcomes that a scheme has achieved.[664] Cardano submitted that investment consultants may object to having performance measured as they are not in full control of

[664] Redington response to the information on fees and quality working paper.

the outcome. However, aggregation across the entire firm should make it valid. A track record is a good way of assessing the investment ability of a provider. [665]

12.183 In our view however, in practice, investment track records are not well suited to an advisory model. As noted by a number of parties, a consultant's advice may be taken with a delay, or not at all, and the scheme sponsor and other advisors can all play an important role in decision making.[666] In general therefore, the performance of any given scheme is not directly attributable to the quality of investment advice provided by the investment consultancy.

12.184 Further, in many cases a consultant may be hired to advise on specific issues that have no direct bearing on overall scheme performance. In these instances, the scheme's overall performance (eg its aggregate return) may not reflect the quality of the particular service provided by the investment consultancy. Relatedly, KPMG submitted that a scheme may have very specific objectives, such as diversifying risk, which are not aimed at increasing overall returns.[667] The investment consultant may add value in helping the trustees to achieve their objectives, but this would likely not be captured in the firm's track record. Importantly, we note that investment consultants are not formally accountable for scheme performance as that duty lies with the scheme trustees.

12.185 We therefore do not propose to introduce any additional information remedies beyond those outlined above.

[665] Cardano hearing summary.
[666] KPMG, LCP, Mercer and WTW responses to the information on fees and quality working paper.
[667] KPMG response to the information on fees and quality working paper.

13. Our remedy package and provisional decision on remedies

13.1 In this chapter we discuss our proposed package of remedies. We set out common design issues and our assessment of how the package addresses the two AECs and resulting customer detriment we have provisionally found. We also set out our provisional decision on remedies.

Scope of our remedies

13.2 Our proposed remedies are designed to address the AECs and resulting customer detriment we have provisionally found. Some of our remedies apply to investment consultants and fiduciary managers as defined in the glossary to this report; and some apply to the trustees of trust-based pension schemes including DB and DC schemes as these are the primary customers of investment consultants and fiduciary managers.

Fit of our remedies with the regulatory framework

13.3 We have considered how our proposed remedies fit with financial and other regulatory requirements on providers.

13.4 In respect of the range of activities conducted by investment consultants and fiduciary managers, we have identified that some elements of our proposed remedies fall within the scope of regulatory requirements under current financial regulation, in particular, MiFID II. That raises two matters on which we invite comments.

13.5 The first matter concerns the mechanism for avoiding overlapping requirements on providers from two sources (that is, a CMA order and existing regulatory requirements), recognising that our proposed remedies need to cover the breadth of investment consultancy and fiduciary management providers.

13.6 To address this point, we propose that there should be a carve out in any CMA order that we make: its effect would be that a requirement imposed by the order would not apply to the extent that it applies pursuant to other regulatory requirements[668] as they exist from time to time[669] (for example, MiFID II and the COBS provisions of the FCA Handbook). Providers that are subject to these regulatory requirements will continue to be bound by them and will not be subject to those parts of the CMA order.

13.7 The second matter is specific to the MiFID II regime and concerns the imposition of any additional requirements on providers that are subject to MiFID II.[670]

13.8 In summary, MiFID II provides that, in exceptional cases, Member States may impose additional requirements in respect of certain matters.[671] Such requirements must be objectively justified and proportionate to address specific risks to investor protection or to market integrity which are of particular importance in the circumstances of the market structure of the Member State in question.[672] Member States must notify, and the European Commission is required to provide its opinion on, the proportionality of, and justification for, any additional requirements that are intended to be imposed.[673]

13.9 Our provisional view is that proposed remedies 4 to 8 cover matters in respect of which additional requirements may be imposed.[674] As those proposed remedies contain additional requirements to MiFID II, they would be subject to notification to the European Commission.

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668 For example, part of our proposed remedy 2 is that IC-FM firms must identify clearly any marketing in the materials provided to existing advisory customers in relation to fiduciary management. A requirement to that effect in any CMA order would not apply to investment firms in respect of their MiFID II business, because they are already subject to such a requirement under Article 24(3) MiFID II Directive.

669 This would mean that as and when requirements in any CMA order are replicated in regulatory requirements introduced by a sector regulator in the future (for example, by way of revisions to the conduct requirements in the FCA Handbook), those parts of the CMA order would no longer apply to firms that are subject to those regulatory requirements.

