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21 August 2018

Dear Peter

RESPONSE TO PROVISIONAL DECISION REPORT DATED 18 JULY 2018 IN RELATION TO THE CMA'S MARKET INVESTIGATION INTO INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT SERVICES

We have carefully considered the CMA's provisional decision report of 18 July 2018 and I attach a memorandum with our comments on proposed remedies 1 and 6.

We welcome the CMA's focus on transparency. When we offer fiduciary management services we strive to be clear with our clients on the scope of our role, the fees they are charged and the costs they bear and the way in which our performance can be assessed. We compete every day to attract clients and investors and we are focused on delivering the best outcomes for them.

We understand fiduciary management services to mean the combination of the provision of investment advice and the implementation of that advice. We believe that a clear definition of fiduciary management services is critical to the application scope of the proposed remedies.

Cost of fiduciary management services

We support any proposed measures that result in clients being fully aware of the total cost of their investment arrangements and exactly what services are included. As well as understanding the total cost, they should know how the total amount is broken down into its component parts. We believe that understanding the component parts of the value chain is not only important for fiduciary management clients but for all stakeholders in the industry including trustees who do not engage a fiduciary manager (**FM**).

In our response dated 10 May 2018 to the "Competitive Landscape" working paper of 26 April 2018, we suggested, in completing its review of market concentration, that the CMA look through the layers of fees that a FM could charge in order to fully isolate the fiduciary management fee component. This will allow the CMA to specifically review FM revenues across all different types of fiduciary management providers

and therefore review FM concentration on a comparable basis. We pointed to the EY's 2017 fiduciary management fees survey and their working definition of fiduciary management fees:

"*This represents the fee paid directly to the fiduciary manager for strategic advice; including modelling and setting the investment strategy, and implementation of the investment strategy; including manager selection, tactical asset allocation and implementing hedges*."

For those FMs who make extensive use of external managers, their total revenue may include fees that are passed on to these underlying external investment managers, which means that their revenue is overstated for the services they provide as a FM. Those fees to underlying investment managers should be excluded. Similarly, for those FMs who manage a client's assets internally, the costs of doing so should be excluded in order to allow proper comparison. By doing this, this may provide a different picture of the revenues retained by different types of fiduciary management providers within the market and therefore the levels of market concentration that the CMA has found. The EY 2017 fiduciary management fees survey found for example that the median fee for fiduciary management services for a £250m pension scheme was 0.2% per annum.

By isolating the fiduciary management fee, we believe the CMA will also find that fiduciary management services are not significantly more expensive than investment consultancy services (contrary to the CMA's findings at paragraph 11.4 of the provisional decision report).

Cost of switching to fiduciary management or a new FM

Similarly in relation to the CMA's finding that there are higher switching costs for fiduciary management services, in our experience there are switching costs associated with clients switching between investment consultants as the incoming consultant will often implement a change in investment strategy or have preferred investment managers that they appoint. As such, there will be switching costs for investment consultancy services but these may arise over a longer time period rather than at the initial stages of appointment. We believe that more work should be undertaken to understand the extent of costs of switching investment consultants over a scheme's full valuation cycle.

Our response to proposed Remedy 1 and Remedy 6

We have reviewed the Investment Association's response to the remedies proposed in the provisional decision report and fully support it. Rather than repeating their points, the attached memorandum sets out Schroders' comments on the CMA's proposals for mandatory tendering (Remedy 1) and standardising performance reporting (Remedy 6).

Fiduciary management services are valuable for many clients and we support any measures to help clients understand what they are purchasing and introduce a transparent and objective tendering process. However, any measures introduced should not be so onerous that they inadvertently deter trustees from considering fiduciary management services because of additional requirements which do not exist for other investment services. Any mandatory tendering requirement should apply equally to all services that combine investment advice and implementation of that advice.

We agree with the CMA that trustees should be able to monitor and assess the performance of a FM. We believe that a standardised performance reporting template should build on the work done by IC Select which has been developed extensively already with input from FMs, oversight organisations and other interested parties.

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Finally, we support the extension of the regulatory perimeter to include investment consultancy and fiduciary management as this will mean a consistent and level playing field for all participants in the industry.

We would be happy to discuss our comments in further detail.

