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CMA Investment Consultants Market Investigation: Provisional Decision Report
Response from Dr. Anna Tilba

CMA's investigation and the Provisional Decision Report is a fundamental step towards greater transparency and accountability within investment consultancy and fiduciary management services market. It is a long awaited formal and in-depth review and analysis of the IC and FD market by the organisation with powers to develop remedies and impose legal statutes, and in so doing helping to make the market more accountable, competitive and fair.

Consistent with the FCA Asset Management Market Study¹ it finds that in the investment consultancy market, there is a low level of engagement by some customers in choosing and monitoring their provider. This is to the material detriment of the IC and FD services customer.

I strongly endorse CMA's recommendations that:

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

This is a particularly significant recommendation that reflects earlier concerns of the Law Commission in their Consultation and the Final Report on Fiduciary Duties of Investment Intermediaries² about the lack of accountability of investment consultants for the investment advice they provide to the pension fund trustees. When answering the question of whether investment consultants should be regulated several consultees told the Law Commission that the lack of regulation for generic advice that the investment consultants give was anomalous.

In that list of responses³ I have specifically highlighted that:

¹ Financial Conduct Authority Asset Management Market Study Interim Report
<https://www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf>

² Law Commission's Report on Fiduciary Duties of Investment Intermediaries. 1st July 2014
http://www.lawcom.gov.uk/app/uploads/2015/03/lc350_fiduciary_duties.pdf ; Law Commission's Consultation Paper No 215: Fiduciary Duties of Investment Intermediaries
http://www.lawcom.gov.uk/app/uploads/2015/03/cp215_fiduciary_duties.pdf

³ Law Commission Fiduciary Duty Consultation List of Responses:
http://www.lawcom.gov.uk/app/uploads/2015/03/cp215_fiduciary_duties_responses.pdf

'Of particular concern here is the fact that investment consultants appear not to fall within the FCA regulatory regime because they are considered to be giving only 'generic advice'. This is problematic, in that in practice consultants are applying qualitative factors (such as a trustee's investment beliefs and the governance considerations of individual pension fund clients) to come up with a recommended strategy. The crucial 'selling point' of consultants' advice stems from their ability and skills to tailor the recommendations accounting for the specific and 'unique' needs of individual clients. This does not represent 'generic advice'. It appears that while investment experts are powerful, they bear little responsibility for the outcomes of the services they provide to trustees'.

I have also argued that the vacuum of accountability and legal responsibility in the investment consultancy market is further exacerbated by investment consultants' practice of presenting 'alternative scenarios' or 'options', thereby allowing trustees to make the final decision. However, the big problem here is that in the eyes of trustees the consultant's advice is mostly perceived as 'endorsement'.

The Law Commissions' Report concluded by saying that 'the lack of regulation of investment consultants does appear anomalous, and [they] would ask that the Government actively monitor this area'.

In light of past concerns, including the FCA's Report, it is crucial that the investment consultants are made accountable for the investment advice they give and also for the value they actually deliver. This should be done by Government extending the FCA's regulatory perimeter to include the relevant services provided by investment consultancy and fiduciary management firms. This is particularly pertinent in the presence of the CMA's evidence that the three largest investment consultancy firms have increased their share of the fiduciary management market by 40 percentage points since 2007 and they have strategies to grow in future.

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

This is another very important recommendation. Notwithstanding, I would argue that one of the key issue which hasn't been addressed in the CMA's remedies is the technical competence and the current governance arrangements of both DB and DC pension schemes.

Lack of Attention to Pension Fund Governance Arrangements

The CMA Report has revealed low levels of engagement by trustees where 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. For example, according to the TPR research, across all schemes, pension trustees spend 11 days a year on average on their duties. Amongst DC schemes, just 62% of boards meet at least every 6 months. Around half (49%) of DC scheme trustees spend less than 5 days a year on trustee duties. Amongst small schemes, 62% of boards meet at least every 6 months, and on average trustees spend 9 days a year on their duties.

