ASSOCIATION OF CONSULTING ACTUARIES

Association of Consulting Actuaries Limited · First Floor · Regis House · 45 King William Street · London · EC4R 9AN
Tel: +44 (0)20 3102 6761 · Email: acahelp@aca.org.uk · Web: www.aca.org.uk

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TO: assetmanagementmarketstudy@fca.org.uk

Consultation response by the Association of Consulting Actuaries to the FCA Asset Management Market Study Interim Report (November 2016)

I am writing on behalf of the **Association of Consulting Actuaries (ACA)** to respond to the consultation on the Asset Management Market Study interim report.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes. Members also advise thousands of smaller pension arrangements and individuals as well as advising life and general insurers.

On the investment front, many of our members are asked to advise on scheme investment objectives and on asset allocation strategies appropriate to these objectives, taking into account each particular scheme's liabilities.

Our response to the FCA Asset Management Market Study Interim Report (November 2016), focusses on the points relevant to institutional investors.

Overall, we welcome the decision to review the asset management and investment consulting industry with a view to providing better value for money and service to both retail and institutional investors. We are supportive of the proposal to bring the provision of institutional advice within the FCA's regulatory perimeter.

Whilst we are supportive of many of the statements made by the FCA in its study, we believe the credibility of some of the conclusions regarding the services provided by investment consultants, leading to the proposal to make a Market Investigation Reference, are distorted by the small set of responses obtained from the FCA's survey (as set out in Annex 5 to the Interim Report) and that this data sample is not representative of the market.

Role of asset managers

Disclosure of fees to investors

We believe institutional investors will benefit from standardised disclosure of asset management fees and charges for all asset classes. We suggest the current Ongoing Charges Figure (set out in Figure 4.8) becomes the actual charge, with managers providing investors with *a range of the possible transaction costs* that could be incurred split by internal trading costs (instructed by the asset manager) and external trading costs (instructed by the investor). This should apply to both retail and institutional funds.

We believe better transparency of fees is in the best interests of investors however, we note the difficulty in quantifying the value of transaction costs in advance of a transaction. If transaction cost estimates are to be shown, we believe that there should be clear guidelines on how the transaction costs should be calculated.

We do not believe it is in the best interests of investors for fixed transaction cost allowances to be incorporated within a fund charge as any cost savings from efficient trading would be passed to the asset manager and not to the investor. It may also dis-incentivise asset managers to carry out efficient trading practices.

Investment consultants can help institutional investors to minimise transaction costs on the sale and purchase of assets, where possible, by either helping to appoint transition managers or to work closely with the asset managers to carry out a trade in specie or to cross trades.

The FCA has asked for views on the unintended consequences if trustees were required to publish costs and charges. At present, trustees have to publish the pound cost of fees and expenses in a pension scheme's annual trustee report and accounts. Typically, details of the individual asset manager charges for a pension scheme are not made publicly available due to confidentiality requirements of the asset managers. If trustees were required to publish this information, asset managers may be reluctant to offer negotiated fees to clients for fear that all clients may demand a similar fee reduction. This links in to the section on confidentiality and Most Favoured Nation ("MFN") clauses. We do not have any feedback on the FCA's proposal to not make any changes in this area.

Negotiation of fees

We agree with the FCA's view that larger institutional investors tend to be better able to negotiate with asset managers and that the pooling of assets, via a platform or via a fiduciary management arrangement, can allow institutional investors access to better fee terms due to the greater buying power of a large pool of assets.

We note that fiduciary arrangements or platforms can negotiate asset manager fees due to the aggregation of assets. However, the ability to negotiate fees for advisory clients can be limited, particularly for smaller mandates. This does not deter investment consultants from attempting to negotiate better fee terms for all their clients.

We believe it would not be possible for investment consultants across firms to work together to negotiate lower asset manager fees due to commercial constraints as the ability to negotiate lower fees can act as a differentiator from competitors. We do not believe this constrains innovation.

Selection of LDI managers

We agree that there is a concentration of asset managers in the LDI space but note there have been new players to the market in the last few years. We believe the LDI managers are price competitive.

We are comfortable that no further work by the FCA is required.

Active vs. passive management

We agree that it is not in investors' best interests to pay active management fees for net of fees performance that is similar to what could be achieved via a passively managed fund. In selecting and monitoring a manager appointment, investment consultants help their institutional investor clients to identify, avoid or address any manager performance which exhibits 'closet tracking' characteristics.

We believe that active management does have a place; in particular for certain asset classes where there is not an appropriate passive alternative (for example, with illiquid assets or assets driven by manager skill, such as private equity).

Measures to improve the usefulness and comparability of performance information used by trustees

The FCA has asked what format simplified and comparable disclosure should take in order to provide information to trustees.

