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# XPS Investment News Alert

Bringing you the latest news affecting UK pension scheme investments

## The CMA's final report and what it means for your scheme

The CMA published its final report into the investment consulting (IC) and fiduciary management (FM) market on 12 December 2018.

It found that there were adverse effects on competition in both markets and have set out a package of 8 remedies alongside 4 supporting remedies. It has a greater concern with the FM market than Investment Consulting; 5 of the 8 remedies relate specifically to FM, 1 to IC and 2 to both IC and FM.

**In this note we summarise the remedies and provide more detailed appraisal of each one.**

### Overview

#### Fiduciary management remedies

Pension funds will be required to competitively tender all FM contracts when they are appointing an FM for more than 20% of the assets for the first time. If pension funds haven't done this already, they will be required to do so within 5 years of appointing the FM. They will also be required to split their advice and marketing into separate documents. This will increase competition as ICs will no longer be able to steer their clients to their own FM solutions without going through a tender process – which is a sensible commercial activity that any well run business adopts.

#### Investment consulting remedies

The CMA found that 'below average' quality firms have substantially higher market shares than 'above average' quality firms, although their market share has declined over the period.

Encouraging competition in this market will therefore also create better outcomes for pension funds. The CMA will require pension funds to set a strategic objective to help assess if they are achieving their goals.

Not only do we think it's a really sensible report, I believe the implications are bigger than most people realise. It's going to create massive amounts of open competition and now it's got some teeth – regulatory oversight – we think it's a real step forward in fiduciary management.



**Patrick McCoy**  
Head of Investment



### In brief

- CMA publishes final report
- Remedies along similar lines to provisional report with some further enhancements
- XPS Investment supports the findings of the CMA review
- Expected to substantially improve FM market competitiveness
- Next step: issuing of the CMA Order in 2019



# The remedies – one by one

Fiduciary  
Managers  
(FMs)

Investment  
Consultants  
(ICs)

FMs  
and ICs

## Promoting Trustee engagement when buying Fiduciary Management

### Remedy 1: Mandatory competitive tendering for FM

When appointing FM for the first time for more than 20% of the funds' assets, trustees are required to run a competitive tender process. This can be a closed process but must include 3 FMs. There is no requirement to obtain independent oversight but TPR is going to provide guidance (Remedy 3).

If trustees have not met these requirements with the appointments made to date, they will be required to do so within 5 years of the FM appointment or within 2 years of the CMA Order which is expected in early 2019, whichever is longer.

FMs will be prohibited from accepting appointments that have not gone through a competitive tender process.

### Remedy 2: Separation of advice and marketing by IC/FMs

ICs will be required to put a prominent notice on their written materials when marketing their own FM services. They will also be required to put marketing in a separate document from their advice (this is an addition to the provisional remedy following a suggestion by XPS during the consultation).

### Remedy 3: TPR to provide guidance on competitive tendering process

The CMA has invited TPR to consider how guidance on running a competitive tender for fiduciary managers can also be used to support trustees when tendering for investment consultancy services. The wider role that TPR's guidance can play in supporting trustees, including in relation to their use of investment consultancy services, is set out in recommendation B.

## Fees and performance reporting

### Remedy 4: Requirement on FMs to report itemised fees to existing customers (FM)

FMs will be required to provide disaggregated fee information to their existing customers on a regular (at least annual) basis. This breakdown will include the 'core' fiduciary management fee (including advice and implementation), asset management fees, transaction costs and other fees (such as custodian fees). The overall fee and the itemised fees will be shown in both percentage and cash terms.

### Remedy 5: FMs to disclose itemised fees to prospective customers

Information on fees provided by FMs will need to be consistent and comparable across bids in a tender process. In particular, the remedy requires firms to disclose and itemise all costs and charges that will be incurred by the customers. This will be provided both in percentage and cash terms.

### Remedy 6: FMs to report their past performance by reference to a common methodology and template

This remedy requires fiduciary managers to report historic investment performance of the firm's full fiduciary management customers by reference to a standardised methodology.

### Remedy 7: Duty on trustees to set strategy objectives for their investment consultant

Trustees will be able to better monitor the performance of their investment consultants by setting and measuring them against an appropriate set of strategic objectives, which are closely linked to the scheme's investment objectives where possible.

### Remedy 8: Requirement on ICs and FMs to report performance of recommended asset management 'products' or 'funds' using a basic minimum standard

Information provided by ICs and FMs to prospective customers on the performance of their recommended asset management products and in-house funds must adhere to certain MiFID II requirements.

## Supporting remedies

Alongside the remedies, the CMA has also made four recommendations to government (Department for Work and Pensions and HM Treasury), The Pensions Regulator (TPR) and the Financial Conduct Authority (FCA) to make the package of remedies more effective.



### **Supporting remedy A: Recommendation to HM Treasury to extend the FCA's regulatory perimeter to cover 'all relevant' investment consultant activities**

Firms which provide IC and FM will be subject to consistent and proportionate regulation that reflects market developments and addresses the competition findings of this investigation.

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### **Supporting remedy B: Recommendation to TPR to provide enhanced trustee guidance**

TPR to ensure trustees have access to guidance on how to assess their existing advisers and how to tender for, assess the performance of and choose fiduciary managers and investment consultants.

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### **Supporting remedy C: Recommendation to the FCA that it maintains oversight of transparency of asset management fee reporting**

FCA to ensure pension scheme trustees have access to accurate, consistent and comparable information on underlying asset manager fees.

Standard templates should help trustees understand the underlying charges they pay.

