Investment Consultants Market Investigation

Working paper: Market outcomes: updated results

25 October 2018

This working paper is published following further analysis undertaken in light of representations made in response to the consultation on the CMA's provisional decision report.

The group is continuing its review of the submissions received during the consultation and will proceed to prepare its final report, which is currently scheduled for publication in December 2018, taking into consideration (among other matters) the evidence obtained, responses to the consultation on the provisional decision report as well as other submissions made to us.

Parties wishing to comment on this working paper should send their comments to investmentconsultants@cma.gsi.gov.uk by 5 November 2018.

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Introduction

1. This working paper presents the updated results of our 'market outcomes' analysis, following comments from parties in response to our Provisional Decision Report (PDR).[1] It covers two areas of analysis:

   a. Gains from engagement: the impact of engagement on the fees paid by fiduciary management (FM) and investment consultancy (IC) customers. For FM customers, we have undertaken two related pieces of analysis:

      i. The 'FM static' analysis compares the *level* of prices across different pension schemes depending on whether they are engaged.

      ii. The 'FM transition' analysis compares the *change* in prices when schemes moved into FM with their existing provider of IC, depending on whether they were engaged.

   b. The relationship between quality and market success: this analysis looks at the relationship between quality of service and market shares for a sample of investment consultancy firms.

2. Table 1 summarises the main updates to the analysis and results.

Table 1: Summary of the main updates to the analysis and results

Analysis	Post-PDR updates	Summary of updated results
Gains from engagement: FM static model	Changes have been made to the underlying dataset, which affects the status of some schemes, and expands the number of firms in the analysis. We have also tested some sensitivities suggested by parties.	The results indicate that internally-acquired schemes that ran a formal tender paid significantly lower prices than internally-acquired schemes that did not run a formal tender.[2]
Gains from engagement: FM transition model	The changes to the underlying dataset made above also apply to the FM transition analysis. We have also tested some sensitivities suggested by parties.	The results indicate that internally-acquired schemes that ran a formal tender had a significantly lower increase in price (when moving from IC to FM) than internally-acquired

[1] The market outcomes analysis is presented in chapter 10 and Appendices 5 and 6 of the PDR.
[2] An 'internally acquired' scheme is one that was an IC customer of the firm prior to moving into FM. Our updated analysis focuses on formal tenders as the primary measure of engagement rather than running formal tender, using a professional trustee or a third-party evaluator.

Analysis	Post-PDR updates	Summary of updated results
		schemes that did not run a formal tender.
Gains from engagement: IC model	In line with the changes made above, we have tested the impact of formal tendering (only) on fees paid.	The results do not substantially change from those presented in the PDR, and provide some evidence that schemes that ran a formal tender paid significantly lower prices than those that did not.
Quality-market shares analysis (IC only)	We have extended the dataset to include 2017 and tested some sensitivities suggested by parties. This includes using an alternative calculation of market shares.	The results indicate that higher 'quality' IC firms typically have lower market shares than lower 'quality' IC firms, and this effect has persisted over time.

Source: CMA Analysis

Gains from engagement

FM static analysis

3. The FM static analysis compares the level of prices paid by pension schemes for FM services in 2016. In the PDR, our results indicated that 'internally-acquired engaged' schemes paid around 24 percent lower fees on average than 'internally-acquired disengaged schemes' (controlling for a range of other factors).[3] Engaged schemes were defined as those that ran a formal tender and/or used a third-party evaluator and/or had a professional trustee.

4. In response to comments on the PDR, we have made some changes to the underlying dataset used to conduct this analysis. These changes can broadly be classified as follows:

    a. The status of some customers has changed, with some customers being reclassified as 'engaged' (having previously been classified as 'disengaged'), and some customers being reclassified as 'internally acquired' (having previously been classified as 'externally acquired').

    b. The number of firms included in the analysis has been increased. We have processed the relevant data of an additional IC-FM provider,

[3] See paragraphs 10.31 – 10.43 and Appendix 5 of the PDR.

enabling us to include this provider in the analysis. We have also expanded the dataset to include 4 FM-only providers.[4]

c. Some technical issues were raised regarding the dataset and coding, which have been dealt with on a case-by-case basis.

5. Our updated baseline results are presented in Table 2. Column (1) presents the results from the PDR; column (2) addresses the data issues referred to in paragraph 4 (a) and adds data for the additional IC-FM firm; column (3) replicates column (2), but restricts the definition of 'engagement' to a formal tender; column (4) replicates column (3) but also includes data from the FM-only firms.

6. We are treating column (4) as our new baseline model. The results in this column show that internally-acquired schemes that ran a formal tender paid around 22 percent lower prices on average than internally-acquired schemes that did not run a formal tender.

Table 2: Updated baseline results – FM static analysis

	(1)	(2)	(3)	(4)
Engaged internal	-0.26**	-0.03	-0.19*	-0.22**
External	-0.14	0.02	-0.00	0.01
Buys Liability hedging (dummy)	0.31***	0.43***	0.45***	0.45***
Performance fee (dummy)	0.38**	0.35**	0.37**	0.37**
Assets Under Management (logs)	-0.39***	-0.42***	-0.42***	-0.39***
Number of AM firms (logs)	0.14***	0.15***	0.13***	0.12***
Percent assets in FM	0.00	0.00	0.00	0.00
Number of Firms	4	5	5	9
Adjusted R^2	0.58	0.62	0.62	0.60
Sample size	198	258	258	298

[4] We have included those FM-only providers from which we have received the necessary data to conduct this analysis.

