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UK

Volume 2017 | Issue 72 | 30 September 2017

Investment Consultancy Services Under the Spotlight

Investment consultancy and fiduciary management services are to be the subject of an investigation by the Competition and Markets Authority (CMA). This follows a Market Investigation Reference (MIR) by the Financial Conduct Authority (FCA). The CMA says its investigation will conclude in March 2019.

The MIR is the first of its kind, and follows on from the FCA's interim report on its asset management market study published in November 2016. The interim report found investment consultancy services to be concentrated, with three firms (Aon Hewitt, Mercer and Willis Towers Watson) taking an estimated 60% of the market. The three firms had offered the FCA a package of undertakings in an unsuccessful attempt to avoid the MIR.

Background

Following feedback from the wholesale sector competition review, which identified areas of concern for consumers within the asset management value chain the FCA launched its market study into asset management back in November 2015. Areas of concern were:

- Whether investors find it difficult to monitor asset managers and ensure they are getting value for money;
- Whether asset managers have the incentive and ability to effectively control costs incurred on behalf of investors; and
- The role of investment consultants and whether there are potentially conflicts of interest in the provision of both advice and asset management services.

A year later in November 2016 the FCA published its Asset Management Market Study Interim Report, along with its provisional decision to refer the investment consultancy market to the CMA.

Although welcoming the package of undertakings that the three largest investment consultants were prepared to offer the FCA have, following consultation with interested parties back in June, rejected the package and gone ahead with the MIR.

Market Investigation Reference

The power to make an MIR exists where the FCA has reasonable grounds to suspect that any feature of a financial service market is restricted or distorted. The features the FCA has relied on with regard to the investment and fiduciary management services industry are:

- A weak demand side, with pension trustees relying heavily on investment consultants but having limited ability to assess the quality of their advice or compare services, with resulting low switching rates.
- Relatively high levels of concentration and relatively stable market shares, with the three largest firms together holding between 50% and 80% of the market share (depending on how you calculate it).
- Barriers to expansion restricting smaller and/or newer consultants from developing their business.
- Vertically integrated business models creating conflicts of interest.

Size of the Market

UK pension funds are the largest institutional client type with £2.1 trillion of assets under management. Twelve of the largest investment consultants potentially affect £1.6 trillion of assets.

What can the CMA do?

If the CMA finds one or more adverse effects on competition, it has wide-ranging powers. It can accept undertakings; recommend action be taken by others, or put remedies into place which address the structure of the market directly. It can use one or more of its powers which include:

- Requiring consultants to provide more standardised performance information to their clients and introduce a template for reporting this information. (This might enhance transparency and assist investor decision making.)
- Requiring consultants to make their performance information publically available so that investors can compare across the market.
- Prohibiting certain fee structures that may misalign incentives for consultants when they are advising clients.
- Improving redress mechanisms when consultants underperform or an investor is not satisfied with the advice they received.
- Requiring trustees to periodically review and re-tender contracts with their investment consultants.
- Making recommendations to trustees and employers on best practices when managing their investments or managing their schemes.

Comment

The reaction from the pensions industry, including from consultancies and fiduciary managers, has been broadly positive to the news. While the three biggest investment consultancy firms are unlikely to be happy that their package of undertakings has been rejected, they can at least look forward to this MIR resulting in clarity and consistency across the investment consultancy business.

Outside of the big three, there is recognition that the MIR is good for investment consultancy generally and only right that the future regulation of this area is not driven by undertakings from the three largest participants.

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