Response to CMA Provisional Decision Report

Please find below the comments of Hyman Robertson LLP relating to the CMA's Investment Consultants Market Investigation - Provisional Decision Report ("the Provisional Decision report"). We have grouped our responses under the remedies proposed and linked them to relevant specific questions raised in the report.

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.

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

- We believe a due diligence process and some form of independent assessment of the options should be carried out. The degree of complexity depends on the type of fiduciary mandate envisaged, therefore the scope of the mandate should be clarified at outset:
    - For an asset manager (i.e. fund of funds) appointment, then the same process should be adopted as for appointment of any other asset manager. So consideration of all the options available and an independent recommendation of who to interview as part of the process, or who to appoint in the absence of a formal beauty parade.
    - Where the fiduciary mandate includes an element of advice in addition to asset management ("full fiduciary"), then we agree a competitive tender process should be followed.

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?

- We believe a suitable closed process for competitive tendering should be sufficient. This would not stop trustees choosing to adopt an open tendering process, but we believe open tendering is likely to be disproportionate in many cases.
- We favour not being too prescriptive or regulated in the approach to tendering, but it is important that, as a minimum standard, the process adopted documents clearly:
    - the alternatives considered;
    - the rationale for exclusion of some options;
    - the rationale for the selection of the short list of at least 2 providers; and
    - why the successful provider was selected.
- In other words, a clear audit trail should be produced showing the due diligence and decisions made for moving from the whole universe of potential options to the provider selected. It should be a requirement that appropriate due diligence and a competitive tender has been carried out and evidenced (as described above) before any mandate is accepted.

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

- We see no rationale for a size threshold and refer you to the answer to the first question above regarding the scope of the mandate.

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

- If the initial appointment was not for both advisory and asset management elements, but is being expanded to include both, then we feel it is important that a competitive tender process is held as detailed above.

How should trustee compliance be monitored?

- The effective monitoring of this process could be by requiring the disclosure of Defined Benefit Chairman's Statement (i.e. similar to that done for Defined Contribution schemes) in the scheme's accounts, subject to oversight by the Pensions Regulator.

Mandatory use of a competitive tendering process for existing mandates

The 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.

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 (e.g. 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?

- Consistent with our comments on remedy 1, we agree that there should be a competitive tender, but the type of process should depend on the nature of the mandate in question.
- At the very least the trustees should be required to retrospectively document the process they went through in reaching their decision, again disclosing this in a DB Chairman's statement with oversight by TPR, ensuring what has been done falls into line with the recommended process for new mandates. If it does not, then a new competitive tender should be required in line with the guidelines proposed above.

What should the maximum permissible tenure without holding a competitive tender process be?

- 5 years feels an appropriate maximum permissible tenure without holding a competitive process.

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.

Should fiduciary management firms be required to provide disaggregated fee information and how should they do this?

- We believe that it is fundamental for fiduciary management firms to disaggregate fee information. Separating fees between core fiduciary management, asset management and other investment fees and charges is appropriate. However, this is insufficient to ensure a transparent and competitive landscape between fiduciary management and alternatives available to trustees.

- In 3.41 of the Provisional Decision report, the CMA have illustrated well the 4 components of full fiduciary management services, namely investment strategy, asset allocation, manager selection and monitoring. As the CMA has correctly identified, investment strategy is advisory, while the fiduciary manager decides (i.e. is delegated responsibility) in respect of the other services. It is well-researched and acknowledged that strategic advice is the most important component in the investment chain, with choice of asset managers being second order by comparison.

- Therefore, disaggregating bundled fees between core and asset management alone fails to provide sufficient transparency to customers and potential customers of fiduciary management as to how much they are paying for the advisory piece and how much for delegated management.

- Given trustees have the option of selecting either a consultant or a fiduciary manager for the advisory piece, it is therefore necessary for the disaggregation of fees to separate out the fees for advisory work from other discretionary or delegated services. The information gathered by the CMA for the working paper on financial performance and profitability appears to indicate that IC-FM firms are able to readily analyse their revenue and profitability on this basis.

- Asset manager fees should be shown separately for products and funds provided by the fiduciary manager and those provided by third party asset managers.

Should asset manager fee information be based on the IDWG templates?

- If the IDWG templates are the standard to be used for all asset managers, then asset management fee paid in respect of fiduciary manager products and asset management products used by fiduciary managers should also be captured by these templates.

What should the frequency of reporting such fee information to customers be?

- We agree with the CMA's proposal that fiduciary managers should provide information at least annually. In practice information should also be available at a client's request.

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.

Should firms be required to provide a fee breakdown to prospective customers?