670 This matter is engaged in the scenario in which, for the purpose of the provision of the services in question, the investment consultant or fiduciary manager treats the pension scheme and its trustees as a retail or professional customer and not as an eligible counterparty (ECP). That is because MiFID II dis-applies certain conduct requirements where firms deal with ECPs in relation to ECP business (for example, the execution of orders on behalf of clients, dealing in own account, and the reception and transmission of orders). That means that in respect of ECPs, it is not possible to re-apply those conduct requirements.

671 For further detail, see Article 24 MiFID II Directive.

672 Article 24(12) MiFID II Directive.

673 A Member State is required to notify the Commission of, and provide justification for, any additional requirement it intends to impose 'without undue delay' and at least two months before the date appointed for that requirement to come into force. The Commission is then required to provide its opinion on the proportionality of, and justification for, that requirement within two months of the notification (Article 24(12) MiFID II Directive).

674 In the description of each proposed remedy in the preceding sections, we have identified where Article 24 MiFID II Directive is engaged.

13.10 As regards the remainder of our proposed remedies, our provisional view is that they do not require notification to the European Commission.[675]

13.11 A further consideration is the fact that some firms are exempt from FCA regulation as a result of being regulated by a designated professional body, such as the Institute and Faculty of Actuaries. (We understand that this is the case for some investment consultancy firms which are also actuarial practices.) We will liaise with the FCA and relevant designated professional bodies to develop our proposed remedies in a suitable framework to ensure that firms are subject to consistent regulation and that there is an even playing field.

13.12 For pension schemes, some of our remedies fit with the existing guidance provided by The Pensions Regulator (TPR) and some would require additions or enhancements to that guidance and/or TPR's codes of practice. We will liaise with TPR to consider how our proposed remedies could best fit with its regulatory remit and functions and we welcome parties' views on this.

Implementation

13.13 As set out above, certain activities conducted by investment consultancy and fiduciary management firms are not subject to FCA regulation. By introducing requirements by order we are able to address the AECs and underlying features of the markets comprehensively and effect change quickly, although we expect that these may become part of sector regulation.[676]

13.14 If the CMA decides to make any order, it must do so within six months of the date of publication of our final report.[677] Any Order will be subject to formal public consultation (within that six-month period).

13.15 As set out in Table 9 below, we propose that nearly all aspects of our order would come into force within 6 months after any order is made.

[675] The part of proposed remedy 2 that would require clarification of which information constitutes marketing goes no further than the equivalent requirement in Article 24(3) MiFID II Directive. The remainder of our proposed remedies do not engage any applicable MiFID II provisions.
[676] Remedies 2 and 4-8 set out above (and to some extent remedy 1) could become FCA conduct requirements subject to its regulatory perimeter being extended and to the permissible imposition of additional requirements to MiFID II.
[677] EA02, Section 138A. The CMA may extend the six-month period only once and by up to a further four months if it considers that there are special reasons why a final order cannot be made within the statutory deadline.

Table 9: Date that remedies will come into force

Remedy	*When provisions come into force (after order is made)*
Promoting greater trustee engagement when buying fiduciary management	
1. **Mandatory competitive tendering on first adoption of fiduciary management**	+ 6 months. No initial fiduciary management mandate will be allowed without a tender process + 2 years. Schemes whose mandate exceeds five years required to hold a competitive tender
2. **Mandatory warnings when selling fiduciary management services**	+ 1 month
3. **Enhanced trustee guidance on competitive tender processes**	Subject to development by TPR
Fiduciary management fees and performance reporting	
4. **Reporting disaggregated fees**	+ 6 months
5. **Minimum fee disclosure requirements**	+ 6 months. Firms to provide new/prospective customers with itemised information on fees (including switching and exit costs).
6. **Standardised methodology and template for reporting past performance**	+ 2 months to establish working group and 6 months to commence use of track record.
Investment consultancy fees and performance reporting	
7. **Trustees to set strategic objectives and firms to report against those objectives**	+ 6 months for all new engagements to agree strategic objectives.
8. **Standards on reporting performance of recommended asset manager products and fund**	+ 6 months for materials referring to performance of recommended asset managers and proprietary/in-house funds to adhere to minimum standards

13.16 While we anticipate that most aspects of our order will come into force after six months, the direct impact on parties' behaviour will vary by remedy. For example: our competitive tender process remedy will lead to historic mandates being subject to a tender process over a five-year period. Given the nature of the different individual remedies on information and fees, the development of standards will vary in complexity. We seek views on both this and the date by which firms should be presenting information in the revised format.

