

INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of Trustee roundtable discussion held on 3 October 2018

Introduction

The following is a summary of points raised in discussions with three groups of pension trustees at a session at the CMA's London office on 3 October 2018.

The Trustees were invited from a list of respondents to the CMA survey and the event was also publicised via the Association of Member Nominated Trustees (AMNT). Staff from the Financial Conduct Authority (FCA) and The Pensions Regulator (TPR) attended the meeting as observers.

Trustees sat on pension scheme boards of various sizes. Some trustees sat on more than one scheme. Together, they represented Defined Benefit (DB), Defined Contribution (DC) and hybrid pension schemes (those that have a DB and a DC element).

We do not consider the views given in these discussions and captured in this note as representative of all pension schemes, but we do consider that they provide useful illustration and explanation of issues we are considering regarding our proposed remedies and recommendations.

Scheme governance and general competition issues

Some trustees considered that there is an inherent conflict in FM as the advisor is also the provider and so judging their own performance. These trustees felt that it could be important for a scheme to get independent advice even if it has FM.

There was debate regarding the benefits of FM. Some trustees felt that the costs were high, and the benefits (e.g. discounts on AM products) could easily be passed on to IC clients without an FM mandate. Others felt that there were clear benefits in terms of professionalisation of investment decisions and having clearer investment objectives, and that having FM enabled trustees to focus on bigger strategic decisions.

Some trustees believed that some pension trustees may be unaware of FM until it is explained to them – they ‘don’t know what they are missing’.

Several trustees commented that it was hard for some schemes to find trustees, or trustees with the necessary skills, and so they are more likely to need to use Third-party Evaluator (TPEs) or professional trustees.

Trustees believe that the quality of the individuals from the consultancy firms matter and that research costs and integration are important. They find that consultancies provide costs for different services, but that ad hoc bits of advice add to the cost e.g. the Statement of Investment Principles (SIP) and the Chair’s Statement.

Comments on CMA proposed remedy 1: mandatory tendering for first FM mandates

Most trustees supported this remedy.

A professional trustee who had participated in two FM tenders noted that there was a wide range of prices offered by firms when tendering. But cost was not the key factor for trustees as net of fees performance is more important.

A trustee stated that moving into full FM is one of the biggest decisions the trustees will make, and so tendering is absolutely vital.

Another trustee agreed that tendering was essential but questioned whether it was necessary to mandate this.

There was some concern about whether a tender would be sufficient to address the conflict of interest that firms that offer both investment consultancy and fiduciary management services have. It was felt by some trustees that the incumbent IC firm might ‘tee up’ the client so that they are more likely to win the FM tender.

There was general support for closed tenders because it was felt that bidders really need to understand the scheme, and it may not be suitable to make scheme-specific information publicly available to all bidders. Also, trustees felt that not all firms will wish to take part in an open tender.

Describing a typical tender process, trustees said that the first step was that they have to decide what services they need so as to be clear about the potential scope of the mandate.

Some trustees considered that six to eight firms should be approached to bid to ensure that at least three respond with a proposal.

Some trustees noted that there may be fewer bidders to supply FM to smaller schemes (although one very small scheme had received 8 bidders for the tender). One trustee said that it is difficult to get anyone outside the three largest providers to participate in a tender for consulting. They considered that this is partly a resourcing issue as completing tender documents is time-consuming, and partly because other firms may be put off if they know the three largest providers are tendering. This view was not widely shared.

Some trustees felt that it is best if they get professional help with tendering, for example from their sponsor's procurement team. A sponsor may insist the trustees follow its corporate procurement process although not necessarily.

A trustee of a scheme which has been with the same IC provider for 17 years said the scheme is now reviewing the position but that the trustees felt a TPE would be too expensive and might not be independent, so they are using their legal adviser to help them with the review. Trustees believe that TPE fees for running a tender exercise are considerable – in £10,000s.

One trustee said that they will circulate to all bidders a list of all the questions that have been raised by other bidders, but this does not mean that the identity of those bidders is then known by all.

Going through tender documents is very time-consuming for trustees. The bidders require feedback, which is also time-consuming.