Source: CMA Analysis

7. In their response to the PDR, one party submitted that the engagement indicator is no longer statistically significant if the variable 'percent of assets in FM' is removed from the model. Table 3 shows the impact of omitting this variable.

8. Column (1) reproduces our baseline model for comparison. Column (2) shows that formal tendering becomes statistically insignificant when the 'percent of assets in FM' variable is omitted from the model. We note that the number of schemes in the analysis increases from 298 to 326 when this variable is omitted.[5] Having analysed the characteristics of these additional schemes, we found that the vast majority of them use performance fees. We have therefore tested whether performance fees affect the results of the model.

9. In column (3) we remove schemes that use performance fees from the analysis. Tendering again becomes statistically significant in this case. We consider that this restriction is relevant because performance fees add an additional layer of complication to the model, which it is difficult to properly control for.

Table 3: Sensitivities I – FM static analysis

	(1)	(2)	(3)
Engaged internal	-0.22**	-0.12	-0.26*
External	0.01	0.07	0.03
Buys Liability hedging (dummy)	0.45***	0.54***	0.45***
Performance fee (dummy)	0.37**	0.32***	-
Assets Under Management (logs)	-0.39***	-0.41***	-0.43***
Number of AM firms (logs)	0.12***	0.10 ***	0.12***
Percent assets in FM	0.00	-	-
Number of Firms	9	9	7
Adjusted R^2	0.60	0.63	0.61
Sample size	298	326	253

[5] This happens because these 28 schemes did not have information on the percentage of assets in FM, and hence are dropped in column (1).

Source: CMA Analysis

10. In response to the PDR, it was also submitted that schemes that underwent a 'structured bidding process' should be classified as engaged. We address this in Table 4.

11. Column (1) reproduces our baseline model for comparison. Column (2) extends the definition of formal tender to include structured bidding processes. In this case the engagement indicator becomes statistically insignificant. Column (3) accounts separately for those schemes that ran a formal tender, and those schemes that undertook a structured bidding process but did not conduct a formal tender. Formal tendering again becomes statistically significant, whilst the structured bidding process is statistically insignificant.

Table 4: Sensitivities II – FM static analysis

	(1)	(2)	(3)
Engaged internal (tender only)	-0.22**	-	-0.22*
Engaged internal (SBP or tender)	-	-0.11	-
Engaged internal (SBP only)	-	-	-0.03
External	0.01	0.01	0.00
Buys Liability hedging (dummy)	0.45***	0.42***	0.45***
Performance fee (dummy)	0.37**	0.36**	0.37***
Assets Under Management (logs)	-0.39***	-0.39***	-0.39***
Number of AM firms (logs)	0.12***	0.12***	0.12***
Percent assets in FM	0.00	0.00	0.00
Number of firms	9	9	9
Adjusted R^2	0.60	0.60	0.60
Sample size	298	298	298

Source: CMA Analysis

FM transition analysis

12. The FM transition analysis tests whether schemes that were more engaged had a smaller increase in their fees when moving into FM than schemes that were less engaged.[6] In the PDR, our results indicated that engaged schemes paid around 26 percent lower fees on average than disengaged schemes (controlling for a range of other factors).

13. Some of the changes to the underlying dataset made above also apply to the FM transition analysis. Our updates to the dataset also mean that an additional IC-FM provider has been included in the analysis.

14. Our updated baseline results are presented in Table 5. Column (1) presents the results from the PDR; column (2) includes the changes to the dataset made in response to comments on the PDR and restricts the definition of engagement to a formal tender; column (3) omits schemes that use performance fees; and column (4) omits schemes that used fewer than 2 IC services.[7]

15. We can see in column (2) that the adjustments made to the dataset result in the engagement variable no longer being statistically significant. In columns (3) and (4) however we make reasonable adjustments to the sample and the variable is statistically significant.

Table 5: Updated baseline results – FM transition analysis

	(1)	(2)	(3)	(4)
Engaged	-0.31**	-0.29	-0.41*	-0.42**
Percent assets in FM	0.01***	0.01***	0.01***	0.01***
AUM (logs)	0.11**	0.08	0.05	0.11
Client buys hedging	0.42***	0.48**	0.59***	0.69***
Adjusted R^2	0.35	0.27	0.26	0.39
Number of firms	4	5	4	4

[6] See paragraphs 10.44 – 10.47 and Appendix 5 of the PDR.
[7] The rationale for this is that schemes using very few IC services may only have appointed their IC for certain services (or 'project work'). Conceptually, we are more interested in analysing the relative FM and IC spending of schemes that use the provider for the full range (or a comparable set) of services.