13.17 To avoid circumvention risks and to facilitate parties implementing any order, we intend to include a small number of interim and enabling measures. These measures will either be in anticipation of our principal remedies or act as key milestones for parties to deliver our requirements. We discuss the relevant effective date within each remedy as appropriate.

Sunsetting

13.18 We consider that the FCA is best placed to supervise new conduct requirements on investment consultancy and fiduciary management firms and as may be necessary adapt any requirements in response to market developments. Similarly, TPR is best placed to adapt its guidance in response to market developments.

13.19 In light of the roles of the FCA and TPR (and in particular the FCA, subject to our recommendation on extending the regulatory perimeter), the CMA does not intend to act as a parallel regulator either of firms or pension scheme trustees in the longer term. Therefore, for all of our remedies we propose including sunsetting (ie termination) provisions in any CMA order to remove obligations from firms and trustees in the event a statutory regulator introduces equivalent requirements (see paragraph 13.6 above).

13.20 In addition to this, we would welcome views on whether any remedy should be time-limited, such that, if it had not become incorporated into ongoing FCA or TPR supervision of their respective sectors, then it would cease after, say ten years.

Relevant customer benefits

13.21 We have not identified any relevant customer benefits (RCBs) resulting from the features we have provisionally found.[678] Parties have also not identified

[678] The CMA may have regard to the effect of any remedial action on any RCBs of the feature(s) of the market(s) concerned (EA02, section 134(7)). For these purposes, a benefit is an RCB if: (a) it is a benefit to customers or future customers in the form of lower prices, higher quality or greater choice of goods or services in any market in the UK, or greater innovation in relation to such goods or services; and (b) the CMA believes that the benefit has accrued, or may be expected to accrue within a reasonable period, as a result of the feature(s) concerned and the benefit was or is unlikely to accrue without the feature(s) concerned (EA02, section 134(8)).

any RCBs so far in the investigation. We have not therefore considered RCBs in designing our remedies.

Effectiveness

13.22 This section considers the potential effectiveness of our proposed package of remedies in addressing our provisional AECs

13.23 In reaching our provisional decision on remedies we have sought to address these features individually and collectively. We set out below how our remedies address the features in each AEC and resulting customer detriment we have provisionally found.

Fiduciary management AEC and proposed remedies

13.24 In chapter 11 we set out five features of the AEC we have provisionally found. We now explain how our remedies seek to address these features or the detriment associated from them.

IC-FM firms steer their advisory customers towards their own fiduciary management service.

13.25 Remedy 1 imposes a requirement on trustees to conduct a competitive tender process on first adoption of fiduciary management. This directly addresses the feature by requiring trustees to compare offers from a number of providers. A corresponding prohibition on firms accepting a new fiduciary management mandate where a competitive tender process has not occurred ensures that trustees do not unwittingly adopt fiduciary management having not fulfilled this requirement.

13.26 Remedy 2 provides warnings to trustees on materials given to trustees by IC-FM firms. The warning reminds trustees of their obligations under remedy 1 but also of the business context of any advice or marketing by making it clear that an IC-FM firm provides both advice as an investment consultant but may also be marketing its fiduciary management services.

13.27 Remedy 3 and the associated Recommendation B are intended to provide trustees with materials to support them both in making the decision on whether to adopt fiduciary management but also how to run an effective competitive tender process.

Low levels of customer engagement at the point of first moving into fiduciary management.

13.28 As set out above, Remedy 1 imposes a requirement on trustees to conduct a competitive tender process on first adoption of fiduciary management. This directly addresses the feature by forcing trustees to make an active and informed decision on which fiduciary management provider to appoint.

13.29 For those schemes which have already adopted fiduciary management, Remedy 1 will require a competitive tender process to be held within five years of initial appointment if one has not been held. This remedy makes trustees evaluate whether they could be getting a better deal and gives the opportunity to either switch provider or get a better deal from their existing provider.

13.30 Remedy 3 and the associated Recommendation B both support Remedy 1 and are intended to provide trustees with materials to support them both in identifying relevant factors when choosing between providers but also how to run an effective tender. The cost of designing and running a competitive-tender process may be reduced when appropriate guidance is available. This is reinforced by Remedy 2 which will help signpost trustees to these materials.

