KPMG LLP
15 Canada Square
London E14 5GL
United Kingdom
Tel +44 (0) 20 7311 1000

Mr Peter Swan
Markets and Mergers Group
Competition and Markets Authority
Victoria House
37 Southampton Row
London
WC1B 4AD

20 August 2018

Dear Peter

Investment consultants market investigation

KPMG Response to CMA Provisional Decision Report

Please find enclosed the response submitted on behalf of KPMG LLP to the CMA's Provisional Decision Report dated 18 July 2018.

Yours sincerely

KPMG LLP

Enclosures: *KPMG response to Provisional Decision Report*

KPMG

KPMG LLP
20 August 2018

KPMG response to Provisional Decision Report

Thank you for affording us the opportunity to comment on the CMA's provisional decision report (the "**Report**"), published on 18 July 2018, which outlines your provisional findings with regards to markets for investment consulting and fiduciary management services. We have supported the CMA throughout its investigation, and look forward to cooperating with the CMA as it finalises its views on the extent to which there are adverse effects on competition (AECs) in these markets and, if so, suitable remedies.

In our response to the Report, we place most focus on the investment consultancy ("**IC**") findings rather than the fiduciary management ("**FM**") findings, given that KPMG does not provide FM services.[1] Some of our broader comments may nevertheless apply to the FM findings, and where we feel it is appropriate we do provide comments on the FM remedies.

Our comments on the Report are noted below.

Overall comments in relation to IC

1 We are pleased that the CMA recognises several aspects of the market for IC services are working well. For example, the CMA has found that:

- Trustees are satisfied with the services provided, providers can achieve greater discounts for them, and asset allocation advice is tailored to clients.[2]
- There are no conflicts of interest issues in the market.[3]
- Barriers to entry in IC are not high.[4]
- The IC market is not concentrated, and has been growing in recent years.[5]
- 94% of investment consultancy customers are satisfied with their provider, with the statistics indicating that trustees consider that they are receiving positive outcomes.[6]

2 The CMA has however provisionally identified an Adverse Effect on Competition ("**AEC**") in the market for IC services. The AEC finding is justified by reference to certain features that the CMA has provisionally concluded are evident in IC services:

- Substantial variation in the ability of trustees to monitor and assess their IC providers, and a lack of engagement by some trustees;[7]
- A spectrum of approaches on the provision of information for trustees to assess the quality of their existing investment consultant, with some investment consultants providing clearer information than others; [8]

[1] We do, however, provide FM advisory services, including supporting clients in selecting FM providers and providing ongoing monitoring services.
[2] Report, paragraph 48
[3] Report, paragraph 43-45
[4] Report, paragraph 21
[5] Report, paragraph 16-19
[6] Report, paragraph 10.95
[7] Report, paragraph 31
[8] Report, paragraph 25-26 and 5.40 – 5.42

- Similarly, a lack of consistency in the information provided to trustees to assess the value for money they would receive from potential investment consultants were they to start using IC services or switch ICs.

3 Given the provisional AEC finding for these market features, the CMA is considering two remedies which will affect IC, one specific to IC only and one shared with FM.

4 As noted throughout our submissions and during our hearing, KPMG is supportive of any proportionate measure(s) that is brought in as part of this market investigation that further increases professionalism in the industry and leads to even better outcomes for the £1.6tn of pensions held by the UK population. In fact, the remedies proposed in respect of IC services are ones that we already proactively seek to implement. As a result, in this case we do not object to the introduction of the two remedies affecting IC set out by the CMA, and discuss them in more detail below.

5 However, although we do not object to these specific remedies, we do not agree with all of the decision making behind the CMA's preliminary finding of an AEC in the market for the provision of IC services, which in turn underpins the justification for these remedies.[9] As noted above, the CMA's provisional findings, which include an adverse effect on competition stemming from a weak demand side, do not correlate with our experience of interaction with trustees. We also note the exceptionally high proportion (94%) of trustees whom the CMA found to be satisfied with their IC provider.