The length of the process depends on things like how often the trustees meet – a minimum of three months was the general view, perhaps extending to six. Bidders may lose interest if kept waiting too long. Two trustees told us that the FM tender process can last six months and then take a further six months or so to do the transition.

Commenting on the proposed requirement for a tender for partial FM mandates, trustees mentioned that there is currently an uneven playing field between schemes with IC-only firms and IC-FM firms. If your consultant is an IC-only firm, you have to tender to get a partial FM mandate. On the contrary, if your consultant is an IC-FM firm, you might move to a partial FM mandate as an 'extension' from your current IC relationship. Many trustees agreed that IC-FM firms should not be able to do these 'extensions' without a tender.

Trustees raised some doubts about the practicality of mandatory tendering for schemes already in FM which had not tendered before. One professional trustee noted that one of their schemes had a lock-in period of five years with their FM

provider and another professional trustee said that this was fairly typical. It was suggested that using a TPE or having a comply or explain regime might be more suitable ways of driving competition for existing mandates.

Comments on CMA proposed remedy 2: “warnings” on marketing of FM by IC-FM firms

A number of trustees had experienced investment consultancy (IC) firms persistently marketing their fiduciary management (FM) services. Trustees believed that individual consultants appeared to have strong incentives to move clients into FM.

IC firms also marketed their own investment products to clients. Some trustees felt that their IC cannot be providing independent advice if they are also a provider of investment products.

Trustees had a range of experience: some were clearly told by providers when they were marketing; some were not told (although these examples were before MiFID II¹ had come into force). Trustees with financial services backgrounds believed that they could identify product marketing more easily. Many said that regulatory wording was typically hidden at the back of paperwork.

Some trustees agreed with this remedy, and none saw harm in it. But many trustees doubted its effectiveness. Some trustees noted that the incumbent IC already has its ‘foot in the door’ and this will simply be a tick-box exercise. It was noted that conversations between trustees and the IC are more important.

Some professional trustees felt that, to be effective, the incumbent IC should be prevented from any marketing of their own FM service until a tender takes place.

Comments on CMA proposed remedy 3: TPR guidance on tendering

Trustees generally found TPR guidance good, especially for new trustees. Guidance is clearer now than it used to be and the comply or explain regime makes it more effective. It was argued that lengthy guidance is only read by trustees who are already engaged in scheme governance.

It was felt that TPR guidance on tendering will be useful for schemes that cannot afford professional help and that templates could be useful for smaller schemes. The

¹ The European Union legislation comprising a package of instruments in relation to markets in financial instruments, of which the MiFID II Directive and the MiFID II Delegated Regulation are the most directly relevant in the context of the present market investigation.

guidance would need to take account of varying sizes of scheme and so have some flexibility in the process. Providers will also look at what regulators require.

Trustees supported there being principle-based guidance and also templates on tendering (covering all services), with specific modules covering IC and FM. A number of trustees stated that guidance should be as concise as possible. Trustees were positive about TPR's trustee toolkit and believed that advice on tendering could be built into this.

Professional trustees or experienced trustees say that they help other trustees keep up to date. They also say that their advisers read and present to them on new guidance.

Some trustees thought that TPR should seek the views of TPEs in drafting new guidance.

With regard to TPR guidance on FM, trustees felt that this would make trustees stop and think before ploughing ahead into FM.

Comments on CMA proposed remedies 4 and 5: FM fee disclosures for existing and prospective clients

Trustees generally supported these remedies and the itemisation of charges proposed by the CMA. They also welcomed the disclosure of transaction costs that are likely to be incurred when changing FM provider.

Many trustees said that they are more concerned about net of fees performance, rather than fees themselves. But several professional trustees argued that fee transparency is still beneficial, and the information proposed was the absolute minimum that should be provided. Trustees stated that bundled fee information was not sufficient.

It was felt that, as a minimum, asset management (AM) and FM charges need to be clearer and the information should disclose passive and active fees. To be meaningful, this requires clarity in what the adviser is meant to be doing. A template could be helpful.

Trustees felt that they are starting to see more clarity on costs but not from all asset managers.