Lack of clear and comparable information for customers to assess the value for money of alternative fiduciary managers.

13.31 Remedy 5 requires the information on fees provided by fiduciary managers to prospective customers in a standardised, comparable and more detailed format. Furthermore, the information will include granular breakdowns of proposed fees.

13.32 Remedy 6 will require firms to support the development and implementation of a standardised methodology to report their historic investment performance. This will enable trustees to compare the historic performance of prospective providers on a like-for-like basis which, alongside the improved fee information under Remedy 5, will allow a balanced assessment of value for money to be made.

Lack of clear information for customers to assess the value for money of their existing fiduciary manager.

13.33 Remedy 4 will require fiduciary managers to provide disaggregated fee information to their customers on a regular basis and at least annually. This improved information will enable trustees to monitor both the overall fees paid for their fiduciary management service, and the fees paid for the distinct elements of the service

13.34 If trustees choose to formally review their fiduciary management provider or go to tender for a new provider, an understanding of their current costs will help them drive competition amongst providers in a tender process.

Barriers to switching fiduciary manager.

13.35 The cost of switching fiduciary manager is largely determined by the nature of the investment decisions made by and on behalf of a pension scheme. Some switching costs are driven by a corresponding change in investment strategy rather than as a result of switching provider. Certain asset classes may have higher sale costs or be more time consuming, whereas other switching costs may arise where funds have been invested in a provider's own investment vehicle or fund which cannot be used by another provider.

13.36 Remedy 5 requires firms tendering for fiduciary management mandates to provide an estimate of all potential exit fees that might be incurred if the customer were to switch to that provider. This allows trustees to make an informed choice. Greater transparency will incentivise firms to reduce switching costs where possible, and explain why they are justified if they are unavoidable.

13.37 Remedy 3 and the associated Recommendation B assist in reducing the burden and costs for trustees in conducting a tender process if they do intend to switch provider.

Investment Consultancy AEC and proposed remedies

13.38 In chapter 11 we set out three features of the AEC we have provisionally found. We now explain how our remedies seek to address these features or the detriment associated from them.

Low levels of engagement by some customers.

13.39 Remedy 7 requires trustees to agree a set of strategic objectives for their investment consultants, and for consultants to periodically report their performance against these objectives. This will help them assess their investment consultant's performance.

13.40 Recommendation B will ensure there is guidance to trustees on how to assess their current provider and conduct a competitive tender process.

Lack of clear information for customers to assess the quality of their existing investment consultant.

13.41 We have provisionally found that there is a lack of clear information for customers to assess the quality of their existing investment consultant. In part this is because the impact of advice and specifically strategic advice is not always identifiable and more generally the range of advice can be very broad.

13.42 Remedy 7 addresses this by requiring trustees to set their investment consultants strategic objectives, and for the consultants to periodically report their performance against these objectives. This sets up a framework to allow trustees to better understand what their consultant has achieved according to the nature of their engagement.

13.43 This will be further supported by Recommendation B, which will provide guidance to trustees on how to set objectives.

Lack of clear and comparable information for customers to assess the value for money of alternative investment consultants.

13.44 We have provisionally found that there is a lack of clear and comparable information for customers to assess the value for money of alternative investment consultants and fiduciary managers.

13.45 It is very difficult for customers to assess and compare the quality of the advice they would get from different providers. In particular, the ways used to calculate track records for recommended investment products makes it difficult to interpret and compare the quality of advice across providers. Remedy 8 addresses this by requiring the information provided on the performance of an investment consultant's or fiduciary manager's recommended asset management products and in-house investment products to adhere to a standardised set of rules and principles.[679] This should help trustees compare the effectiveness of the investment consultant's recommendations.

[679] We note that investment firms that are regulated in respect of their MiFID II business are subject to various requirements in respect of information provided to their customers or potential customers. These include, for example, the requirement that information must be fair, clear and not misleading and there are additional requirements when providing information on the past performance of a financial instrument (Article 24 MiFID II Directive and Article 44 MiFID II Delegated Regulation).

Provisional view on effectiveness

13.46 Our provisional view is that our proposed package of remedies addresses the individual features and resulting customer detriment we have provisionally found.

13.47 We are however conscious that the actual impact on addressing the competition problems we have found will in part be affected by a number of factors, most specifically the nature of presentation of information and disclosure remedies. We are therefore keen to receive party views on approaches to designing, testing and measuring the impact of information remedies.