Yours sincerely

Charles Prideaux
Global Head of Product and Solutions

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ANNEX 1

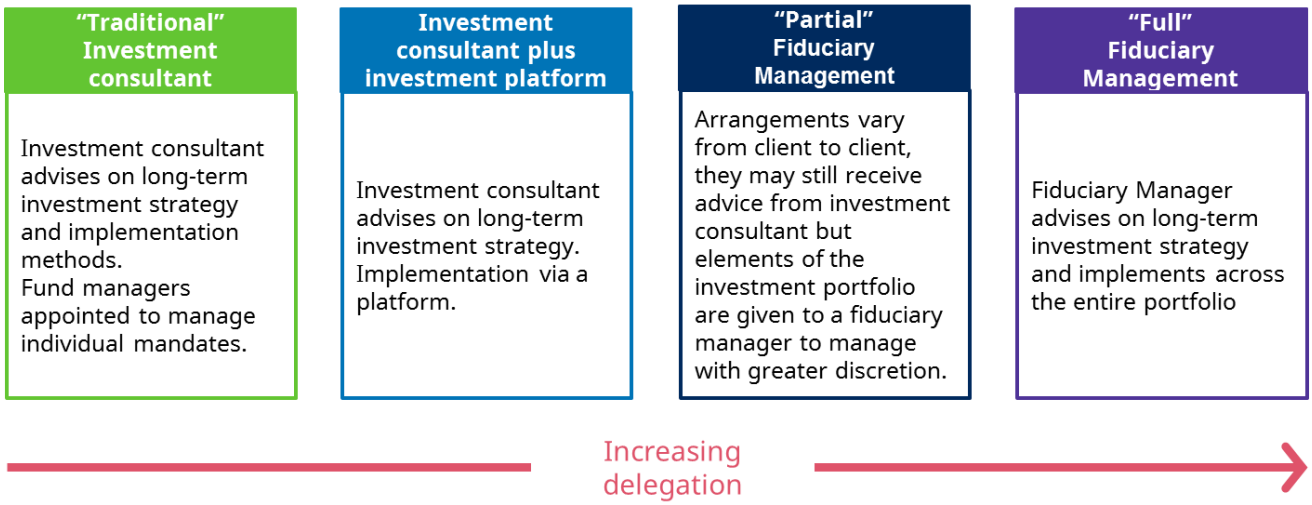
MEMORANDUM IN RELATION TO SCHRODERS' RESPONSE TO THE CMA'S INVESTIGATION INTO INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT SERVICES

REMEDY 1 – MANDATORY COMPETITIVE TENDERING ON FIRST ADOPTION OF FIDUCIARY MANAGEMENT

Should trustees be required to hold a competitive tender process when first choosing fiduciary management?

We support the CMA's proposed remedy to require trustees to hold a competitive tender process when first choosing fiduciary management. The decision to move to a fiduciary management approach and the subsequent choice of a FM is a key one for trustees. We believe that it is of paramount importance, for pension schemes and for the industry as a whole, that trustees make well-informed decisions when considering their governance structure and choosing the appropriate FM. As mentioned, we have interpreted fiduciary management as the provision of investment advice and the implementation of that advice.

However, there are a wide range of solutions that involve greater delegation of investment decisions by combining investment advice and execution – see diagram below. These solutions can be known as "fiduciary management", "implemented consulting", "outsourced-CIO", and "investment advice with execution through an investment platform". It is important that this proposed remedy is applied to a clearly defined set of services to help ensure all services that combine advice and implementation are treated equally and therefore reduces the risk of creating unfair advantages towards investment execution services that fall outside of the scope of the proposed remedy.



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?

We believe that fiduciary management can bring significant benefit to schemes for which it is suitable. The tender process should therefore not be overly onerous and inadvertently deter trustees from considering fiduciary management. This is particularly true for trustees with limited resources to spend on investment matters, which is the very same driver for many trustees appointing a fiduciary manager.

We define an open tender process as one where all market participants are invited to tender. This may not be the most appropriate for both trustees and prospective FMs if, for example, trustees after due consideration determine that one particular type of provider (such as IC-FMs or asset manager FMs) are the most appropriate fit. In such cases, the requirement to run an open tender to all FMs would be unnecessarily onerous and costly for both the trustees and the prospective FMs. In such cases, a shortlist of relevant providers may be preferable.

A pragmatic alternative to an open tender would be a thorough and proportionate process based on the guidance set out in Section 34(4) of the Pensions Act 1995 (**PA**). Section 34(4) PA governs the delegation of investment discretion and therefore can be applied to fiduciary management as defined by the CMA. Section 34(4) PA specifies that trustees may delegate discretion to a fund manager provided "they have taken all such steps as are reasonable to satisfy themselves [...] (a) that the fund manager has the appropriate knowledge and experience for managing the investments of the scheme; and (b) that he is carrying out his work competently and complying with section 36 [of the PA]."

