ADDLESHAW GODDARD

COMPETITIVE EDGE

Investment consultancy market investigation

INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT SERVICES

On 14 September the Competition and Markets Authority (**CMA**) announced it is launching an in-depth market investigation into investment consultancy and fiduciary management services. This follows a reference from the FCA, one of the outcomes of the FCA's recent market study into the asset management sector. Whilst the FCA rejected attempts over the summer by the "Big 3" to offer remedies to avoid an in-depth investigation, these offer some further insight into potential remedies that the CMA might adopt, should it conclude that it has competition concerns in this area.

The FCA's concerns

The FCA made the reference following concerns it identified in its market study into the asset management sector. The FCA's final decision on a market investigation reference was published on 14 September and identified concerns regarding:

i. a weak demand side with:

   a. trustees of many pension schemes often having limited or variable experience together with limited resources, resulting in a high dependency on investment consultants;

   b. trustees finding it difficult to assess the quality of advice provided by investment consultants (either before purchasing their services, or once they have been purchased) and the services of fiduciary managers (in particular in relation to improving the disclosure of fiduciary management fees); and

   c. low switching rates;

ii. relatively high levels of concentration and relatively stable market shares, with the FCA estimating that the largest three firms together hold around a 60% market share (although the decision noted alternative market share figures from less than 50% to 80%, depending on the measure used);

iii. barriers to expansion, with trustees often selecting firms based on well-known names and reputations, and the fact that investment consultants do not appear to compete principally on quality of advice, but on relationships and brand. The FCA found these barriers particularly restrict smaller, newer consultants from developing their business outside of niche, specialist areas; and

iv. vertically integrated business models (where firms offer both advisory and fiduciary management services) creating conflicts of interest, with the FCA having a specific concern regarding the recommendation of an investment consultant's own products or services above other, potentially more appropriate, options elsewhere. The FCA noted that respondents to its consultation were especially concerned over these conflicts of interest.

What the CMA will be considering

Over the next 18 months, the CMA is required to decide whether there are features of the referred markets which are having an adverse effect on competition. If it concludes that there are, the CMA will consider whether remedial action would be appropriate. Any remedies will need to be sufficiently comprehensive to address the adverse effect(s), as well as being effective, reasonable and proportionate.

Potential remedies identified by the FCA

In its provisional decision to make a market reference (published in November 2016), the FCA identified some potential remedies, including:

- requiring consultants to provide more standardised performance information to their clients and to introduce a template for reporting this information;

- requiring consultants to make their performance and fee information publically available (e.g. on their websites or on other publically accessible databases) 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 have received;
- requiring trustees to periodically review and re-tender contracts with their investment consultants; and
- making recommendations to trustees and employers on best practices when managing their investments or managing their schemes.

Remedies offered to avoid a reference

Following the publication of the FCA's provisional decision to make a reference, the three largest investment consultants (Aon Hewitt, Mercer and Willis Towers Watson) offered undertakings in lieu in an attempt to avoid the need for a reference to the CMA.

The remedies offered principally aimed to improve the quality of information provided to clients. The undertakings included: (i) encouraging regular tendering of investment services contracts; (ii) industry standards for the public disclosure of performance in relation to manager selection within active asset management; (iii) providing information on the performance of fiduciary management whole-fund solutions to clients; (iv) providing information on fee structures, including through an Annual Disclosure Statement in a standardised format provided to clients receiving fiduciary management services; (v) commitments that consultants no longer recommend their own master trust to a client (although they could continue to introduce it); and (vii) implementing an investment consultants' code of conduct.

The FCA rejected these, concluding that the proposed remedies did not go far enough. In particular, the FCA noted (a) concerns that the conflict of interests as a result of the vertical integration of firms would not be sufficiently addressed and (b) that any disclosures to help trustees understand the value of advice and services provided need thorough consideration to minimise the risk of unintended consequences.

Next steps

The terms of reference given to the CMA are to investigate the supply and acquisition of investment consultancy services and fiduciary management services to and by institutional investors and employers in the UK.

The CMA has sent requests for information to the main companies involved and will shortly publish an issues statement setting out the proposed scope of its investigation and potential remedies, on which the CMA will seek the views of interested parties.

The CMA's investigation will conclude in or by March 2019.

Comment

Whilst the attempts of the "Big 3" to negotiate a remedies package to address the concerns identified by the FCA ultimately did not bear fruit, they provide some indication of the issues the CMA inquiry team is likely to focus on in its market investigation.

There are also similarities to the CMA's retail banking market investigation in which there was an equivalent attempt by the "Big 4" to negotiate a remedies package to avoid a market investigation reference. At the time, it was felt that the proposed remedies were quite far-reaching, although in fact following the market investigation, the CMA's Order went considerably further. The FCA's conclusions suggest that it is likely that information provided to clients and concerns around vertical integration will be put further under the spotlight by the CMA in its market investigation.

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