There is also limited evidence of the amount of time that trustee boards spend addressing investment issues. Aon's research indicates that up to a quarter of time at board meetings is typically spent on 'investment matters. Furthermore, there is evidence from third party research that many trustees only rarely challenge the advice of their advisors (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).

My own research⁴ into pension fund governance and trustee investment decision making confirms this lack of trustee engagement and lack of challenging of the investment consultants. The lack of engagement is particularly worrying as the CMA Report's evidence indicates that 'less engaged schemes in investment consultancy pay higher prices than more engaged schemes'. Furthermore, in the context of the move away from the Defined Benefit to the Defined Contribution arrangements, the lack of trustee engagement within the DC arrangement is particularly worrying.

However, the CMA Report does not highlight the need for better pension fund governance, which would enable trustees to operationalise the CMA's remedies. It is unclear how can greater trustee engagement be achieved if the average time they spend in meetings is around 5 days a year. I would argue that there needs to be a recommendation of extending trustees time (governance remit) to encompass these changes. There is a need to improve the existing pension fund governance structures to accommodate these changes.

Lack of Attention to Behavioural Biases within Trustee Decision-Making

In the presence of the amounting evidence of investment consultant's ability to generate the kind of value for money that they are promising to trustees (but unfortunately often not fulfilling), what is surprising is that many trustees are broadly unaware of this. It is alarming to read that in the presence of a lack of trustee engagement with monitoring IC and FM performance, there is a 94% customer satisfaction rate with the investment consultancy services. At the same time, only 24% of trustees found it very easy to monitor investment fees paid to third parties.

These contradicting findings indicate the presence of behavioural biases within trustee boards. This is something that Tilba, et al. (2017) have highlighted in the FCA study. Namely, trustees are unable to judge what 'good value' looks like so they are biased to assume that their IC is providing good service. CMA's evidence of behavioural 'nudges' biases in steering clients towards Fiduciary management also supports this assumption and highlights the need to create more awareness about behavioural biases within trustee boards.

My own experiences of consulting pension funds trustees about behavioural biases suggests that there is a need to create more awareness of these issues as well as what information would trustees need to ask of their IC and FM. This is another area that the Pension Regulator should be looking at alongside developing 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.

I fully support this recommendation and suggest that similar templates should be developed for the fees and performance reporting by the IC and FM service providers.

⁴ Tilba, Anna & Wilson, John F. (2017). Vocabularies of Motive and Temporal Perspectives: Examples of Pension Fund Engagement and Disengagement. *British Journal of Management* 28(3): 502-518. <http://dro.dur.ac.uk/25868/>
Tilba, A., Baddeley, M. & Yixi, L. (2016). FCA Asset Management Market Study: Research Report on the Effectiveness of Oversight Committees: Decision-Making, Governance, Costs and Charges. London, Financial Conduct Authority. <https://www.fca.org.uk/publication/research/tilba-baddeley-liao.pdf>
Law Commission's Consultation Paper No 215: Fiduciary Duties of Investment Intermediaries http://www.lawcom.gov.uk/app/uploads/2015/03/cp215_fiduciary_duties.pdf Pages 7, 17, 38, 40, 41, 44, 53, 144, 193, 194
Tilba, A. & McNulty, T. (2013). Engaged versus Disengaged Ownership: The Case of Pension Funds in the UK.. *Corporate Governance: An International Review* 21(2): 165-182. <http://dro.dur.ac.uk/25869/>

Select Responses to Additional Questions:

Box 1: Consultation questions for mandatory tendering on first appointment

- Should trustees be required to hold a competitive tender process when first choosing fiduciary management? **YES.**
- Should the tender process be open? **IT DEPENDS. AN OPEN PROCESS COULD SIGNIFICANTLY INCREASE THE AMOUNT OF PAPER WORK/ TIME AND COMPLICATE THE PROCESS.** 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 trustees be required to hold an additional tender process for any expansion in the scope of fiduciary management? **YES OR AT LEAST SOME DUE DILIGENCE WHEN DOING SO.**
- How should trustee compliance be monitored? **INDEPENDENT COMPLIANCE COMMITTEE(?)**

