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Response to the CMA Investment Consultants Market Investigation *Provisional Decision Report*

24 August 2018

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Executive Summary

The Provisional Decision report represents a useful step forwards in addressing competition problems within both the fiduciary management and investment consulting markets, particularly given the conflicts of interest that arise when firms provide both services.

Since bfinance does not provide fiduciary management services, this response chiefly focuses on the four subjects outlined below:

(1) We note that the CMA appears not to have addressed broader conflicts of interests that arise when **investment consulting firms provide asset management services that do not constitute fiduciary management**, although this is an increasingly widespread practice. It is not clear to us whether this is a conscious choice or an oversight. *We strongly encourage the CMA to give full and proportionate consideration to this issue.*

(2) On Adverse Effects on Competition (AECs), bfinance supports the findings. However, we note with some concern that the language used in the AECs (and Remedies) refers only to the use of a single "advisor" and does not account for the use of **multiple advisors**. This causes concern regarding unintended consequences for specialist consultants. We also present research (conducted with an independent partner) on multiple consultant usage globally. *We urge the CMA to consider global best practice and take care that measures do not damage the competitive position of specialist consultants.*

(3) On remedies relating to the purchase of fiduciary management services, we find the proposed measures appropriate and proportionate. The response outlines modest concerns relating to effectiveness and implementation, and provides some initial feedback relating to competitive tender requirements. *We encourage the CMA to engage in discussions with firms that have expertise in tendering for asset management services.*

(4) On remedies relating to investment consultancy performance reporting, we strongly support the core principle that investors should be able to assess their own consultant and other consultants more effectively.
   i) The measures proposed for assessing one's own consultant(s) appear appropriate, although we advise that effectiveness would require separate objectives for distinct services and proper **granularity** within those objectives.
   ii) The measures proposed for assessing alternative consultants do not appear to offer meaningful support for comparing different consultants' services outside of the **very narrow subject of fund manager recommendations**. This causes some concern regarding bias and proportionality.
   iii) In the measures proposed for assessing alternative consultants, we observe risks that the framework used for comparing product recommendations will not effectively address **alternative investments** such as private debt and infrastructure (increasingly important to UK and global clients) and will be strongly biased towards the **"buy-list" model** for manager selection, excluding or disfavouring consultants that use different approaches. *We advise the CMA to seek input from experts on "alternative" investments*, and to *engage with firms that do not use the buy-list model for manager selection.*

bfinance would greatly welcome the opportunity to engage actively with the CMA during the next phase of the investigation through face-to-face interviews, information sharing and additional meetings.

Sam Gervaise-Jones, Head of Client Consulting UK & Ireland, [redacted]
David Vafai, Chief Executive Officer, [redacted]

Comments on Adverse Effects on Competition (AECs)

Relevant findings in the Provisional Decision Report

- There are AECs in both the investment consultancy and fiduciary management markets (11.1).
- The information that trustees need in order to assess the value for money (fee levels and quality) is difficult to access. (11.3).
- Features of the investment consultancy market that restrict or distort competition include: low levels of engagement by some customers; lack of clear information for customers to assess quality (customers do not set and consultants do not agree sufficiently clear objectives); lack of clear information for customers to assess other investment consultants (in particular the ways used to calculate track records for consultants' recommended investment products) (11.6).
- In investment consultancy, barriers to assessing quality of the existing consultant and comparing with alternative providers makes it difficult to select the best advisor (11.13).

Response from bfinance

a) We note that the CMA does not appear to have explored **AECs that may arise when investment consultants provide asset management services that do not constitute "fiduciary management"** (management of a client's entire portfolio). This is an increasingly prominent trend: we frequently now find consultants competing for bfinance client mandates in sectors such as private markets, real assets and multi-asset. The confidential data provided by consultants to us as part of manager selection research indicates that non-fiduciary asset management (i.e. where the consultant is managing only a portion of the client's portfolio rather than the whole) comprises a very substantial proportion of consultant AuM.

b) We note that the language exclusively refers to the use of a single *"advisor"* and an *"alternative"* advisor, as opposed to multiple "*advisors*" and "*alternative or additional* advisors".
   i) We would caution against this presumption, given the possibility that it may result in processes and frameworks that are detrimental to specialist consultants.
   ii) We encourage the CMA to consider international practices. Our 2018 global study of 485 investors (66% pension funds, remainder endowments, foundations, SWF and similar, with over $4.5 trillion in assets), conducted in association with Pensions and Investments (a leading financial publishing company) and their partner Signet Research (an independent market research firm), finds that 33% of investors used just one consultant or investment advisor during the past year, 25% used two, 31% used three or more and 11% have used none.

c) We note a substantial difference between the criteria that are advised for assessing one's own consultant (performance against specific objectives agreed with the client) and the criteria for assessing alternative consultants (generalist, non-client-specific measures, with – it appears – a particular focus on track records for recommended investment products).

