PENSIONS AND LIFETIME SAVINGS ASSOCIATION

CMA INVESTMENT CONSULTANTS MARKET INVESTIGATION – PROVISIONAL DECISION REPORT

PLSA RESPONSE

24 August 2018

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

INTRODUCTION

The Pensions and Lifetime Savings Association brings together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with just over £1 trillion in assets under management and over 400 supporting businesses, including asset managers, investment consultants and other service providers. Our mission is to help everyone achieve a better income in retirement.

SUMMARY

We welcome the opportunity to feed in to the Provisional Decision Report (PDR) of the Competition and Market Authority's (CMA's) investigation into the market for investment consultancy and fiduciary management services. The PLSA supported the referral of this sector to the CMA owing to member concerns about the potential for misalignment of interests in the industry.

We believe that many of the CMA's findings and proposed remedies are sensible and, cumulatively, should have a positive impact on the sector. Our response addresses what we believe are the key issues to be considered in the design and implementation of each remedy as well as our views on the CMA's provisional conclusions. However, we also believe more should be done to improve scheme governance and thereby trustee engagement on all investment issues. We outline these in our 'Other Remedies' section below.

In formulating this response, we have drawn upon input from senior industry experts in our membership, including from trustees, scheme investment managers, master trusts and investment consultants. We also ran a survey of our pension fund members between 2 and 23 August on the design and implementation of the proposed demand-side remedies. We have welcomed the CMA's willingness to engage with the industry throughout its inquiry and would be pleased to provide a further opportunity for engagement with our members over the remainder of the investigation.

RESPONSE

THE CMA's PROVISIONAL CONCLUSIONS

The CMA's analysis of competition in the markets for investment consultancy (IC) and fiduciary management (FM) services broadly coincides with our members' understanding of the market[1].

Conflicts of interest

A fiduciary management approach can benefit schemes, including helping to reduce the governance burden and allowing for nimbler investment decision-making. There are also potential benefits for schemes which choose to undertake a partial or full fiduciary management approach offered by their incumbent investment consultancy firm, as it is likely the firm will have a good understanding of the history of a scheme's objectives, parameters and overall approach.

However, our members are concerned with the way in which the investment consultancy and fiduciary management markets operate due to the *potential* for misalignment of interests in the sector. The CMA's conclusion that there is "*some evidence of practice and behaviours that could be consistent with some customers being steered towards the FM services of the incumbent IC*" therefore aligns with some members' experience of the matter (although other members were happy with the way in which their IC-FM firms had managed any potential conflicts).

Other potential conflicts of interest

We note the CMA's findings that "*given the limited penetration that [vertically integrated employee benefits consultancy (EBC) -master trust (MT)] firms currently have in the master trust and wider Defined Contribution (DC) sectors; [the CMA considers] it unlikely that any potential steering by these firms towards their own master trusts has had a material impact on competition to date.*" It is likely that there will be cases where moving to an arrangement with an (incumbent) EBC-MT has benefits and is the best option for schemes[2]. However, some of our members have expressed concerns about the potential for conflicts of interest in these firms. We are keen that a competitive market for master trusts continues to develop and we

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[1] See also our previous responses to the CMA's Working Papers 1 through to 4 for further details.
[2] For instance, a scheme may want the new MT arrangement to closely mirror their previous investment approach.

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think it is important for policymakers to monitor what is likely to be a growing portion of the master trust and DC market[3].

Trustee engagement

The trust based model is an effective way of protecting pension scheme members, provided that the trustees are suitably skilled and knowledgeable[4]. However, trustees need to be able to properly hold their investment service providers to account and achieve the best possible value for money to obtain good member outcomes. We agree with the CMA's conclusions that there is a variation in the level of active trustee engagement with their investment consultancy and fiduciary management providers. This is in line with the results of other work undertaken by policymakers[5].

Our full views on trustee engagement are outlined in our response to the CMA's fourth Working Paper on this issue. However, we believe a few points bear further exploration.