Proportionality

13.48 We are required to consider the proportionality of our proposed package of remedies. Our guidance says that a proportionate remedy or package of remedies is one which (a) is effective in achieving its legitimate aim; (b) is no more onerous than needed to achieve its aim; (c) is the least onerous if there is a choice between several effective measures; and (d) does not produce disadvantages which are disproportionate to the aim.[680] We discuss briefly each aspect in turn.

13.49 We ask for evidence from parties on the anticipated costs of our remedies and will consider this in the detailed design of individual remedies.

Is effective in achieving its legitimate aim

13.50 We set out under each of our 8 remedies how it addresses one of the two AECs we have provisionally found and why it is effective. Our remedies are designed to provide better quality information to trustees and provide support, prompts and hooks to engagement.

13.51 We set out above how our package of remedies in combination works to address the relevant AECs and underlying features.

13.52 As part of that assessment we have explained why we consider our remedies to be effective.

[680] CC3 (Revised), paragraph 344.

Is no more onerous than needed to achieve its aim

13.53 Our approach to ensure that our remedies are proportionate has been to identify the feature or features we wish to remedy and introduce requirements which directly address that feature. In starting with a desired outcome, we have sought to design our remedies without unnecessary complication.

13.54 We set out in detail our consideration of design issues under each remedy but highlight key aspects of our approach where we have sought to reduce cost:

(a) **Remedy 1** – we have considered the phasing of the two aspects of the remedy, and in particular the impact of different periods before trustees with historic mandates will be required to conduct a tender process.

(b) **Remedy 2** – we have considered the feasibility of separating advice and marketing and have proposed what we consider to be an effective remedy while also aiming to reduce burdens on firms.

(c) **Remedies 4 - 8** – we have set out simple, high-level approaches and outcomes to give trustees better information on fees and performance. We have proposed that firms develop these standards. While this may lead to some initial costs to them in the short term we expect it to lead to a better outcome in the long term as firms will be in a better position to ensure that any standards are workable and do not introduce excessive burden to firms in producing the information

13.55 We are keen to receive views on any aspect of design which can be amended to reduce burdens on firms or trustees without reducing effectiveness.

Is the least onerous if there is a choice between several effective measures

13.56 In setting out the remedies we have chosen to pursue, we have identified those which we consider to be effective at remedying the two AECs we have provisionally found.

13.57 In our discussion on remedies we are not pursuing we have included a number of remedies which we consider to be potentially effective but disproportionate.

13.58 In particular, we are proposing a remedy to require mandatory tendering and warnings ahead of the adoption of fiduciary management but are not pursuing either mandatory switching or preventing IC-FM firms from offering both services as we consider these to have significant monetary and non-monetary costs to firms and pension schemes.

Does not produce disadvantages which are disproportionate to the aim

13.59 In reaching our provisional decision we have considered the risk of unintended consequences from our remedies.

13.60 We have not identified any significant possible unintended consequences in relation to Remedy 1 and 2 as they are currently drafted.

13.61 In relation to our information remedies, remedies 4-8, we have sought to make the requirements relevant to addressing the lack of clear information for customers to assess the quality of their existing investment consultant or fiduciary manager, as well as the value for money of alternative investment consultants or fiduciary managers. We were particularly concerned that the nature and variety of ways used by firms to calculate fees and track records made it hard for customers and potential customers to compare quality and fees across providers. We have sought to address these issues by suggesting fees disaggregation, standardised reporting of fees and performance and reporting against specified strategic objectives.

13.62 For our mandatory tendering remedy 1, we have sought to make the requirements relevant to addressing low levels of engagement.

The cost of our package of remedies

13.63 We have not, at this stage, estimated the monetary costs of our proposed remedies. However, we do not expect them to have significant monetary costs, either in relation to ongoing investment costs incurred by pension schemes, the revenue earned by investment consultants and fiduciary managers or the scale of detriment we have identified. We expect the majority of costs to be borne by investment consultant and fiduciary management providers. We are keen to hear views on the likely complexity of these remedies.

13.64 As a result of mandatory tendering for fiduciary management services, some fiduciary management firms may incur increased costs of participating in tenders which would not have otherwise occurred. However, no firm is obliged to take part in more competitive tenders than it does now. Our remedies only require pension schemes to conduct one competitive tender process when first adopting fiduciary management.