d) The latter causes us some concerns, which are discussed in response to the "remedies" below. These concerns include:
   i. a risk that consultant selection will be inappropriately skewed towards fund manager recommendation versus other very important services;
   ii. a risk that assessment of fund manager recommendations will be biased towards capability in equity and fixed income versus alternative investments (an increasingly high priority for our pension fund clients);
   iii. an assumption that the performance of recommended managers can be assessed separately from client objectives, which may be true for consultants that operate a buy-list model (a conventional but not universal approach) but is not true for all models;
   iv. a risk that bfinance's model (and the models of some other consultants) will not fit within a product recommendation comparison framework, leading to unfair disadvantage in competition and bolstering the market position of larger mainstream consultants.

Comments on Remedies relating to “promoting trustee engagement when buying fiduciary management”

Remedies proposed by the CMA

- Mandatory competitive tendering on first adoption of fiduciary management (and a requirement for schemes that have appointed without a competitive tender to conduct one within five years of the current mandate’s start date).
- Mandatory warnings when selling fiduciary management.
- Enhanced trustee guidance on competitive tender process.

Response from bfinance

e) We support the recommendations for “competitive tendering” in fiduciary manager selection. However, **effectiveness** will very much be determined by how a competitive tender is defined and how consistently that definition is implemented. We urge the CMA to be clear on this point, and consistent on the threshold for past and future processes.

f) bfinance has a long record of running tendering processes, including OJEU public procurement procedures and various types of closed / open tenders. Tenders vary hugely in terms of duration, costs, resource requirements and more. In our experience, a “competitive tender”:

   i. Should be truly open (not just technically “open”) to all relevant providers;
   ii. Should feature a robust weighted framework or scorecard that can be customised to the buyer;
   iii. Should incorporate strong qualitative analysis and not be excessively reliant on quantitative data (e.g. track records);
   iv. Should be conducted by personnel (in-house and/or external) with suitable expertise to evaluate proposals rigorously and carry out appropriate due diligence.
   v. Should involve an independent third party if a conflict of interest exists between the party seeking the service (the asset owner) and one or more of entities vying to provide it.

   Source: Tender or “Pretender”? bfinance, July 2018

g) The report makes a distinction between “open” and “closed” tenders, with a preference for the former. Although we broadly agree, we advise that this distinction is a simplistic one, and that both open and closed tenders can vary substantially in design. *We strongly recommend engagement with experts on tendering for asset management services* for greater insight.

h) The report considers resource challenges and the idea of a minimum threshold in asset volume for this process to be mandatory. In our experience, it is not the case that a more exclusive process will necessarily be cheaper or less time-consuming than a more inclusive one, especially where long-term costs and performance are considered.

i) We have observed some commentators suggesting that the CMA and TPR should look towards the example of OJEU procurement procedures. This model has merits, but policymakers should exercise caution before copying what is, by comparison, a relatively onerous process.

j) In the interests of effectiveness and proportionality, we ask the CMA to consider whether remedies may be appropriate for **all asset management services provided by consultants** as opposed to purely fiduciary management services (see [a]).

   i) Would mandatory competitive tendering be appropriate for asset manager selection in all circumstances where the investor’s consultant provides an asset management service in that sector/asset class?
   ii) Would mandatory disclaimers/warnings be appropriate when investment consultants are providing written information about subjects where they also provide asset management services, to ensure investors are aware that the consultant has a product in this area and do not view the contents as purely advisory?

Comments on Remedies relating to: “Fiduciary management fees and performance reporting”

Remedies proposed by the CMA

- Requirement to report disaggregated fees to existing customers.
- Minimum requirements for fee disclosures for prospective clients.
- Standardised methodology and template to report past performance.

Response from bfinance

k) bfinance does not provide fiduciary management services, and therefore is not providing comments on the three remedies above.

Response continues on following page.

Comments on Remedies relating to: "Investment consultancy performance reporting"

Remedies proposed by the CMA

- Trustees to set strategic objectives and firms to report periodically against them
- Basic standards for reporting performance of recommended asset management 'products' and 'funds'.