6 Our experience is that engagement overall in the IC market is very high, and trustees overall are well informed. As ICs, our advice does in fact come under significant challenge from multiple stakeholders: trustees, other advisers, the sponsor and the sponsor's advisers. With this support, we consider that trustees are already well placed to assess and identify the best value for money.[10]

7 We consider that clients currently have easy access to information on fees, though we agree more could be done to enable clients to *assess* the information they get access to. [11]

8 However, while work can be done to improve the ability of customers to assess the information received, we do not believe that at present this feature of the market has any material effect on the strength of competition between IC providers during tender processes nor day to day business.

9 We would therefore not agree that there is an AEC in respect of IC services that in principle justifies the imposition of remedies. Nevertheless, as mentioned above, in this case we do not object to the introduction of the remedies (and in fact KPMG already proactively acts in a way that is envisaged by the remedies).

Comments on the CMA's proposed remedies

10 In this section, we provide our comments on the CMA's remedies and supporting recommendations. We first discuss the IC remedies (i.e. remedies 7 – 8), before providing views, where applicable, on the FM remedies (i.e. remedies 1 – 6) and the supporting recommendations. Our responses to the consultation questions on the CMA's remedy package are included within these responses.

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[9] More generally, we continue to have significant concerns with elements of the CMA's analysis, including its econometric work, which we do not consider to be robust.
[10] See KPMG's Response to Trustee Engagement WP.
[11] See KPMG's Response to Information on fees and quality WP.

11 The CMA will need to ensure that these remedies are effective and proportionate, which will include an assessment of the detriment arising from any AEC it will identify in its final report.

12 We look forward to supporting the CMA in the design, implementation or testing of these remedies, which may for example need to be built on an understanding of the existing practice of behavioural remedies in the financial services industry.

IC remedies

Remedy 7 - Trustees to set strategic objectives and firms to periodically report against them

13 As noted above, we do not object to any remedy that further increases professionalism in the industry and this remedy echoes the sentiment coming from the regulator already. As a critical part of the investment strategy process we already set clear strategic objectives with trustees and update these periodically. More generally, we also believe that the industry is increasingly setting objectives with trustees when providing IC advice. As we note below in relation to Remedy 8, we consider that performance against stated objectives is the best measure of outcomes to clients. We do not object to the CMA's proposed remedy in this case. In this section, we discuss overarching points for consideration, our views on remedy design, and our views on its implementation.

Overarching points

14 It is important to consider the relationship ICs have with trustees, and how that may be affected by the setting of objectives. In our experience, the objectives trustees set in collaboration with the providers of IC services at the onset of an engagement largely dictate the future investment decisions. Therefore, not setting objectives or focusing on the wrong outcomes when setting objectives may negatively affect subsequent investment decisions as well.

15 However, it is important to draw a distinction between performance against the stated investment objectives and quality of the advice provided by an IC firm. First of all, scheme performance may fall short of the trustees' stated objectives due to unforeseen circumstances or market shocks. Secondly, it is not necessarily true that trustees will follow the advice provided by consultants, and therefore the position of the scheme – and its performance - may not reflect the advice given by the IC and is therefore not necessarily a marker of how good the advice was.

16 Given the above, the *design* and *implementation* of the remedy will be important to ensure that no unintended consequences arise. We turn to these next.

Remedy design

17 We think that objectives can be set across two measures: scheme performance and IC performance:

- We consider that a relevant measure of scheme performance would be one which compares the scheme's investment position under the IC provider's advice to the position the scheme would have had under an alternative scenario, such as the scheme's previous strategy. This analysis could be conducted by the IC.[12]

[12] A small number of our clients who have been on performance related fees have chosen this as one of the metrics they have looked at in assessing KPMG's performance.

