Principles for Responsible Investment

INVESTMENT CONSULTANTS MARKET INVESTIGATION:

CMA PROVISIONAL DECISION REPORT

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INTRODUCTION

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 2000 signatories (pension funds, insurers, investment managers and service providers, including investment consultants and fiduciary managers) globally with approximately US $82 trillion in assets under management.

Over 250 PRI signatories are based in the UK, 50 of which are asset owners. They manage assets worth approximately GBP £927 billion, primarily in non-corporate and corporate defined (DB) benefit and defined contribution (DC) pension funds.

Responsible investment explicitly acknowledges the relevance to investors of environmental, social and governance (ESG) factors in investment decision-making for the long-term health and stability of financial markets.

The PRI welcomes the publication of the CMA's Provisional Decision Report (18 July 2018).

Our comments are largely restricted to chapters 1, 2 and 13 on remedy package and provisional decision on remedies: how proposed remedies fit with financial and other regulatory requirements on providers.

SUPPORTING STATEMENTS AND RECOMMENDATIONS

The CMA's Provisional Report recognises developments regarding transparency, conflicts of interest, fees, and other strategic information to be made available to trustees, all of which the PRI welcomes.

In particular, the PRI supports:

- Promoting greater trustee engagement when first buying fiduciary management services, including:
  - The requirement for trustees to tender for fiduciary management (FM) services on an initial appointment and re-tender every five years.
  - The provision of greater support from The Pensions Regulator for trustees in the fiduciary management appointment processes.
- The recommendations on fiduciary management fees and performance reporting, including:
  - The implementation of a standardised method to measure the performance of FM providers.
  - A requirement to report on this to trustees.
- The recommendations on investment consultant appointment, fees and performance, including:
  - Greater support from The Pensions Regulator for trustees running an investment consultant appointment process.
  - A requirement for trustees to: set objectives for their investment consultant provider at least every three years to judge the quality of the service they are receiving; and establish basic standards for reporting the performance of recommended asset management products and funds.

The PRI agrees that:

- The government extends the FCA's regulatory perimeter to include the main activities of IC and FM providers.
- The Pensions Regulator develops enhanced guidance for trustees when choosing and assessing current and prospective IC and FM providers.
- The work of the FCA's Institutional Disclosure Working Group is implemented and its use and effect is monitored.

The PRI believes that the proposals put forward by the CMA should open the door to improving the quality of advice, including the incorporation of ESG factors in IC service lines. Avenues for influence include:

- Challenging incumbency practices. The Report recommends the appointment of a client's first FM must be run by competitive tender. This would increase competition in the market and reduce the competitive advantage held by the incumbent IC when it comes to getting the new business.
- New pensions regulator guidance. The Report recommends new guidance from TPR, which would provide trustees with more advice on how to choose and scrutinise providers.

- Transparency on fees. The Report recommends requirements for FMs to provide clearer information on fees and how they have performed for other clients, so that pension trustees have the information they need to make meaningful comparisons between different providers.

The CMA report provides detailed insight into the fragmented regulatory oversight of the IC sector with potential risks for arbitrage. Of significant interest is the proposal that the government broadens the FCA regulatory scope, to ensure greater oversight of the industry. This would cover fee reporting, performance reporting and the implications of regulatory developments such as MiFID II. **Should the government agree and extend the FCA's regulatory perimeter, the PRI recommends the FCA clarify ESG requirements for ICs and FMs.**

In addition, the PRI recommends that the CMA should directly respond to developments concerning the integration of ESG factors into the IC advisory process. This is because failing to adequately consider ESG issues in investment advice impacts service quality, product choice and product innovation.

The PRI recommends that the CMA:

- **Incorporate ESG issues in its recommendation to The Pensions Regulator in providing enhanced guidance for trustees when choosing and assessing current and prospective investment consultant and fiduciary manager providers.**
- **Incorporate ESG issues into Remedy 7, by requiring pension trustees to consider ESG issues when setting and reviewing strategic objectives for their investment consultants.**

As stated in PRI's submission (1 March 2018) neglecting ESG issues can lead to asset owners mispricing risk and making poor investment decisions. In turn this can undermine investment returns on behalf of their beneficiaries and as such, the quality of service delivery from ICs to clients.

The CMA's Provisional Decision Report represents an opportunity for ICs to review their own service delivery from an ESG perspective. If ICs are to retain their position as trusted advisors and develop their future businesses (e.g. FM), they need to ensure that their asset owner clients navigate these challenges effectively.

The PRI recommends that ICs review:

- Investment strategies and beliefs – The way that consultants and their clients publish investment strategies and beliefs, implement investment beliefs throughout the organisation and include ESG performance as a standard agenda item at performance review meetings.
- Asset allocation and portfolio construction – The way ESG risks and opportunities can be integrated into funding assumptions, asset allocation and portfolio construction, and how the service offering needs to evolve.
- Fund ratings – Inclusion of ESG questions in due diligence questionnaires and assessment of responses. All clients should be presented with ESG fund options.
- Reporting – Client reporting and inclusion of ESG performance reporting as standard.

- Fiduciary management – Full incorporation of ESG issues in fiduciary management, including in stock or fund selection, stewardship and active ownership, voting and reporting.

For further details, please contact policy@unpri.org.