The CMA's findings regarding lower levels of trustee engagement on fiduciary management are not surprising. A fiduciary management approach, whether partial or full, is complex and our understanding is that trustees need significant training and opportunities for discussion before even taking the initial decision regarding whether to pursue a fiduciary management arrangement. This is in addition to the fact that fiduciary management remains a relatively new and evolving market and most trustee boards will not have had extensive experience of engagement on fiduciary management issues[6].

We also note the CMA's findings that there is "*some evidence that scheme size is correlated with engagement*" and that "*DC pension schemes are less likely to be 'engaged' customers of investment consultants and fiduciary managers*". Further to our responses to the CMA's Working Paper 4, we would suggest that the DC charge cap has meant a shift in investment approaches towards more passive (and cheaper) options which could also reduce the need to seek significant levels of engagement with investment advisers.

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[3] Given the new authorisation regime, EBC-MT firms will probably form part of what is likely to be a shorter list of authorised DC consolidators and consolidation looks set to be an increasingly popular option for schemes as the market evolves.
[4] Please also see our response under 'Other Remedies' for our recommendations on how to improve scheme governance.
[5] Please see TPR's *21st Century Trusteeship* programme of work, as well as the FCA's *Asset Management Market Study*.
[6] For instance, our survey of 62 fund members found that only 18% of respondents said their scheme had tendered for a fiduciary management arrangement in the last five years.

PROPOSED REMEDIES

Remedy 1 – Mandatory competitive tendering on first adoption of fiduciary management

The decision as to whether or not to enter a fiduciary management arrangement, as well as the precise choice of service provider, is a complex one which can be difficult to unwind. We believe that it is good practice for schemes to assess the broader market for fiduciary management services prior to choosing a provider and therefore support the principle behind the CMA's Remedy 1[7] - if the process is designed in a way which does not impose disproportionate costs on schemes, particularly smaller ones. In our survey, 82% of respondents supported mandatory competitive tendering on first adoption of fiduciary management.

We do not believe that mandating an *open* invitation tender process is the correct approach. An open tender process could result in a high volume of boilerplate responses from the supply-side, which could crowd out the other important issues – such as asset allocation or member communications – which trustees need to consider.

Instead, we think the emphasis of Remedy 1 should be on ensuring a well-run *closed* tender process, supported by guidance which defines what best practice looks like. We envisage such best practice as including: approaching a variety of providers; engaging a third party to assess tender responses where possible and affordable; designing and undertaking a meaningful (set) process for evaluating potential providers; documenting the process by which a specific provider is chosen and outlining the reasons for the decision, demonstrating how a broader assessment of the market was undertaken.

We think having a minimum threshold runs the risk of turning the requirement into a box-ticking exercise instead of encouraging schemes to think through the best approach for their scheme. Instead we believe that requiring some kind of light-touch, formal documentation[8] of both the process and the ultimate decision where the scheme must demonstrate that it undertook a broader assessment of the market, could be helpful[9]. Preventing suppliers from accepting a mandate where no such

[7] Although we do not think that the evidence is such that it would have merited mandatory (re-) tendering or switching, we do believe that given the significant concerns raised regarding fiduciary management tenders in particular, that it makes sense in this specific case.
[8] This could perhaps be done through an extension of the minutes taken at the meetings where such decisions were made.
[9] Please note that although we think this may have merit in incentivising trustees to document their thought process, trustee boards are already under a significant burden in terms of reporting requirements and consideration must be given to how any such requirement could be done in a

competitive process has been undertaken could also be effective in preventing non-compliance.

We agree that the scope of Remedy 1 should apply to both full and partial delegated management approaches. It is important that trustees are encouraged to engage with the choice to enter fiduciary management across the full spectrum and we believe that otherwise an incentive could be created for regulatory arbitrage if partial approaches were not carefully defined.

We also believe that the CMA's proposal not to require additional tenders for increases in the scope of a fiduciary management mandate is sensible; the initial tendering for FM services should be the key focus of a trustee board's decision-making and any further requirements in this area are likely to be disproportionately costly with respect to the expected benefits. We agree that those schemes which have already entered a specific fiduciary management arrangement without a considered appraisal of other potential providers should be required to do so within the next five years. We note that no schemes will be required to have run a competitive tender on an already-awarded FM mandate within two years of the remedy's implementation; it is important that trustees have control over the timing of any tender process (to ensure it is meaningful) and we would urge the CMA to explore the need for longer timescales.