Sample size	104	110	96	66

Source: CMA Analysis

16. Some additional points were made by parties in response to the PDR, for example regarding further sensitivities of the baseline model. These points will be addressed on a case-by-case basis in the Final Report. Where necessary, we have undertaken additional analysis and this will be included in the data disclosed in the Confidentiality Ring.

IC analysis

17. The IC analysis compares the prices paid by pension schemes to investment consultancy firms in 2016.[8] In the PDR we found some evidence that more engaged schemes paid significantly lower prices than less engaged schemes. However, this result was not statistically significant when firm-level 'fixed effects' were introduced (which control for average prices at each firm). We therefore placed limited weight on these results.

18. We have updated this analysis by defining engagement to consist of a formal tender, as in the FM analysis above. This has little material impact on our results.

The relationship between quality and market success in IC

19. This analysis assesses the relationship between quality of service and market shares for a sample of investment consultancy firms.[9] Data on quality of service is provided by Greenwich Associates (using their Greenwich Quality Index (GQI)) and data on market shares (using revenues) was collected directly from investment consultants.

20. Our analysis in the PDR covered the period 2010-2016. We found that in each year, firms that provided a higher quality of service had lower market shares. Whilst there is some evidence that these 'high quality' firms gained market share over the period, our regressions did not find that this was statistically significant.

21. Following the publication of the PDR, we have collected updated revenue figures from parties which has enabled us to produce market shares for 2017. We have therefore extended this analysis to cover 2010-2017. We continue to find a negative relationship between quality of service and market share.

[8] See paragraphs 10.24 – 10.30 and Appendix 5 of the PDR. Price is defined as total spend per hour of advice.
[9] See paragraphs 10.102 – 10.109 and Appendix 6 of the PDR.

22. In its response to the PDR, one party commented that we have used incorrect market shares in our analysis. As noted in the PDR, we have used two different calculations for market shares. For the cross-section 2016 market shares, we 'deflated' each firm's market share to account for the percentage of respondents to the CMA survey that used an 'unknown' provider. In the timeseries market shares, we do not make such an adjustment.[10]

23. As this analysis is based on several years of data, we relied on the timeseries market shares. Table 6 demonstrates that the relationship between quality of service and market share in 2016 is not materially affected by using the alternative cross-sectional market shares.

Table 6: Correlation between quality and market share in 2016

	Correlation with GQI
Market share (as calculated in the PDR analysis)	-0.62
Market share (alternative calculation)	-0.66

The table shows the pairwise correlation between two separate measures of market share and the GQI score across firms in 2016. This is based on 11 observations.

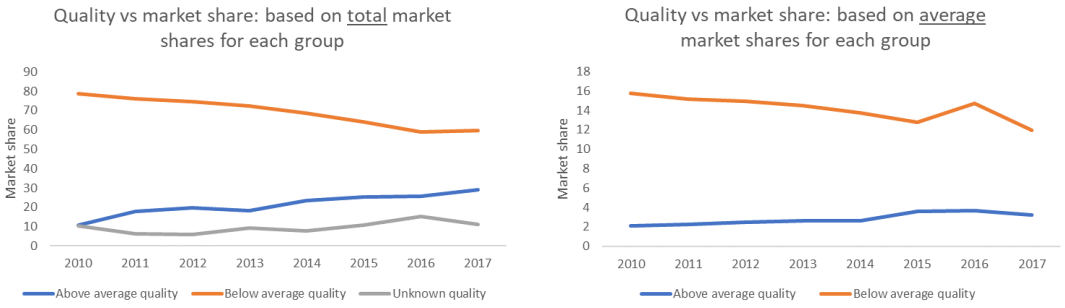
Source: CMA Analysis

24. In Figure 28 of the PDR (p.255), we compared the *average* market shares of 'above average' and 'below average' quality firms over time. One party commented that we should instead have analysed the *total* market shares of these two types of firm. In Figure 1 we consider both approaches (extending the analysis to 2017). The two charts show similar trends. The 'below average' quality firms have substantially higher market shares than 'above average' quality firms, although their market share has declined over the period.

25. We note however that this decline is driven largely by a single firm, and (particularly in the right-hand chart) the market share of the 'above average' quality firms is increasing only slowly. In each year, there continues to be a negative correlation between quality and market share.

[10] This is because we do not know what the share of the unknown providers would be across time.

Figure 1: Market shares over time, split by quality levels



Source: CMA Analysis

26. In its response to the PDR, one firm submitted that this analysis does not control adequately for price and other related factors. We note that if price was a relevant 'omitted factor' in this analysis, we would expect to see a positive correlation between price and quality – ie 'high quality' firms may have lower market shares because they charge higher prices.

27. As part of our investigation we have collected data on the revenues per hour received in 2016 by different investment consultancy firms. If we correlate this measure of price with the GQI score of different providers in 2016, we find a negative but statistically insignificant relationship. We therefore find no evidence that the negative relationship between quality of service and market share is driven by price.

28. Some additional points were made by parties in response to the PDR, for example regarding the definition of quality and the construction of the GQI variable. These points will be addressed on a case-by-case basis in the Final Report. Where necessary, we have undertaken additional analysis and this will be included in the data disclosed in the Confidentiality Ring.