Whilst we believe there is merit in having consistent reports, it will not be possible to achieve a standardised report that will be suitable for all clients. The level of sophistication and expertise of the trustee board will vary by pension scheme as well as the complexity of the asset manager and risk management arrangements in place. Requiring fund managers to report performance against their target or objective, rather than a benchmark index, would be helpful.

The role of investment consultants

Providing investment advice to clients

Manager selection advice

We agree with the FCA's findings that some institutional investors spend a disproportionate amount of time on manager selection (including monitoring and retention decisions) rather than focussing on strategic asset allocation. In helping institutional investors make decisions with regards to asset manager appointment, monitoring and termination, we believe it is correct for investment consultants to consider wider issues in their advice, such as team and business structure, portfolio construction and operational due diligence as well as past performance. Performance is a function of all of the wider factors so you need to understand them in order to understand the performance.

Investment consultants can add value to clients with segregated mandates by helping to tailor the objectives, guidelines and restrictions set out in the asset manager agreement to be in line with the client's needs, preferences and any requirements that are documented in the client's supporting governance document (such as a Trust Deed and Rules for pension schemes). There is little or no scope to amend the terms within pooled fund documentation but investment consultants can help their clients at the manager selection stage to consider the asset manager products, which best meet the clients' needs and objectives.

Measuring the quality of investment advice

The FCA has found that institutional investors find it difficult to assess the quality of the investment advice they receive from investment consultants. The metrics to assess the performance of asset managers against their stated objectives are easily accessible. To assess the quality of strategic asset allocation advice using quantitative metrics is complicated by the fact that each client will have different investment objectives.

Trying to isolate the value added by the investment consultant's advice is not straightforward. For defined benefit pension schemes, the long-term funding objectives, contribution schedules and risk tolerances will differ by client making a single quantitative metric meaningless to use as a comparator across schemes. Institutional investors using investment consultants may receive "good advice" (based on the current market conditions and the client's individual objectives) but see a "bad outcome" (in terms of absolute manager performance or relative to the scheme liabilities due to change in economic conditions, for example). Some clients may receive "good advice" but decide not to implement the advice. Other clients may receive "bad advice" but see a "good outcome".

We believe that investment consultants can add value to their clients if they are good communicators and give clear and relevant investment advice. One of the principles of the Actuaries' Code is that members of the Actuarial Profession will communicate effectively. The value that investment consultants bring to clients is in introducing ideas and opportunities that the pension trustees may not come across. Explaining complex issues to a layperson is a skill required by a consultant. The quality of advice can be assessed through client reviews or the use of independent trustees.

To help assess the quality of the advice provided to institutional investors by investment consultants, we suggest the FCA provides guidelines (whether quantitatively or qualitatively) around this.

Gifts and entertainment

We agree with the FCA's finding that hospitality given or received by attending or participating in sporting and social events provided by asset managers are not conducive to business discussions. We believe there is value to be gained through informal business lunches or coffee with asset managers to discuss clients, issues and product offerings, and believe a proportionate approach is justified.

The FCA may wish to clarify what it believes to be reasonable limits on the value of food or drink provided as part of a wider business meeting by an asset manager.

Fiduciary managers – fee transparency and monitoring performance

We agree that there is a limited transparency and consistency in the fee information provided by some fiduciary managers to institutional investors. We agree that there is limited independent monitoring of fiduciary managers and intermediaries can help fiduciary clients to monitor their manager.

We suggest that fiduciary manager fees are unbundled to show the fees and charges that go directly to the asset managers, the fees and charges that go to the fiduciary manager and the other operational charges. Due to confidentiality clauses, we believe it would be difficult to unbundle the asset manager fee to the charge levied at the individual manager level.

We believe it is difficult to benchmark fiduciary managers at the strategic level due to the bespoke nature of each pension scheme's investment and funding objectives, the funding position and levels of investment risk being taken.

To help trustees make an informed decision about accessing fiduciary management (whether fully or partially delegated), the Pensions Regulator could consider drafting a Code of Practice to help trustees understand what fiduciary management is, what the advantages and disadvantages of fiduciary management are, what to look for when selecting and appointing a fiduciary manager and what the alternatives to fiduciary management are.

Consultants are incentivised to recommend their own products

To help address and manage the issue of conflicts of interest (whether real or perceived) when an investment consultant talks to a client about one of their own product solutions, clear disclosure and transparency is required in the advice (in line with the requirements under Section 36 of the Pensions Act 1995) and communication to clients. In particular, the clients should fully understand what the solution is, what the cost is (and how this is broken down) and what other options are available to the client for investing in the asset class.

We would be happy to discuss this matter further if you wished. In the first instance, please contact Simon Cohen, Chair of our Investment Committee, at Simon_Cohen@spenceandpartners.co.uk

Bob Scott
Chairman and Director
On behalf of the Association of Consulting Actuaries Limited