Please also see our response in 'Other Remedies' below where we highlight other reforms we believe are necessary to fundamentally improve scheme governance and improve trustee engagement on all investment issues.

Remedy 2 – Mandatory warnings when selling fiduciary management

We agree that trustees need greater clarity regarding the nature of the information that they receive and whether it constitutes advice, marketing or both. This needs to be done both early in the decision-making process and further on at key points. Although we are aware that there are some IC-FM firms who are closely aligned with best practice on this issue, we believe that provision of this information needs to be made mandatory.

Content

We think that the balance of information proposed by the CMA is right. We do not believe it is necessary for specific alternative providers to be mentioned as we think there is value in encouraging scheme trustees to go on a 'journey' themselves

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proportionate way; one way in which this could take place is through the Chair's Statement – the proposal for a DB Chair's Statement is currently under consideration in the DB White Paper.

regarding alternative providers. We think that there could be merit in allowing firms to change the specific use of the term 'fiduciary management' to better reflect the precise service offered but think that a list of possible terms should be provided by the regulator in order to ensure more standardised presentation of information.

Tone

The language used by policymakers and bodies like the CMA can play a vital role in shaping industry and consumer attitudes; we believe that the tone of the CMA's language and proposals on Remedy 2 should be neutral. As mentioned above, fiduciary management can be of benefit to trustees – as can fiduciary management offered by an incumbent consultant. Using language like "*warning*" to describe the thrust of the proposals in Remedy 2 and suggesting red box formatting might inadvertently deter trustees from considering an approach which is in their best interests.

Presentation and process

We think it may hinder trustee understanding and engagement to include these warnings on oral marketing. We also believe that lessons can be learnt from the Financial Conduct Authority (FCA)'s *Smarter Consumer Communications* agenda[10] in ensuring trustees are not inundated with a lot of disclosures and that the clarification on advice or marketing is sufficiently clear and prominent.

Remedy 3 – enhanced trustee guidance on competitive tender processes

We think that there are often misperceptions around how granular and lengthy tender documents need to be. We also know that there is a variation in the quality of Requests for Proposal (RFP) documents produced by trustee boards, and significant levels of confusion surrounding how to run an effective tender process. We therefore support the provision of guidance which aims to help dismiss some of the myths around tender processes and offers practical support.

There is also demand from scheme trustees and scheme managers for such guidance, with only 10% of respondents to our survey saying they would *not* want to receive any guidance in this area. However, we urge The Pensions Regulator (TPR) and others to ensure that any guidance is carefully designed and involves close consultation with the full range of demand-side representatives as any new guidance will be entering a crowded space. We would be happy to support TPR in developing more practical guidance for trustees on the tender process.

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[10] The intended audience for the IC-FM disclosures will have significantly higher levels of financial literacy than the consumers which were the focus of the FCA's work in this area, but there are still useful learnings.

Please also see our response to Supporting Remedy B.

Remedy 4 – Requirement to report disaggregated fees to existing customers *and* Remedy 5 – Minimum requirements for fee disclosures for prospective clients

We strongly believe that transparency of costs at each stage of the value chain is vital in enabling trustees to hold their investment service providers to account and is key to ensuring any market works effectively. Such information must be accurate, clear and consistent. We have supported the work of policymakers to improve transparency of fees and costs, particularly through our role on the Institutional Disclosure Working Group (IDWG) as well as our response to the Department for Work and Pensions' (DWP's) work on cost information disclosure to members in DC schemes.

Our members tell us that there is a wide variation in the quality and timeliness of fee disclosure provided by both investment consultants and fiduciary managers: some firms provide detailed information as a matter of course, while others only offer clear fee disclosures in response to persistent requests from schemes.

