The CMA Investment Consultants Market Investigation

July 2018

More engaged trustees get better outcomes….

The CMA produced its 'Provisional Decision report' on 18 July. Its key finding is that:

- The market is not overly concentrated, with trustees having a wide range of firms available to choose from, and that there are no significant barriers to entry

However, competition in the investment consulting market is not all it should be because:

- Some trustees do not scrutinise their advisors closely enough
- Low levels of engagement can mean that switching occurs infrequently
- The quality of the service delivered is hard to assess

And within fiduciary management:

Too many trustees appoint without a formal tender process

Information from fiduciary managers to help assessments is of mixed quality

Combined investment consultants and fiduciary managers have an advantage when selling fiduciary to existing clients and the larger firms are taking an increasing market share.

The CMA has produced provisional recommendations which they consider to be proportionate with the issues identified. For the most part they are also consistent with the series of interim reports and potential remedies published earlier in the year – so there are no great surprises. The key recommendations are:

- Compulsory tendering when appointing a fiduciary manager
- Compulsory retendering of existing fiduciary appointments if they were not subject to a tender originally
- Combined investment consulting and fiduciary management firms to warn clients when they are pushing their own products
- The production of better information on performance and fees through the development of new industry standards
- Trustees should set their investment consultants clear strategic objectives.

The CMA recommends that The Regulator supports trustees by providing new and improved guidance on tendering for services and that the FCA's remit is expanded to include more of the services provided by Investment Consultants and Fiduciary Managers.

The CMA has not recommended a change to the structure of the industry, for example the forced separation of combined Investment Consulting and Fiduciary Management firms.

The CMA acknowledges that more engaged trustees achieve better outcomes – that should come as no surprise, so the key questions are, will the potential remedies improve engagement in practice and how will the industry react to them. We comment below:

Overall, our view is that the remedies are consistent with the issues identified. We are pleased that there is no significant change to the structure of the industry being proposed. Restructuring would have increased overall costs massively, created an extended period of uncertainty for trustees and, potentially, led to an extended period of Fiduciary Managers and Investment Consultants focusing on managing their businesses rather than their clients' assets.

The governance related improvements suggested will help if they are implemented well.

Competitive tendering for all services used by trustees should be the norm and many trustee boards already run tenders efficiently and achieve very positive outcomes. Mandatory tendering on the first appointment of a fiduciary manager seems appropriate and will help if the tender process is robust. Note however that the CMA has a preference for 'open tendering'; in our view this is likely to be highly inefficient – it is more efficient and cost effective to run focused tenders based on matching a client's requirements with a relatively short list of potential providers that we know in advance can deliver those requirements. This also encourages a potential FM provider that currently has no relationship with the client to participate.

The compulsory retendering of mandates that were not originally tendered may also help, by creating downward pressure on fees for example. However, it may prove to be ineffective - take the example of a trustee board that has a good relationship with its fiduciary manager and that manager is delivering good results. It seems unlikely that other fiduciary managers will be willing to participate if the only reason for the tender is to satisfy the CMA.

Forcing combined investment consulting and fiduciary management firms to warn clients when they are pushing their own products has to be a good thing; although well-governed schemes should already be aware of potential conflicts at all of their service providers. It is also hard to believe that any trustees have missed all of the discussions on conflicts created by the original FCA review and the CMA review.

The production of standard performance reporting and more granular information on fees is also to be welcomed. However, as with all information of this type, the devil will be in the detail:

- The majority of fiduciary mandates are managed against client specific benchmarks and objectives so creating universes of outcomes leads to distortions
- Fiduciary mandates are still relatively new in the UK, many years of data for multiple schemes is required to prove that outcomes reflect skill rather than just luck
- Attributing performance to different decisions has always been difficult but doing so is essential when trying to understand the performance of fiduciary managers. Positive steps have already been made in this area, but in future it will become even more crucial as, whilst fiduciary managers appear to have been successful in the past, a lot of their success has been driven by hedging more liabilities than most advisory clients. The tailwind for fiduciary managers created by falling yields may not persist, so a clear understanding of the gains made by the other key elements of fiduciary offerings (e.g. accessing diversifying assets classes) will become key
- Fiduciary managers present their fees and the fees of the underlying managers they use in many different ways, so standardisation will help. However, we think that trustees should also be given more detail on underlying costs, within pooled funds for example, and what steps fiduciary managers are taking to mitigate those costs.

Past performance and fee information should of course be taken into account when appointing and assessing fiduciary managers and investment consultants. However, it requires very careful interpretation and should be considered alongside a range of additional factors including the team being used, quality of the service delivered and the overall relationship.

Advising on appropriate strategic objectives should be a core part of an investment consultant's role and trustees should of course assess outcomes against those objectives.

Industry participants now have until October to comment on the CMAs proposals and the CMA will then have until 13 March 2019 to publish its final report.

We anticipate that the major investment consultants and fiduciary managers will be supportive of most of the proposed remedies, mainly because they are not particularly extensive or onerous. As it seems likely that the majority of the recommendations will be adopted, any reviews of investment arrangements that were planned but put off pending the CMA review should now be started – waiting longer would not constitute good governance.

If you wish to discuss an investment governance related issue or are thinking about a fiduciary management or investment consultant tendering exercise, please contact one of our team:

anne@museadvisory.com
barry.mack@museadvisory.com
chris.fagan@museadvisory.com