We would suggest that the rules for the mandatory tender process are as follows:

1. The tender exercise involves a minimum number of fiduciary management firms;
2. The trustees produce a statement confirming their compliance with Section 34(4) PA, and recording the steps that they have taken to satisfy themselves under Section 34(4) PA. Such a statement could (for example) be included in the chair's statement, which is currently required for DC schemes, and is recommended for DB schemes by the DB Taskforce; and
3. Where not overly onerous, the tender exercise including selecting the fiduciary management firms to participate is run by a third party evaluator or independent third party.

Should firms be prohibited from accepting new mandates if no such competitive tender process has taken place?

As mentioned above, so long as the tender process is thorough and proportionate, then yes, we believe this would assist with the enforcement of the mandatory tender process and could be facilitated by the production of the Section 34(4) PA compliance note referenced above. It is important that the process to ensure compliance is not overly onerous on either the part of trustees or FM providers.

Should there be a minimum threshold either for size of schemes or scope or scale of the mandate?

We believe the mandatory tendering requirement should be applied across all FM appointments for schemes of all sizes, scope and scale provided the required tender process is proportionate and not overly onerous.

Please note our comments to the first question relating to Remedy 1 relating to the scope of application.

Should trustees be required to hold an additional tender process for any expansion in the scope of fiduciary management?

If the proposed mandatory tendering remedy is only applied to "full" fiduciary management (as we set out in the diagram in relation to the first question relating to Remedy 1) then we believe that an additional tender process should be required for significant scope changes. This should include the expansion of a "partial fiduciary management" mandate to a "full fiduciary management" mandate. The guidance should ensure that mandate 'creep' where the scope of a partial fiduciary management grows over a long period is captured.

How should trustee compliance be monitored?
We suggest that an oversight body (for example, The Pensions Regulator) monitor which schemes have adopted fiduciary management and select a sample to test for their statement of compliance with the required tender process.

Should trustees be required to hold a competitive tender process if they did not previously do so?
Given the large number of fiduciary management appointments that the CMA has found have been made without a competitive tender, we believe that trustees should be required to hold a competitive tender process if they did not previously do so. This will help to ensure that all fiduciary management appointments are made through a well-informed process.

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)?
Provided the required tender process is proportionate and not overly onerous, we believe the same process should be required.

What should be the qualifying criteria of a previous competitive tender process, such that trustees are not required to hold an additional tender process?
The qualifying criteria should be the same as that of the mandatory tender process and we propose the following requirements:

1. The tender exercise involves a minimum number of fiduciary management firms; and
2. The trustees (retrospectively) produce a statement confirming their compliance with Section 34(4) PA, and recording the steps that they have taken to satisfy themselves under Section 34(4) PA.

What should the maximum permissible tenure without holding a competitive tender process be?
We suggest five years would be a reasonable period.

What should the grace period for schemes which have already reached the maximum permissible tenure be?
We suggest two years would be a reasonable period as this allows sufficient time for trustees and prospective fiduciary management providers to carry out the required tender processes.

REMEDY 6 – STANDARDISED METHODOLOGY AND TEMPLATE FOR REPORTING PAST PERFORMANCE OF FIDUCIARY MANAGEMENT SERVICES TO PROSPECTIVE CLIENTS

Should there be a fiduciary management performance standard?
Yes there should be.

Who would be best placed to develop and implement a fiduciary management performance standard?
FMs have spent the last five years developing a standard which is currently run by IC Select but which will transfer to the CFA Institute where it will be implemented alongside GIPS. We believe that this framework is the most appropriate basis.

How do you envisage the implementation group working: how should it be funded, who should be part of it, etc?
We believe that the CFA Institute would be able to fund the standard in the same way it does for GIPS (the Global Investment Performance Standards). We think verification should be self-funded by FMs. However, we understand that the CMA considers that mandatory verification will be necessary so further consideration will be needed as to which body would be best placed to do this. Typically accountancy

firms verify GIPS but in our view a specialist firm may be better placed to do this for fiduciary management performance standard reporting.

What backstop would be appropriate in the event that the group is unable to agree on the standard in the required period?

The CFA Institute because they are the industry expert on performance standards.