On fiduciary management specifically, we believe that disaggregation of fees will be important and not disproportionately costly for firms to provide; we understand most firms will already have the necessary information. Such a step should make it simpler for trustees to be able to compare like with like when it comes to evaluating different service providers.

We agree that it is important that trustees are informed of the potential costs of switching; the implications of unwinding a decision if necessary – including the costs of doing so – should be known and understood by trustees at the very beginning of the journey towards fiduciary management. Such information should, as far as is possible given the number of variables needed in the calculations, be presented in a standardised way.

We believe that any cost information presented must include explicit signposting to further information on performance and broader value for money considerations, as well as how these – taken together – contribute to the achievement of a scheme's objectives. We would be concerned if any new requirements resulted in a tendency to present cost information in isolation, which might lead to a disproportionate focus on costs at the expense of other important information on the value for money achieved and the overall quality of the service.

Remedy 6 – Standardised methodology and template to report past performance

We support the principle of a standardised methodology to report past performance for fiduciary management. However, we agree that there are several practical challenges in finding the appropriate performance benchmark metrics. For instance, any standards would need to achieve the right balance between comprehensiveness (to ensure comparability) as well as flexibility (to allow for the wide variety of investment strategies and approaches schemes undertake). There would also need to be consideration of how to measure and compare performance where clients have acted against their consultants' advice.

We had previously called for close consultation with the industry on any performance framework and we therefore support the creation of a cross-industry implementation group on a fiduciary management performance standard. It is particularly important that the clients of fiduciary management providers play an active part in any such group, both so that their views can be considered in the design and implementation of any standard, and to ensure that the standard has widespread credibility. Both pension scheme trustees and scheme investment managers – who often oversee the day-to-day execution of a scheme's investment strategy – must be represented on this group. Our experience of the IDWG and other groups has demonstrated to us the benefits of having the DWP, TPR and others attend such meetings as observers and we would support a similar approach taken here.

The PLSA is one of the sponsors of the Global Investment Performance Standards (GIPS). We have also previously worked with the investment consultant and pensions industry to create its own Investment Consultant Toolkit and currently play a role in upholding industry standards as part of our Pension Quality Mark (PQM) and Retirement Quality Mark (RQM) programmes. As an organisation which represents the full breadth of the institutional investment chain, we would be happy to discuss to what extent we might be able to take part in any future implementation group.

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

It is good practice for scheme trustees to have thought through what it is they would like their advisers to help them achieve as well as what they expect from their advisers. We are aware that many schemes will have done so but believe there is a need to ensure a meaningful consideration of, and monitoring against, a stated set of goals across all schemes. We therefore believe there is merit in the principle of encouraging trustees of schemes of all sizes to set strategic objectives for their consultants.

While for many schemes a requirement to do so will be primarily a matter of documenting already agreed objectives, we believe that some of the less engaged trustee boards – which are dealing with a significant number of new regulatory initiatives – will need significant levels of support in doing so. It is also important that trustees are encouraged to consider what the most appropriate objectives for their scheme may be; if we end up drifting to a situation where schemes simply fill out a boilerplate set of objectives then it is hard to see what additional benefit such a requirement provides.

We believe there are certain considerations which trustees should include in their thinking when setting objectives for their consultants. Firstly, the objectives must be clearly linked to the investment objectives set out in the Statement of Investment Principles (SIP) as well as the (Defined Benefit (DB)) scheme's funding objectives, such as reaching solvency or achieving buy-out within a set period of time. More granular objectives – which should be time-limited – could include:

- The quality of the personnel and overall service levels: is information received in a timely manner? Does the adviser manage to avoid surprising the board e.g. with a change in strategy? Do they take on board trustee questions about investment topics e.g. ESG investment?
- How clear the advice is: does the adviser seek to make sure the advice is understood by the breadth of the trustee board?
- Does the adviser help the board spend its (limited) time wisely? Do they help the board allocate sufficient time to asset allocation strategy vis-à-vis manager selection?

We agree that every three years is a sensible timeframe for a formal review as it gives sufficient time for a track record to be built up. We would suggest that any guidance provided on trustee objectives encourages trustees to monitor their advisers in the meantime and allows both sides to raise concerns in good time.