- IC performance would be measured by some qualitative measures of how well the providers have performed in terms of trustees' expectations, for example in terms of pro-activeness and quality of advice, and the quality of the research provided (which is subjective). We do not consider that cost (for example, effective fees against budget) should be considered as a metric, as this may distort incentives for the IC and the trustees.

Remedy implementation

18 In terms of implementing the remedy, we consider that:

- For the measure of scheme performance against strategic objectives, the CMA's proposed three year time span would be adequate. For the more qualitative measure of IC performance, more frequent reporting, such as annually, may be more appropriate.
- There should not be any *de minimis* exclusion based on size of the scheme. We consider that a degree of self-selection exists, in that very small schemes will often not use IC services. For all those that do, then objectives should be set and reported upon.
- The duty of setting targets would be on the trustees – with the advice and support of IC advisors.
- TPR would be best suited to monitor compliance with this remedy. It fits within their increased focus on ensuring integrated risk management.[13]
- The remedy should be made by way of a CMA order, with guidance from TPR on "best practice" for setting objectives as a useful complement.

Remedy 8 - Basic standard for reporting performance of recommended asset management 'products' and 'funds'

19 We do not object to this remedy insofar as it helps to provide even clearer information to customers.[14] However, we do hold some concerns that while reporting performance may be attractive insofar as it's quantifiable, placing undue focus on reporting alone could lead to adverse outcomes for trustees. Within this section, we discuss our overarching points for consideration in relation to this remedy, our views on its design, and our views on its implementation.

Overarching points

20 We support the remedy as we consider that where information on performance is presented it would be helpful for trustees for this to be presented in a clear and comparable way.

21 However, whilst we agree that there needs to be standards when such information is presented, we do not consider that it would be proportionate for the CMA to mandate the provision of this type of information on past performance.

22 In our view, more holistic measures of performance, such as whether stated objectives were met, are more informative for IC services than a particular return on an asset class. This is because, while the impact of manager selection can be meaningful, it is not as important as strategic decisions, such as which asset classes to invest in, or how much to hedge liabilities. Track record is likely to be of more relevance for FM

[13] I.e., holistic oversight of covenants, funding and investment strategy.
[14] We would note however, as indicated in the CMA's own survey, that 94% of respondents considered that it is very or fairly easy to monitor the investment performance of their scheme.

than IC, as FM portfolios are typically more complex and have greater reliance on active managers.

Remedy design

23 In relation to how the remedy should be designed:

- We would caution the CMA against pursuing excessive standardisation or mandating the provision of reports. As noted in our response to the "Information on Fees and Quality" Working Paper, some trustees decide not to receive certain reporting to limit costs, and mandating these reports may therefore result in additional costs that the trustee would not otherwise be willing to incur. In our experience, preparing reports is often less informative than providing real time information on the status of the investment to trustees in the course of regular update meetings. The CMA should take this into account when designing this remedy.
- We agree with the CMA that the results should be presented net of fees.
- We do not consider that comparisons against other schemes would be appropriate, as the correct performance metric is the trend in assets vs liabilities for the fund.
- We consider that these results (and any associated risk metrics) should be presented along a reasonably long time frame, such as several quarters[15] or years.
- We consider that reported results should be audited and/or verified by a third party. There is the potential for the date of a rating change (within a quarter, for example) to be selected to flatter performance. Adding an independent, third party audit would provide additional comfort to trustees.

Remedy implementation

In relation to how the remedy should be implemented:

- We would propose that, once the industry has agreed the standards, firms should have one year to implement this remedy
- We would not propose that there are any exclusions to this remedy (e.g. for very small schemes).
- We believe that monitoring of this remedy is more suited to the FCA's remit.

FM remedies

24 The CMA has outlined a series of remedies specific to FM providers. While we do not provide FM services, we do provide some advisory services in relation to FM, including as third-party evaluators ("**TPEs**"). Where we consider it appropriate, we provide views on some of the FM specific remedies below.

