

Praful Depala
Project Assistant
Investment Consultants Market Investigation
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

7 March 2019

Dear Mr Depala

Investment consultants market investigation draft Order

We are pleased to respond to the Investment Consultancy and Fiduciary Management Market Investigation Order 2019 ("the Order"). We offer our comments in the capacity as an independent third-party evaluator of fiduciary management services provided to UK pension scheme trustees.

Overall, we are supportive of the Order, however there are some amendments which we would like to suggest which could help to improve further the level of information made available to pension scheme trustees.

Article 9.2.c.i

We appreciate that it is useful for trustees to have an estimate of the costs of transitioning into a fiduciary management portfolio, so they can make an informed choice as to if or when to appoint a fiduciary manager. However, different methodologies are used by fiduciary managers to estimate their transaction costs, which means that trustees are sometimes unable to make like-for-like comparisons between their prospective fiduciary managers. For example:

- Fiduciary Manager 1 ("FM1") calculates the bid-offer spreads for each fund it proposes to invest in, and provides the total bid-mid spread as the cost of the transition.
- Fiduciary Manager 2 ("FM2") proposes to invest in funds which are all priced at Net Asset Value ("NAV") and therefore quotes transaction costs of zero.

In this example it seems that it would be more expensive to transition to FM1's portfolio. The reality is that there are trading costs with both providers, and FM2's transition costs are not clear and would only come through in the experienced returns.

We suggest that the methodology used for calculating transition costs is explained by fiduciary managers, setting out clearly where any further transaction cost leakages may be experienced.

Article 13

Fiduciary managers and investment consultants often use performance over a benchmark to illustrate their ability to identify outperforming managers. While article 13.2 provides some guidance on this, there are an increasing number of asset classes (e.g., hedge funds, private market assets, absolute return funds) where a reliable index benchmark is difficult to find.

We have, for example, seen consultants showing an outperformance on hedge funds where the benchmark was simply a cash return, even though they had expected net cash returns of plus 4% per annum at the time of investment. We believe this situation is common in a range of alternative asset classes and diversified growth funds, and such asset classes can make up over a third of a pension scheme's portfolio. Therefore, a lack of clarity on benchmarking could result in some trustees potentially making ill-informed investment decisions.

To help improve matters we suggest that the Order requires consultants to show past performance relative to their assumptions / expectations for asset classes that do not have an obvious / unique benchmark. For example, if a consultant assumes that a given hedge fund can generate a growth in cash of plus 4% per annum, this expectation should be set out at the time of investment, and past performance should be shown relative to this expected return.

We are grateful for the opportunity to offer our comments on the Order, and we would be pleased to discuss our views and answer any other questions you may have on the subject.

Yours sincerely

Iain Brown
Partner, Head of Investment Governance & Oversight

Ernst & Young LLP
United Kingdom