Remedy 8 – Basic standards for reporting performance of recommended asset management 'products' and 'funds'

As with our responses to Remedies 4 and 5 above, we strongly believe in the standardisation of information (and its calculation) presented to schemes by their investment service providers; only then can trustees compare like with like to reach the most appropriate decision.

The methodology and approach is important, but we also think firms should be encouraged to report and format the information clearly and in a way which ensures the relevant information 'jumps out' at trustees. We would not recommend an overly prescriptive approach, which could be disproportionately time-consuming for firms.

We would again draw the attention of any implementation or decision-making group to learnings from the FCA's *Smarter Consumer Communications* agenda.

For instance, we think that there could be merit in mandating that presentation of product/fund performance be shown left to right in decreasing order (time period) so that it would, for example, read: 10 year performance; 5 year performance; 3 year performance. This could enhance the prominence of the longer-dated information in a way which may encourage trustees to take a long term investment approach.

Supporting Remedy A: Extension of the FCA regulatory perimeter

We support this Remedy. We have previously noted that consultants advising pension funds are subject to less scrutiny than retail investment advisers, despite the fact that poor or misleading advice to a pension fund can disadvantage many thousands of individuals instead of just one. Ensuring all aspects of consultants' and fiduciary managers' advice and work are subject to regulatory oversight could help boost trustees' and savers' confidence in the market and bolster the ability of consultants to carry out their positive role in the investment chain.

We also note that the PDR itself highlights the mixed views of parties surveyed (p.165) as to "*whether activities relating to the introduction and sale of fiduciary management services are covered by regulation*". We believe that this further demonstrates the need for greater clarity and consistency of regulation in this area so that schemes can be confident that the advice they are receiving is in their best interests.

Below are some specific issues we think should be considered when designing the regulatory framework:

1. The term 'fiduciary management' is very broad and can cover a wide range of delegated investment solutions. This will need to be defined in a way that inhibits regulatory arbitrage and also achieves the intended aim of the regulation
2. Strategic advice on asset allocation is a service potentially offered by a variety of firms and institutions, including banks, in-house scheme investment staff (including LGPS pools)[11] and actuaries (with regards to the investment approach's link to funding objectives); careful consideration must be given to precisely which organisations or individuals will be subject to FCA regulatory scrutiny in this area

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[11] In-house investment staff – despite providing asset allocation advice or investment management services – only do so for the pension scheme of which they are part and are therefore not faced with the kinds of conflicts of interest that the CMA has identified; we therefore believe it would make sense to exempt these staff from any new regulations.

It must also be made clear to firms exactly where the boundaries between the different regulations regarding management of conflicts of interest lie – as well as for these regulations to be aligned and avoid duplication as far as possible.

Supporting Remedy B: Enhanced TPR trustee guidance and oversight of Remedy 1

We agree that guidance should be provided to trustees both on how to run a competitive tender process and more broadly on engaging with investment consultants and fiduciary managers. This will be particularly important for less engaged schemes or those schemes which do not necessarily have the resources or expertise in doing so. However, guidance must be designed in such a way that it does not evolve from a recommendation to a requirement; schemes must be allowed the space to run the tender process or engage with their investment advisers in a way which is best suited to their scheme's resources, objectives and circumstances.

Respondents to our member survey were asked what kind of guidance on running a competitive tender process they would find useful; 81% of respondents thought that a checklist/to-do list on the full tender process would be helpful, while 66% said they would like best practice case studies and 60% wanted a template or standardised RFP document. This is in line with the PLSA's own experience as providers of trustee guidance on investment topics: trustees often like to be given practical tools which they can take away and use.

Similarly, when asked what kind of guidance they would find useful on broader engagement with investment consultants and fiduciary managers, 69% of respondents said they would appreciate a checklist on what to consider when choosing an investment consultant and 63% would like a similar checklist on what to consider when deciding upon a fiduciary manager.

Please also see our response to provisional Remedies 1 and 3 as well as our views on 'other Remedies'.

