Response to FCA Asset Management Market Study Consultation

February 2017

We fully support efforts to improve transparency and ensure greater value for money for both retail and institutional investors. There are many areas set out in the study we agree with, but there are some areas we would challenge, particularly in relation to the FCA's summary of the investment consulting market.

The investment consulting market is more competitive than the Study suggests:

The investment consulting market is significantly less concentrated than it was several years ago. There are more firms involved in the market than ever before. Added to that trustees have more choice of implementation methods than ever before. This increase in market participation, along with diversification of approaches, has given a welcome boost to competition.

The FCA study itself refers to the latest figures for advisory revenues of the three largest firms as representing upper bound estimates, with the true level of concentration potentially much lower. Medium sized-firm, as well as smaller firms, have been taking market share. We've seen a range of new entrants in recent years.

With trustees placing increased focus on good governance and more market players attempting to build market share, there is already a natural trend for more review of incumbent providers.

Many trustees of the pension schemes we advise already have formal or informal programmes of regular review of their investment consultants and other advisors in place. Trustee Boards usually comprise business professionals from all walks of life who take their duties, particularly in relation to governance, seriously. Most also include Independent Trustees who are essentially professional trustees, adding an additional layer of governance, knowledge and expertise.

The investment consulting market is more diverse than the Study would suggest:

The growth in competition in the investment consulting market has led to a more diverse range of implementation solutions, and as a consequence more diverse business models. It is not a homogenous market. There is greater diversity in the business models of investment consultancies than this report infers, with some offering fiduciary management services as well as advice, and others offering pure advice based business models.

The value of consultants' advice should be assessed, but measured against clients' specific objectives not an arbitrary benchmark:

Clearly there are challenges, but at the same time it is also clear that institutional investors find it difficult to assess the quality of advice they receive. We would be keen to work with the industry to develop a common set of guidelines and best practice to measure the value added by consultants.

It's widely recognised that developing quantitative metrics to measure consultants' strategy advice in isolation is difficult. Qualitative measures would be required alongside any quantitative measures.

Each scheme has different investment objectives with a wide range of attitudes, beliefs and appetites for risk as well as different strength of sponsor covenant, and these will also change over time. The provision of advice needs to be measured against longer-term objectives set by a client and should focus on a combination of returns achieved and risks mitigated. Looking only through the lens of absolute returns or short term performance would be wrong. The Department for Work and Pensions (DWP's) Defined Benefit Green Paper issued today recognises the importance of objective setting in this way for schemes. It is currently consulting on whether there could be a role for Government in setting out a range of acceptable objectives such as buy-out, a reduction in balance sheet volatility, or reaching a certain level of funding by a certain time.

Furthermore advice is just that – advice. Clients may choose to implement it; they may not. This adds further complexity to measuring the value of advice, as not all clients follow it. The clear exception is fully delegated fiduciary management where the advice is also implemented by the consultant giving it. Even in this instance, however, the client sets the framework that the fiduciary manager operates in.

The significant growth in independent trustees introduces another influence to decision-making and assessing advice. The oversight independent trustees have of multiple schemes puts them in a unique position of knowledge to compare the quality, effectiveness and 'value add' of advice. These professional trustees have grown in number and provide an invaluable service in assessing the value of advice trustee boards receive.

It is also worth noting that a scheme may see a good 'outcome' irrespective of the advice (in a bull market asset values may rise improving funding levels – but downside protection wasn't in place for example). The reverse is also true. A scheme could receive good advice to reduce risk and volatility and then lose out on the upside in the event of a market bull run. In the context of the objectives set and agreed, this could have been an effective strategy in terms of maintaining affordability and offering greater long-term protection, for example.

The regulatory regime for strategy advice needs to be appropriate:

The Law Commission's 2014 report on the fiduciary duties of investment intermediaries looked at whether the asset allocation advice delivered by investment consultants should be brought into the FCA's regulatory perimeter. It concluded that extending regulation in this area was unjustified.

Professional standards in investment consulting and employee benefits consulting businesses are already extremely high, and more rigorous than in many other professions. In our business we abide by the Institute and Faculty of Actuaries' (IFoA's) Actuaries Code. This applies to all our actuaries for ethical standards. We are also regulated by the Financial Reporting Council (FRC). This applies to all our actuaries through technical standards. The Pensions Regulator (tPR) has codes of practice and other guidance that our consultants must understand and abide by.

Determining what that 'regime' should be is not a 'market competition' issue:

The question of how to monitor and measure the quality of strategy and asset allocation advice consultants give is not a market competition issue. In that context, a Market Investigation Reference (MIR) to the Competition and Markets Authority (CMA) is not an appropriate course of remedial action.

All evidence points towards more competition in the investment consulting and employee benefits market in recent years. The professionalism of trustees, through widespread use of independent trustees, has introduced significant knowledge of what is offered by consulting firms, increasing the ability for comparison of quality and advice provided by consultants. It's hard to see how an investigation by the CMA will help the industry arrive at a means of better assessing the quality of strategy advice delivered by consultants.

While we are supportive of initiatives that allow trustees to more easily assess the value of advice they receive, and this is something we strive to deliver for our clients, there is a danger of applying a regulatory regime that's fit for one market on to another where its application would be less appropriate; particularly where high standards already exist. Scheme actuaries already operate within the professional standards of the IFoA. Investment strategy advice is more aligned to the professional environment scheme actuaries operate in than to the regulatory environment of fund managers.

Actively managed funds can be strategically valuable to a portfolio:

For some asset classes active management is a zero sum game. Our clients invest passively where it's appropriate to do so, and most have an increasing proportion of their core listed equity and bond market exposure via passive management.

However, there are some asset classes that are strategically valuable to a client where there are no passive options, for example alternative forms of credit and UK infrastructure.

The focus of the FCA study analysis is almost entirely focused on tracking error rather than absolute risk or risk relative to liabilities. Tracking error is not the focus of all institutional investors when considering active mandates. We note that active management can be as much about accessing targeted outcomes, i.e. seeking risk adjusted returns, as much as it is seeking outperformance of a sometimes arbitrary benchmark. This point applies equally to listed markets and alternative investments.

Fiduciary management:

Fiduciary management can make sense for schemes with lower governance budgets, particularly smaller schemes, as a means to benefit from scale through pooling. Disclosure of potential conflicts is widespread, and the use of external oversight growing, albeit from a low base. However, we do share the FCA's concerns on conflicts of interest around firm's offering independent investment advice whilst also providing the underlying investment product.

We do have some concern that a primary focus on lower cost solutions would have unintended consequences. If the industry is directed towards achieving lower costs through service consolidation, this could lead to greater use of combined advisory and fiduciary services through a single entity, with inherent conflicts. There would also likely be consolidation in the market as fewer entities support these larger scale operations.

Reporting standardised costs and charges:

Institutional investors would benefit from standardised disclosure of fees and charges for all asset management products, but only if the information is delivered in the context of value for money, rather than cost alone. The challenge lies in devising a framework that delivers this in a way that avoids the traps of short-termism or one that presumes lowest cost leads to best outcome.

Striking a balance between sensible transparent disclosure without creating an unwieldy and expensive process for doing so will be key.

Disclosure of an Ongoing Charges Figure that includes all fees, charges and costs other than transaction costs, and separate disclosure of estimated implicit and explicit transaction charges. This is in line with the FCA's specific option B.

Disclosure of fiduciary manager fees should be unbundled to show the balance of fees and charges that go to the fiduciary and those that go to the underlying managers.