Box 3: Consultation questions for warnings when selling fiduciary management

- Should this remedy apply only to IC-FM firms, or to other investment consultancy and fiduciary management providers? **SHOULD APPLY TO ALL**
- What should the structure and form of the warning be? Should there be any separation of content? **A GOOD EXAMPLE OF A WARNING WAS PROVIDED IN THE REPORT.**
- Should there be any requirement to give a warning on oral advice and marketing? **YES, BUT HOW WOULD THAT BE MONITORED/ENFORCED.**
- 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? Are any additional safeguards necessary? **THE DESCRIPTION NEEDS TO BE CLEAR ABOUT WHAT IS BEING ADVERTISED AND/OR RECOMMENDED.**

Box 4: Consultation questions for fiduciary managers reporting disaggregated fees to existing customers

- Should fiduciary management firms be required to provide disaggregated fee information and how should they do this? **YES, USING SIMILAR TEMPLATES THAT THE IDWG HAS BEEN WORKING ON.**
- Should asset manager fee information be based on the IDWG templates? **YES.**
- What should the frequency of reporting such fee information to customers be? **ANNUALLY**

Box 6: Design questions for fiduciary management performance reporting

- Should there be a fiduciary management performance standard? **YES**
- Who would be best placed to develop and implement a fiduciary management performance standard? **THERE NEEDS TO BE SOME CONTINUITY OF EXPERIENCE FROM THE IDWG AND SOME NEW EXPERTS IN FIDUCIARY MANAGEMENT**
- How do you envisage the implementation group working: how should it be funded, who should be part of it, etc? **CONSULT WITH THE IDWG**
- What backstop would be appropriate in the event that the group is unable to agree on the standard in the required period? **FCA/TPR**

Box 7: Consultation questions for setting strategic objectives for investment consultants

- Should pension trustees be responsible for setting objectives for their investment consultant? **YES, BUT GIVEN THE LACK OF TRUSTEE INVESTMENT EXPERTISE, HOW WILL TRUSTEES BE ABLE TO DO IT EFFECTIVELY?**
- Is review and agreement of objectives every three years a suitable timeframe? **INVESTMENT FUND MANAGER PERFORMANCE IS ASSESSED ON A QUARTERLY BASIS, WHEREAS INVESTMENT CONSULTANTS PERFORMANCE IS RARELY ASSESSED OR**

DURING THE TRIENNIAL CYCLE. THIS IS DISPROPORTIONATE. IC PERFORMANCE SHOULD AT LEAST BE ASSESSED ONE A YEAR.

- Should there be a minimum threshold based on pension scheme size or the scale of the consultancy contract? **YES**
- When do you consider that the formal review of an investment consultant against the scheme's strategic objectives should take place? **AT THE START OF THE IC MANDATE AND THEN ANNUALLY (UNLESS SOMETHING GOES SIGNIFICANTLY WRONG IN THE PENSION SCHEME'S FINANCES).**

Box 9: Consultation questions on extension of the regulatory perimeter

- Should the FCA regulatory perimeter be extended and what activities should be included? **YES, THE FCA SHOULD EXTEND REGULATORY PERIMETER TO INCLUDE INVESTMENT CONSULTANCY SERVICES, PARTICULARLY AROUND THE KEY AREAS OF ASSET ALLOCATION, INVESTMENT FUND MANAGER SELECTION AND FIDUCIARY MANAGEMENT.**

B• Would trustees benefit from enhanced guidance? YES

- What should the scope of any guidance include? **TPR TO DEVELOP ENHANCED GUIDANCE FOR TRUSTEES PLUS SEE MY COMMENTS ABOUT TRUSTEE GOVERNANCE ARRANGEMENTS ABOVE.**
- How detailed should guidance be and what form should it take? **SEE MY COMMENTS ABOUT TRUSTEE GOVERNANCE ARRANGEMENTS ABOVE.**