Supporting Remedy C: Improving information on underlying asset manager fees and performance

The PLSA has been part of the IDWG since inception and we strongly support its work to improve disclosure of asset management fees and charges. We will continue to champion ongoing efforts in this area. We support the provisional recommendation of the CMA that the FCA take steps to encourage whole of market adoption of the templates. We would particularly encourage the take-up by investment consultants of the templates; given the influence their advice has on schemes' investment approaches, this is a key constituency in ensuring wide use of the templates.

OTHER REMEDIES

We believe that many of the remedies proposed by the CMA should, cumulatively, have a positive impact depending on the details of their design and implementation. However, it seems to us that some of the demand-side remedies are more effective in tackling the symptom, rather than the cause: variation in the quality of scheme governance. We believe that other remedies could fundamentally improve trustee board governance and hence their engagement with the broad range of investment decisions.

Given the adverse effect on competition (AEC) that has been found in terms of trustee engagement/demand-side capabilities, we believe that making the following recommendations is within the CMA's scope to do so "*for the purpose of remedying, mitigating or preventing the AEC or any detrimental effect on customers, so far as it has resulted from, or may be expected to result from, the AEC*". We think statements in support from the CMA of the remedies below could be powerful and have a significant impact on improving trustee engagement.

Recommendation to consider changes to the current regulatory approach

We have supported much of the government's and Regulator's work to try to improve the governance of trustee boards, for instance TPR's recent *21st Century Trusteeship* programme of work. However, as mentioned in previous responses to the CMA[12], we believe that a shift in regulatory focus is needed.

Currently, regulatory approaches are often characterised by a strong focus on outputs instead of inputs, and on processes rather than people[13]. This has resulted in a potentially confusing array of guidance, codes of practice and code-related guidelines for trustees and we believe this may have led to a more risk-averse and compliance-led approach from trustees; one outcome could be reduced innovation in the sector and a reluctance to choose new/different advisers.

We think that lessons for the UK approach to pension scheme governance could be learned from the UK's approach to *corporate* governance which instead focuses on how the quality of the people determines the quality of outcomes. Specifically, we believe that there is scope for the CMA to recommend that:

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[12] Please see our response to the CMA's *Issues Statement* as well as to Working Paper 4 on *Trustee Engagement.*
[13] Please also see our *Good Governance: How to Get There* paper (August 2017).

- TPR consider rebalancing its priorities to include a greater focus on scrutiny of board appointments and effectiveness;

- TPR consider how best it could encourage a governance structure which more closely resembles a split into a board (which carries out strategic oversight) and an executive body (responsible for day to day running of the scheme).

We also think there is scope for TPR to improve the effectiveness of pension schemes' annual Chair's Statement. This could be through publication of the Statement on a scheme's website to enable effective scrutiny as well as a new requirement that the Statement demonstrates the competence and qualifications of the governance body, including the training trustees have undertaken in the previous year[14].

Recommendation to government to further consider support for scheme consolidation

We note the CMA's findings in its PDR and its previous Working Papers that smaller schemes tend to have "*less effective trusteeship and governance*." Although we believe there are examples of best practice governance at schemes of all shapes and sizes, the second report of the PLSA's DB Taskforce – *The Case for Consolidation* – summarised the growing body of research demonstrating the beneficial impact of scale on scheme governance. The UK pension scheme system is highly fragmented and characterised by a high number of small schemes. We believe that for many schemes, consolidation with other pension funds into larger entities could be a good way of equipping such schemes with the necessary governance capacity and structure.

We welcome the government's current commitment – as part of its DB White Paper programme of work – to supporting consolidation of schemes. Although it is clearly beyond the scope of the CMA to direct schemes to consolidate, we believe that a recommendation to the relevant government departments to continue to work towards further consolidation in the sector could be helpful – and could encourage progress in an area which would have an important and positive impact on scheme governance.

For further information, please contact Caroline Escott, **Policy Lead for Investment and Defined Benefit**.

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[14] Please also see our *Hitting the Target* report (July 2018).