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### **Supporting remedy D: Recommendation to DWP to pass the necessary legislation to enable TPR to oversee remedies 1 and 7**

TPR should be empowered to oversee those remedies that pension scheme trustees must comply as part of its regulation of them, namely 1. Mandatory competitive tendering and 7. The duty is on trustees to set their investment consultants strategic objectives.

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# Key changes in the CMA final report

Remedy	Responsibility	Change from July 2018 provisional report	Implementation timescale	XPS view
<b>1. Mandatory competitive tendering for FM</b>	Trustees to adopt with FMs required to confirm that a competitive tender has taken place in order to accept an appointment	20% threshold introduced given the relatively small proportion of schemes that employ FM for less than 30% of assets	Within 5 years of the FM's original appointment subject to a minimum of 2 years from the CMA Order coming into effect (expected in 2019).	This has scope to introduce much needed competitive tension into the FM market. The CMA has linked formal tenders with a 20% reduction in FM fees. We believe the voluntary use of a third party evaluator will enhance the benefit.
<b>2. Separation of advice and marketing by IC/FMs</b>	IC/FM to use separate documents and prescribed warnings. FCA to oversee in the long term	Requirement for separate documentation introduced following XPS feedback	Takes effect from 6 months of the CMA Order coming into effect.	We believe that this is an appropriate remedy that will aid a clear distinction being made between investment advice and FM marketing.
<b>3. TPR to provide guidance on competitive tendering process</b>	TPR to produce and trustees to adopt on a voluntary basis	No substantive change	Expect TPR to issue within 6 months of the CMA Order coming into effect.	Based on our experience of guidance issued by TPR in other areas we would expect this to be a valuable reference that trustees will benefit from applying in practice.
<b>4. Requirement on FMs to report itemised fees to existing customers (FM)</b>	FMs	No substantive changes	Takes effect from 6 months of the CMA Order coming into effect.	We believe the first step in managing costs is good quality information. These remedies will provide the means to assess the cost/benefit of different solutions and assess the value for money of existing services.
<b>5. FMs to disclose itemised fees to prospective customers</b>	FMs	No substantive changes	Takes effect from 6 months of the CMA Order coming into effect.	
<b>6. FMs to report their past performance by reference to a common methodology and template</b>	FMs, Third Party evaluators and other participants to agree a proposed approach and the CMA will consider if it meets the requirements. The IC Select FM Performance Standard may be accepted for this purpose in due course.	No substantive changes	Takes effect at the date of the CMA Order.	Comparable performance information is an important aspect of a transparent market. We believe the suitability of a fiduciary manager is about much more than past performance but it is nonetheless an important measure, and one that can be reported with relatively little subjectivity.
<b>7. Duty on trustees to set strategy objectives for their investment consultant</b>	Trustees to set objectives and investment consultants to report	No substantive changes	Takes effect 6 months after CMA Order.	Setting measurable goals in advance has clear benefits. Measuring the performance of a consultant needs to encapsulate a range of aspects, and we believe the CMA has provided sufficient flexibility for schemes to set objectives of their consultant to reflect the nature of the relationship.
<b>8. Requirement on ICs and FMs to report performance of recommended asset management 'products' or 'funds' using a basic minimum standard</b>	Investment consultants and fiduciary managers who provide information on past performance of recommended funds	No substantive changes	Takes effect 6 months after CMA Order.	Clear and comparable disclosure of performance of funds will help trustees assess the claims of recommended products. XPS believes that the choice of a fund manager is about much more than trying to identify outperforming managers, which is very difficult to do consistently. Therefore better information will lead to a greater understanding of this within the market and consequently a greater focus on the other relevant considerations in selecting a fund manager, such as cost and market access.

## Supporting remedies

<p><b>A.</b> Recommendation to HM Treasury to extend the FCA's regulatory perimeter to cover "all relevant" investment consultant activities</p>	<p>HM Treasury</p>	<p>No substantive changes</p>	<p>Government has made a non-binding commitment to respond within 90 days of the publication of the CMA final report (12 Dec 2018)</p>	<p>The specifics of exactly what services will be included is vague, given it is a decision for Government.</p>
<p><b>B.</b> Recommendation to TPR to provide enhanced trustee guidance</p>	<p>TPR</p>	<p>No substantive changes</p>	<p>Expect TPR to issue within 6 months of the CMA Order (expected in 2019).</p>	<p>We believe guidance will be highly beneficial in this area.</p>
<p><b>C.</b> Recommendation to the FCA that it maintains oversight of transparency of asset management fee reporting</p>	<p>Proposed that the FCA oversees in addition to the Cost Transparency Initiative who has direct responsibility (CTI is a group formed by the Institutional Disclosure Working Group following the FCA Asset Management Study)</p>	<p>No substantive changes</p>	<p>No timescales indicated</p>	<p>Adding regulatory oversight gives the CMAs remedies real teeth which we support. It means trustees, FMs and ICs will need to comply.</p>
<p><b>D.</b> Recommendation to DWP to pass the necessary legislation to enable TPR to oversee remedies 1 and 7</p>	<p>Department for Work and Pensions</p>	<p>No substantive changes. Whilst D is a new Remedy, it was previously largely captured under the provisional remedy B</p>	<p>Government has made a non-binding commitment to respond within 90 days of the publication of the CMA final report (12 Dec 2018)</p>	<p>Adding regulatory oversight gives the CMAs remedies real teeth which we support. It means trustees, FMs and ICs will need to comply.</p>



**For further information on this or any other investment topic, please get in touch with Patrick McCoy or your usual XPS contact.**



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