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Dear Sir

Investment consultants market investigation
Response to the Competition and Markets Authority's Working Paper on Market outcomes: updated results

Introduction

EY is responding in its role as an independent third-party evaluator of fiduciary management services provided to UK pension scheme trustees.

EY comment

We concur that pension schemes which have undertaken formal tenders have benefitted from lower fiduciary management fees. Running an exercise that introduces competitive tension into the process often results in a lowering of the fee, but we would like to share some observations on this:

- Significant care needs to be taken not to focus too much on fees at the expense of a fiduciary manager's quality of service. For example, negotiating a reduction in fees under the transition model can sometimes mean that trustees are uncertain as to whether they are receiving the full extent of services normally expected from the fiduciary manager e.g. portfolio construction, asset allocation, manager selection and reporting.
- Likewise, when considering the static model, the overall service and operating model can vary significantly across fiduciary managers. It is therefore vital that trustees compare and understand what these differences in service are, in order that value-for-money becomes the test, rather than simply the fee level.
- Consideration needs to be given to the overall service offering, including expected investment efficiency, quality of reporting, contract length, fee variability over time as scheme AUM changes, style of exist clauses etc.
- Elaborating further, one of the key attributes of a high quality tendering process is the ability to influence fiduciary managers to create a portfolio for each scheme that is aligned to all of its requirements and beliefs – this is an important point we have highlighted in our previous responses to the CMA's working papers. Selecting the right fiduciary manager to create the right portfolio based on well-thought-through

investment beliefs is fundamental to the whole selection exercise. To put this into context, it would only take a very modest amount of investment outperformance to negate the impact of a higher fee. Extreme care therefore needs to be taken not to focus on fee levels at the expense of the trustees' investment beliefs and the resulting portfolio that needs to be constructed.

- Whilst considering fiduciary management fees is important, it is even more important that trustees do not lose sight of the total cost of investment. We note that the larger proportion of fees in a fiduciary management mandate come from investment management fees rather than fiduciary management fees, with the latter varying considerably across fiduciary managers. We elaborate on this, and the other key investment costs, in our 2017 Fiduciary Management Fees Survey.

It is our view that value creation is a composite of cost, the investment proposition, the operational risk management offered by the fiduciary manager, and the legal terms of the fiduciary management agreement. This leads to a strong need to consider the total service offered by the fiduciary manager and the total cost of investment, rather than, whilst still important, focusing too much on the fiduciary management fee.

We support the view that a formal tender exercise adds value, but it does not produce a robust and all-encompassing view of the fiduciary managers. The need to have such a view is vital as a lot of investment decision-making is being delegated to the fiduciary manager, so areas such as operational risk management become very important.

We believe that any guidance on a formal mandatory selection process for trustees should be principles-based, rather than rules-based with standard templates for RFPs and fee comparisons. The use of principles will help to avoid unintended consequences being introduced, and also enable trustees to ensure that it is their investment beliefs and needs that determine the appointment of a fiduciary manager.

We also believe that any firm or body supporting trustees in the selection of a fiduciary manager should be able to demonstrate a robust knowledge of the market, along with a full understanding of the investment propositions, operating environments and cost bases, to ensure trustees make a fully informed decision. By the very nature of a fiduciary management solution offering a high level of delegated investment activity, trustees should not be over-constrained by restrictive templates.

We are grateful for the opportunity to make a contribution to this important inquiry, and we would be pleased to answer any questions or provide more detail.

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