BBS Consultants & Actuaries

The workplace pensions experts

BBS briefing note

Final report of CMA investigation into investment consultancy services

On 12 December 2018, the Competition and Markets Authority (CMA) published its final report on its market investigation into investment consultancy and fiduciary management services. This followed a referral from the Financial Conduct Authority (FCA) in September 2017, in response to their study into the workings of the asset management industry, and the CMA's provisional findings in July 2018 (see *BBS briefing notes 155 and 168*).

The CMA found that there were issues that had an adverse impact on competition in both the investment consultancy and fiduciary management markets. However, the CMA had greater concerns about fiduciary management than the investment consultancy market generally.

This *BBS briefing note* summarises the findings of the investigation and the reforms the CMA wishes to see implemented, along with our view on the report's findings and remedies.

The CMA's conclusions are largely unchanged from their provisional findings.

Investment Consultancy

The CMA concluded that the investment consultancy market was not highly concentrated, especially for smaller pension schemes.

There is a low level of engagement by some pension scheme trustees in choosing and monitoring their investment consultants. They do not have the tools to evaluate the quality of their consultants and identify if an alternative may be better.

The CMA believes this reduces competition and is expected to be detrimental to outcomes.

Fiduciary Management

Fiduciary management is an asset management approach where trustees delegate investment decisions to a third party with a view to meeting their investment objectives.

The CMA believes that there is a significant advantage to the incumbent investment consultant where it advises on its own fiduciary management service. This is caused by:

- Low engagement by trustees when entering such arrangements.
- Investment consultants steering clients towards their own fiduciary management services.
- A lack of information on the fiduciary managers' performance or fees.

The result of this is that trustees may make use of their current investment consultant's fiduciary service, even if a better deal is available elsewhere. The CMA also found that high costs of switching providers may make matters worse.

Furthermore, they found that difficulties in comparing fees between fiduciary managers also hindered comparison when considering changing managers.

The CMA believes that this reduces competition between fiduciary managers and is therefore expected to be detrimental to pension schemes.

Market Impact

The CMA believes any negative consequences for pension schemes will be significant and may have a cumulative and compounding impact. This is based on the overall size of UK pension scheme assets advised by investment consultants and fiduciary managers, of £1.6 trillion, and the long time horizon of pension scheme investments.

CMA Actions

The CMA has proposed a series of 'remedies', which primarily focus on increasing competition between fiduciary managers and increasing trustee engagement.

The remedies for fiduciary managers are:

- A mandatory duty on trustees to competitively tender when a fiduciary manager is initially appointed (if covering 20% or more of scheme assets) and a duty on trustees to carry out a competitive tender within five years if such a mandate has previously been awarded without such a process.
- A requirement for investment consultants that offer fiduciary services to separate marketing of their fiduciary management service from their investment advice and to inform clients of their duty to tender.
- A requirement for fiduciary managers to provide better and more comparable information on fees and performance for prospective clients and on fees for current clients, including exit fees.

The remedies for investment consultants are:

- A requirement for trustees to set objectives for their investment consultant, to help judge the quality of advice received.

The remedies for both are:

- A requirement to report the performance of recommended products and funds to trustees using common standards.

In addition, the CMA would like The Pensions Regulator to oversee the remedies on pension scheme trustees and, in particular, to provide greater support for trustees when running a competitive tender process, as well as guidance to trustees to support the other remedies.

The CMA also recommended that all the main activities of investment consultants and fiduciary managers be brought under the regulation of the FCA.

The CMA expects most remedies to be implemented by the end of 2019.

BBS View

The remedies are mostly unchanged from the original proposals, and hence our view is unchanged from that in our previous briefing note (bn168). The CMA's actions are limited in extent compared with some of the options that were initially on the table, for example, breaking up firms that offer both investment consulting and fiduciary management.

We are supportive of the CMA's desire to improve trustee engagement with investment consultants and believe this will make it easier for them to judge the quality of service they receive. In practice, many of our clients already have strategic objectives against which performance can be measured, such as to outperform the change in value of the liabilities by a certain margin, with a defined level of risk.

Moving the main activities of investment consultants and fiduciary managers under the regulation of the FCA could be viewed by trustees as leading to an increased regulatory burden and additional costs. However, a significant proportion of the work undertaken is already regulated by the FCA.

The requirement for compulsory tendering for fiduciary mandates may slow down the transition from 'traditional mandates', as the complexity of a formal tender exercise may put some trustees off.

As a significant number of fiduciary mandates have been awarded without a competitive tender, a number of schemes will now need to undertake one. We suggest such schemes act sooner rather than later given the potential for fiduciary managers to be swamped by compulsory tenders. Also, by tendering they could benefit from improved terms.

In theory, an increased level of tendering and transparency around fees and performance should make the terms offered by fiduciary mangers more competitive. However, if fiduciaries become more selective, this could reduce competition.

Please contact your usual consultant if you have any queries on this briefing note.

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