Concerns were expressed that fees might not all be presented in the same way, so they would not be comparable. Monthly reporting is normal in, say, banking but FM

firms haven't done this to date and some say they can't. There was some concern that fee standardisation has the potential to restrict innovation.

Comments on CMA proposed remedy 6: FM performance standard

Trustees felt that the IC Select performance standard is a good initiative but that it has been a very slow process. Trustees are keen that progress to date on agreeing a standard is not discarded.

Trustees generally supported the IC Select standard and believed it would help them to compare FM providers. They also supported some independent oversight of the standard. It was noted that there is currently no meaningful way to compare the performance of different providers, so even an imperfect standard would be beneficial.

Some felt that measuring performance against composites has challenges as the FM provider may not have any clients on which it could provide information which are sufficiently similar to that of the client requiring the information.

Some trustees suggested that the standard might result in trustees focussing on past performance and not taking into account other factors when selecting their FM provider.

Comments on CMA proposed remedy 7: trustees set investment consultants strategic objectives

Trustees felt that having to set advisers objectives is a good idea in principle, but that it needs to be a flexible requirement.

Trustees were unclear whether small schemes would have sufficient knowledge to set sensible objectives for their advisers and might be unclear over what they were meant to be measuring. It was noted that the sponsor may influence this.

Trustees felt that these objectives could be linked to the adviser's role in helping them achieve their scheme objectives.

A number of professional trustees stated that strategic objectives were useful to hold consultants accountable for the quality of their investment advice. It was noted that ICs generally do not currently have targets or strategic objectives, and that ICs have not been accountable in the past for scheme performance. It was suggested that an ex-ante journey plan would be a good strategic objective, although one trustee was concerned that investment objectives might lead to some short-termism from consultants which could increase scheme risks.

Suggested indicators of good adviser service performance may include clarity of reporting, seeking feedback, good ideas, clear advice.

Trustees were keen to limit the 'red tape' that is placed on them in complying with this requirement, but they considered that a simple tick-box on the scheme return (or similar) would be fine.

Comments on CMA proposed remedy 8: standards for reporting the performance of recommended asset managers

The general view was that this remedy will work if the CMA designs it well, but trustees recognised the challenges in agreeing the principles.

Some trustees were not clear how useful it would be, whether their providers could do it or what the cost of it might be to providers. To make it effective, proper comparability of reporting from different providers was felt to be key, with regard to reporting timescale and other matters. Trustees suggested that the asset managers' own reporting might need some verification.

There was broad support for net of fees reporting wherever possible, as this is seen to be the outcome that is relevant to a pension scheme.

Comments on proposed recommendation that investment consultants should be regulated by the FCA

There were mixed views amongst trustees regarding this recommendation. Some stated that FCA regulation of their adviser would be a comfort factor for clients. But some felt that the extension of the perimeter will make little difference in practice.

Some trustees argued that regulation might affect smaller firms negatively. Some stated that the FCA's oversight should only cover conflicts of interest which generally don't apply to the smaller firms.

Appendix: List of schemes represented by trustees at the discussion

(Please note, trustees may also represent other schemes not listed below)

Acco Europe Pension Plan

Acer Group Pension Scheme

Arcadia Group Senior Executives Pension Scheme

ARRI GB Ltd Pension and Assurance Scheme

British & Foreign Bible Society (1972) Staff Pension Scheme

Britvic Pension Plan

Capital Cranfield

Consumers' Association Pension and Employee Benefit Scheme

Dover Harbour Board's Pension Scheme

Hermes Group Pension Scheme

Lazard, Directors and Staff

London Business School Pension and Life Assurance Scheme

Methanex (UK) Ltd Pension Plan

Midcounties Co-operative Pension Scheme

New England Windows Limited Pension Scheme

Oxford University Press

Royal Agricultural College Pension Scheme

Russell Hurst Pension Scheme

Stolt Nielsen

The Bank of New York Pension Plan

The Calor Group Retirement Benefits Plan

The East of England Co-op Retirement Benefits Scheme

The Europe Arab Bank Plc Pension Scheme

The SME Centralised Pension Scheme (DB Master Trust)

The Wolters Kluwer Holdings (UK) Plc Final Salary Scheme

UBM Pension Scheme