Remedy 1a and 1b - Mandatory competitive tendering of fiduciary management and Remedy 3 - Enhanced trustee guidance on competitive tender processes

25 It is important when undergoing a tender process that trustees are aware of all options available to them, how different FM providers may be better suited to their objectives,

[15] Quarterly reporting can be useful, however the actual assessment of strategic decisions should be made over a longer period.

and the different costs and benefits associated to each FM provider. This knowledge is required to ensure that tendering processes lead to the best outcomes for trustees.

26 Given this, in our view, TPEs should play a role in helping trustees choose FM providers through tendering processes. In our experience, TPEs:

- Often have better visibility of the wider FM landscape than trustees.
- Can help trustees evaluate the full spectrum of possible providers.
- Provide an understanding to trustees of the fees both for the FM scheme, and for the underlying asset managers.

27 We have helped a number of clients through formal tender processes for FM services. In our experience, involvement of a TPE can lead to trustees considering a provider different from the one they would have otherwise used. A TPE is also able to provide valuable input to the terms of appointment (including fees and the range/nature of permissible investments). These can all lead to a better outcome for the trustees.

28 In short, the use of a TPE during a tender process is likely to help trustees better access, assess, and act on information in relation to FM providers.

29 Additionally, we think the regulators should play a role in this process. We consider that disclosure of the appointment process by the Chair of the Trustees to the TPR would provide an incentive to maintain a rigorous selection process.

30 In addition to tender processes, we consider that it would be useful for the CMA to encourage the use of TPEs in the ongoing monitoring of the trustees' FM provider. Based on our experience in working on these mandates in a TPE capacity, it is possible to provide better outcomes to clients. For example, our work has:

- Helped break down and clarify the true value being added by the FM provider (after the impact of the trustees' strategic decisions, fund manager's and FM provider's costs).
- Helped trustees decide on increasing the range of in-house funds (including the impact on liquidity, costs and alternative open market options).
- Provided trustees with understanding as to whether the combined return from a suite of active managers in an asset class was outperforming the index (net of costs).
- Ensured key items such as journey plans and insurance options are included in the FM's strategic planning.
- Ensured key changes to the FM's personnel and processes are communicated and understood by trustees.

31 To effectively support their clients, we consider that TPEs should be able to demonstrate at a minimum:

- The ability to provide independent advice, free of conflicts of interest.
- Expert knowledge of the FM market, providers and underlying funds.
- Appreciation of the nature of FM as a solution relating to the governance of an investment.
- The tailoring of advice to a client's circumstances.

32 We would welcome the opportunity to discuss this further with you in more detail, if required.

Remedy 5 - Minimum requirements for fees disclosures for prospective clients

33 We consider that, in addition to the cost of exit fees, it may be helpful to include an indication of the time it may take to exit. For example, if the proposal involves moving part of the scheme into illiquid assets, it may take significant time to unwind and exit the product.

Remedy 6 - Standardised methodology and template to report past performance

34 As the CMA notes in the Report,[16] a third-party evaluator, IC Select, has developed a reporting standard for fiduciary management track records which appears to have the support of several providers. This will be incorporated into the CFA Institute's Global Investment Performance Standard by January 2020.

35 We consider that IC Select already represents a standardised methodology and template to report past performance. As far as we are aware, the primary difference between IC Select and the CMA's proposal is that at present IC Select is a proprietary source, only available selectively, whereas the CMA's proposal would be for past performance to be more publicly available.

36 We therefore think the CMA could consider whether it would be more efficient to utilise the IC Select framework and make that public as opposed to develop a second, potentially duplicative framework.

Supporting recommendations

37 In relation to the CMA's recommendations, we are strongly supportive of recommendation A, which looks to increase the FCA's regulatory perimeter. As noted at our hearing, we believe the FCA's remit should capture all services provided by ICs. This may mean IC providers need to retrain staff for FCA accreditation. We do not consider that should be seen as a cost, but a right to provide IC services.

38 Our comments in relation to recommendations B and C are covered in the broader commentary above.

[16] Report, paragraph 12.97.