- Our comments in respect of Remedy 4 apply equally here. From our experience, it is clear that investment consultants providing advisory services only are often in competition with fiduciary management offerings, and we have consistently stated that there are clear overlaps and that this competition exists, rather than assuming that these are entirely different markets. Where the decision to go advisory or fiduciary is made in advance, the competitive tendering process may be restricted to one or the other, but the key issue arises before that decision has been made.

- Given this, it is imperative that clients are provided with sufficient information on fees to be able to make decisions on which type of provider to use for each component of investment services. Therefore fiduciary managers must be required to disaggregate their fees between the investment advisory component and the fiduciary component.

- In particular, fees should be shown separately for investment strategy advisory services. This is necessary to ensure customers enjoy a competitive market between fiduciary and consultancy firms, not just between fiduciary firms. Fiduciary managers should show fees split between investment strategy advice, implementation (covering asset allocation, manager selection and implementation) and asset management.

Should any other fees or costs be disclosed in addition to those mentioned in this remedy?

- A key cost not covered is the cost of transitioning assets from an existing structure into the fiduciary management offering. Typically the latter will involve investing in the provider's own funds and incur significant, unavoidable transition costs will arise; these costs should be disclosed in full as part of the fee disclosure. The costs are not fees to the fiduciary manager but can be very significant and can outweigh any fee they receive by a margin.
- Transition costs will also be incurred on leaving a fiduciary, either to join another fiduciary firm or to move to advisory or indeed to pass assets to an insurer. Arguably that is the same as moving assets from within an advisory mandate, but only if the fiduciary offers in specie transfer of assets.

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.

Should pension trustees be responsible for setting objectives for their investment consultant?

- Trustees should set their investment consultant clear objectives. We anticipate that there will be an alignment between these objectives and the Trustees' own overall objectives. Most contracts between trustees and investment consultants will include the provision of a range of services. Objectives are likely to include a mixture of more quantitative outcome based targets and qualitative objectives.

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?

- A formal review and agreement of objectives should be done at least every three years, potentially in line with the valuation. We would also recommend an annual review to reconfirm existing objectives remain appropriate, with any material changes noted in the DB Chairman's statement. As the review could be incorporated within the review of the Trustees' statement of Investment Principles, there does not appear to be a strong argument for a minimum threshold.

When do you consider that the formal review of an investment consultant against the scheme's strategic objectives should take place?

- As a minimum, some sort of formal review of the consultant's performance against the objectives should take place every three years. Based upon our own experience with clients, we would consider it good practice to provide annual updates. It is likely that objectives will have longer timeframes (journey planning may be extending decisions across many years), and so the assessment must be viewed in the context of the objectives.
- Trustees should determine what is suitable for their own circumstances. Guidance must recognise that not all objectives will be measurable using quantitative assessments. Moreover, objectives should be scheme

specific, and assessment should not revert to peer group performance comparisons over short time periods that may lead to other unintended consequences in advice.

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

Should basic standards apply to the reporting of recommended asset management 'products' and 'funds'?

- Agreeing a framework of basic standards seems appropriate. We agree with the points identified in 12.131, with the exception of (c); if a firm is tendering for advice on a particular asset class selection, there should be no need to include results in respect of all asset classes. Moreover, not all firms promote the same degree of active management in all asset classes. By placing too much attention on comparative statistics for product selection there is a risk that the CMA perpetuates Trustees' focus on only one aspect of investment consultants' advice. For this reason, we believe there should be basic standards, but not excessive prescription.

Should standards be developed and agreed by an implementation committee similar to Remedy 6?

- We agree that an implementation committee makes sense. There are differences between fiduciary management and investment consultant product advice, and it may therefore require a separate implementation committee from that developing solutions to remedy 6.

What fees should be used to make the gross to net fees conversion?

- Gross returns are most easily comparable, but net returns are what matters to the client. As there is no single approach to showing net of fees returns that is suitable for all circumstances or all prospective clients we favour showing both gross and net returns where possible, with the firm disclosing the basis upon which they have made the gross to net conversion.

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.

Should the FCA regulatory perimeter be extended and what activities should be included?

- We support this level playing field as we are currently an Authorised Professional Firm and apply FCA standards to Investment Consultancy activities. However, it is important that the scope of the activities to be regulated is clearly defined.
- The most obvious "grey" area is the strategic asset allocation, which both the investment consultant and the scheme actuary (regulated by the IFoA) will often be involved in, given the link to funding requirements.
- This could have significant impact on firm's operational and compliance costs and so a reasonable transition period of at least 12 months should be provided for.

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.

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 agree that guidance may be beneficial for some trustees, but we feel that it is important that it is pitched at a high level and the temptation to provide too much detail is resisted. The ultimate objective must be that trustees remain able to set objectives which are appropriate to their scheme's own individual circumstances, rather than being driven from any sort of proforma.

Hymans Robertson LLP

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