13.65 We recognise that in relation to mandatory competitive tendering, some costs will fall on the pension scheme or its sponsor. These will be one-off. They would be likely to include:

(a) The monetary (where trustees are remunerated) and opportunity cost of trustee time in designing, running or overseeing a competitive tender process.

(b) Scheme sponsor, where its staff assist in the administration of a tender process or the evaluation of bids.

(c) Any professional fees and charges incurred in designing and running a competitive tender process.

13.66 Specifically, in relation to our information and performance remedies we have identified that there will be costs to fiduciary management firms of the staff time of those involved in developing the standards through the implementation group.

13.67 There may be some additional costs associated with compliance reporting but we consider that these are likely to be low.

13.68 In chapter 11 we note the current level of potential detriment in this market and note that in terms of the total detriment from higher prices, by way of illustration, even if fees are on average only 10% above those in a well-functioning market, this would in aggregate lead to investment consultancy customers paying around £250 million and fiduciary management customers paying around £200 million more over ten years.[681] It is our provisional view that the likely cost of our remedies will be of a much smaller magnitude.

13.69 We are keen to hear parties' views on the likely costs for each remedy as well as the package of remedies as a whole, for both initial implementation and ongoing use. We invite parties to comment on whether specific aspects of our remedies or our proposed approach to monitoring could be developed or amended to reduce cost without reducing effectiveness.

Provisional decision on remedies

13.70 Our provisional decision is to propose a package of remedies to address the AECs and resulting customer detriment we have provisionally found.

[681] Based on the lower bound estimates of the total revenues of each market, multiplied by 10% to represent the price increase, and then multiplied by 10 to represent the aggregation over ten years.

13.71 In respect of fiduciary management, we propose two groups of remedies by order which are set out in Box 1.

13.72 The first group will require and support trustees and schemes to engage with the market, either at the point of first appointment or subsequently for those schemes already purchasing fiduciary management.

13.73 The second group will provide better information to support trustees in understanding the service they currently receive or can expect to receive and the price they pay.

Box 1: Our proposed remedies in respect of fiduciary management

Remedies to be imposed by CMA order

- **Engagement remedies**
  - Mandatory competitive tendering on first adoption of fiduciary management (Remedy 1).
  - Mandatory warnings when selling fiduciary management (Remedy 2).
- **Information and performance remedies**
  - Requirement to report disaggregated fiduciary management fees to existing customers (Remedy 4).
  - Minimum requirements for fiduciary management fee disclosures for prospective clients (Remedy 5).
  - Standardised methodology and template to report fiduciary management past performance (Remedy 6).
  - Basic standards for reporting performance of recommended asset management 'products' and 'funds'. (Remedy 8).

13.74 In respect of investment consultancy, we propose two remedies to improve the quality of information provided by firms. These will also be implemented by CMA order.

Box 2: Our proposed remedies in respect of investment consultancy

Remedies to be imposed by CMA order

- **Information and performance remedies**

- Trustees to set strategic objectives and firms to periodically report against them (Remedy 7).
- Basic standards for reporting performance of recommended asset management 'products' and 'funds'. (Remedy 8).

13.75 To support the implementation and effectiveness of our remedies package, we propose to make recommendations to government, TPR and the FCA respectively. These are set out in Box 3.

Box 3: Supporting recommendations we intend to make

Recommendations to government and regulators

- Government to expand FCA regulatory perimeter
- TPR to develop enhanced guidance for trustees.
- FCA to ensure improved information on underlying asset manager fees and performance.

Views on our proposed package of remedies

13.76 We welcome views on any aspect of the design, effectiveness or proportionality of our proposed package of remedies.

13.77 We have included specific questions with our discussion of each proposed remedy. In addition, with regard to the package as a whole, we welcome views on the following points.

Box 4 Consultation questions on our remedy package

In addition to the questions we have asked on the individual proposed remedies set out above, we are particularly keen to hear parties' views on the following:

- Is our package of remedies effective and proportionate in addressing the AECs and resulting customer detriment?
- How should we define the scope of our remedies?

- What are the expected costs to schemes and firms of implementing our remedies and reporting compliance?
- Are any transition provisions needed?
- How should compliance with remedies be demonstrated and how should they be supervised by the relevant regulators?
- Should any remedies be time-limited?
- Are there any relevant considerations in relation to remedies which would impose additional requirements to those in existing regulatory provisions (FCA conduct rules and MiFID II)?
- Are there any relevant customer benefits in either market that we should consider as part of our assessment of a remedy package?