Response from bfinance

l) We fully support the proposals for trustees to set clear objectives for all consultants that they appoint, whether the appointment is on project or retainer, and assess their performance against those objectives. This appears to be both **feasible** and **proportionate**.

m) We would suggest that consultants should be required to report against those objectives once per year, although we agree that the reporting should show long-term performance (e.g. three-year results). We would add that, where discrete project work is being conducted, objectives should be established at the start of the engagement and assessment should be conducted at the end of the engagement.

n) For **effectiveness**, we would strongly recommend separate objectives for the different elements of consulting service, which are highly discrete in their nature. These could include: asset allocation, ALM, manager recommendations, risk management, trustee education and so forth.

o) Furthermore, we recommend appropriate granularity in those objectives, so that they are qualitatively and quantitatively meaningful. For example, on the specific subject of manager recommendation objectives, we would support some delineation in the objectives for different sectors (e.g. equity, fixed income, private markets, diversifying strategies); due to the very different expertise and information required, consultants can be strong in some asset classes and weaker in others. In asset allocation, as another example, a consultant may be strong on Strategic Asset Allocation but weak on Dynamic Asset Allocation.

p) We broadly support the development of basic standards for reporting performance of recommended asset management 'products' and 'funds', which investors can use to compare their consultant(s) against other consultant(s). However, we envisage several significant problems in terms of feasibility, effectiveness and implementation, as well as certain unintended consequences.

q) Firstly, we strongly disagree with the conclusion that the performance of recommended managers can be assessed separately from clients' objectives and decisions while performance of asset allocation advice *cannot* be judged separately. *This would be a fair conclusion based on the examination of some consultancy models, but it is not true for all.*
   i. Multiple consultants do generate lists of product recommendations or highly-rated products/managers that are not based on individual client needs (we term these "buy lists"). However, this is not a universal model.
   ii. bfinance, for example, does not operate a buy-list: we consider the full universe of available providers for each client, with a fresh analysis based on specific needs and objectives: these may include very particular restrictions (e.g. local regulatory requirements), and may not prioritise outperformance against a common market benchmark but could frequently be based upon some very different objective (e.g. diversification versus incumbent managers or existing risk exposures).
   iii. In addition, since we operate as an extension of a client's team, the client is involved at every stage and makes choices – guided by our analysis, but not controlled by us – about which firms are retained through the stages of the selection process.
   iv. As well the appropriateness of divorcing manager recommendations from clients' specific objectives/needs, we are also concerned about the competitive impact of any

framework that has been designed with buy-list models in mind. It is a possible **unintended consequence** that bfinance and some other firms would not be able to compete fairly with consultants operating “buy lists”.

r) Secondly, we foresee an **unintended consequence** wherein consultant selection (and comparison of current vs other consultants) will be inappropriately skewed towards fund manager recommendation data, and away from hugely important capabilities such as asset allocation, risk management and more.
   i. It is a truism that *what gets measured gets managed*.
   ii. Many investors believe that services such as asset allocation advice have a stronger impact on long-term outcomes than the choice of investment products.
   iii. The report does not appear to provide proposals that would allow investors to compare the performance of different consultants in the areas of asset allocation, risk management and so forth.
   iv. If the CMA recommends a framework through which investors can compare manager recommendations, we strongly encourage proposing frameworks through which investors can compare services such as asset allocation. Not to do so could produce a problematic bias.
   v. We note that the CMA has opted not to pursue one initial concept for approaching (iii): the idea that scheme performance could be used as a proxy for consultant performance. We support the reasons for opting not to pursue this approach, but are surprised to see no alternative concept suggested as a replacement.
   vi. One example of a replacement concept could be an aggregation of consultants’ scores against their established objectives with past and current clients, since those may be instituted as part of the previous Remedy. *As long as the objectives are sufficiently clear and suitably granular (n – o), with the guidance of TPR, then it may be plausible to quantitatively aggregate consultants’ performance against them.*

s) Looking specifically at the proposed framework for assessing the performance of asset manager recommendations, we are concerned about what appears to be lack of consideration for assessing capability in alternative investments (e.g. private debt, unlisted infrastructure etc).
   i. Alternative investments (such as private equity, infrastructure, Alternative Risk Premia, hedge funds etc) comprise an increasingly substantial part of investor portfolios, versus traditional equity and fixed income investments. Implementing investments in these sectors represents a high priority among our UK clients during the last three years.
   ii. These are widely viewed as more challenging to invest in, with greater risk of losses and greater costs, making effective support from advisors particularly important.
   iii. They have largely not been addressed in the CMA’s analysis of asset manager product recommendations. We observe that there is a **feasibility** obstacle: it is significantly more complicated and challenging to produce frameworks for these asset classes.
   iv. One potential **unintended consequence** of manager recommendation performance frameworks that insufficiently consider alternative investments is that consultant weakness in these asset classes can be overlooked, resulting in detrimental outcomes for clients.

t) We warmly urge that bfinance be invited to participate in the consultation regarding the design of the framework on asset manager product/fund recommendations.

Comments on Supporting Remedies

Remedies proposed by the CMA

- Extension of FCA regulatory perimeter.
- Enhanced TPR trustee guidance and oversight of Remedy 1 (mandatory competitive tendering on first adoption of fiduciary management).

Response from bfinance

u) We support the CMA's proposal to extend the FCA regulatory perimeter to include investment consultants.

v) We approve of enhanced TPR trustee guidance and oversight of Remedy 1.

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