Response to FCA Document MS15/2.2a *Asset Management Market Study - Provisional decision to make a market investigation reference on investment consultancy services*

Introduction

We are pleased to respond to the FCA's document on behalf of Redington Ltd. We set out our views on some of the important issues raised in the FCA interim report below. We believe that our experiences growing Redington's investment consulting business from the firm's inception a decade ago are relevant to the questions posed by the FCA. We welcome the chance to expand on these views in person and share further important data. In addition to our own views below, we include highlights from a recent online survey (conducted in January and February 2017) of 66 trustees and individuals together representing over 60 pensions funds, with combined assets of over £300bn, including many of our clients.

Dan Mikulskis | Head of DB Pensions

Pete Drewienkiewicz | Head of Manager Research

Mitesh Sheth | CEO

Rob Gardner | Co-founder

Dawid Konotey-Ahulu | Co-founder

REDINGTON

Contents:

About Redington: Redington is an independent and 100% employee-owned investment consulting firm founded in 2006. We currently provide advice to 75 long-term savings and investment institutions, including many defined benefit pension funds. Our clients have a combined £400bn of assets under management, and, within that, around £70bn relates to DB pension funds for which we are the sole or main strategic advisor to the trustees (out of a total private sector DB market in the UK of c£1,500bn). Our ultimate goal is to contribute to the financial security of 100m people. We are proud of the fact that, through our work with DB, DC pensions and private wealth, our advice has benefited over 2 million individuals to date. In 2016 we were ranked as the 4th most influential investment consultant in the UK (by assets under advice) according to the Spence Johnson DB Market Intelligence Report 2016. We have 100 staff located in London. Our core values are: Responsible | Open | Clear.

Executive Summary

Competition

1. **There is not currently a competition issue in the investment consultant market at the point of selection (we expand on this statement further in section 1).**

The investment consulting industry has evolved considerably over the last decade. In 2006, when our firm was founded, there was clear market concentration among three firms. Arguably this gave rise to issues of competition and concentration, but this has changed over recent years. Independent firms such as ourselves consistently win business from the larger firms in highly competitive tender processes. Our experience includes pension fund clients across a range of sizes, but predominantly those with more than £100m in assets. A full breakdown of our client base by size is included in the appendix for reference.

However, we believe there are reasonable grounds for concern over competition issues around *fiduciary management* at the point-of-sale.

We would broadly agree with the data that suggests there is a concentration of market share among the 3 largest investment consulting firms.

We note the definition of “optimum competition” is important, and this requires a thorough understanding of the nature of the service and relationship between client and consultant (a similar conclusion was made in the CMA’s provisional report on the audit market). Regulating with the goal of increasing competition (according to inapproriate measures) could have adverse consequences.

We believe the prevailing concentration of market share is explained by factors that favour the incumbent and larger firms, including:

- real and perceived frictional “costs” of switching;
- the relational, enduring, nature of consulting (and the further roles of trust, brand and credentials within that);
- benefits of scale (which can support more specialist functions and research) and the “bundled” way in which services are typically required (for example Manager Research alongside Strategic Advice).
- the difficulty in creating objective reference comparisons among firms, especially given the complexity of the subject domain and the inherent uncertainty of outcomes (which makes it difficult for clients to evaluate the possibility of “a different outcome”).

Not all of these are unreasonable influences on decision making, and we find that they are significant drivers of behaviour, all combining to reinforce a *status quo* bias.

The decision makers are often not experts in investments. When combined with the complexity and the uncertain nature of outcomes this creates a powerful behavioural decision-making challenge. It is, perhaps, not surprising that a significant status quo bias has persisted.

We have seen the role of professional trustees strengthen the buy-side, in particular, by having a clearer idea of the achievable outcomes and fees charged to other clients. This gives the demand side more bargaining power outside of competitive tenders. The influence of professional trustees was initially noted at the larger end of the pension fund spectrum, but increasingly that has spread to medium and smaller funds which we think further strengthens the buy-side in those areas.

We do **not** believe that a referral to the CMA is warranted given the current trend in competitive dynamics that we observe in the market (and that we describe in detail in section 1). If a referral is made we think it's vital this be done in the right context. Specifically, clear consideration should be given to the nature of the relationship and the dynamics that exists between trustee board, consultant and asset manager. Much of the consultant's role is to build trust with all parties and reach clear consensus on very difficult matters. This takes time, and to view competition primarily in terms of a transactional relationship and product sales would, in our view lead to poor outcomes. We would therefore urge that care is taken to avoid regulating in order to increase competition by using inappropriate measures.

Secondly, it would be a mistake to assume that competition has been static over the last decade. There have been significant improvements in competition in recent years, and the current trajectory is positive. There are many more participants from which to choose. We would urge that any remedies put in place are designed to work with and enhance the recent improvements in competitiveness, rather than inadvertently creating additional barriers to them.

Investment Consultants as Gatekeepers

2. We believe the role of an Investment Consultant is to select managers to fulfill the strategic objectives of the client, within the asset classes and strategies chosen as part of the strategic asset allocation. This includes ensuring all clients get value-for-money.

We are interested in net of fees outcomes, and the ultimate value delivered to the client.

We don't think it is possible, or right, to focus on fees in a vacuum.

Our aim is to identify the most compelling manager propositions within the asset classes that we have selected to fulfill the strategic objectives of the client, and access these propositions at a fee that leaves the largest possible share of value in the hands of the client. One key metric that we focus on is the "Manager's Share of Value Add" - MSVA. We define this as: ***The Manager's fee take as a % of the strategy's targeted (ex-ante) performance in excess of the relevant benchmark*** . We aim to achieve low MSVA ratios of 15-20% in the asset classes that we allocate to, which are below levels considered norms for the industry. We avoid asset classes where it becomes clear we are unlikely to achieve our target levels for MSVA.

We also believe clients of all sizes should benefit from buying power. All too often, smaller clients have to pay "rack rate" to access funds. We operate at a portfolio level, meaning all of our clients, accessing any solution, will get the best possible price. While "rack rate" represents the headline rate that managers charge, we frequently find that even a modest amount of negotiating power can achieve fees below this rate.

We believe the FCA should consider the risks of the regulator intervening in price issues. It may lead to a greater concentration risk, and have a negative impact on competition. If we only focus on fees and not outcomes, we believe competition will decrease and ultimately clients will get worse outcomes, as assets may be allocated to the cheapest solutions, which may not deliver the best overall outcomes.

When evaluating the value add of an investment consultant's manager recommendations, we would note this should be viewed alongside the value added or detracted by the consultant in other key areas. The most important of these being strategic asset allocation and risk management, followed by strategy selection and implementation/manager selection. The performance of managers and selection of a strategy are often inextricably linked; it would give an incomplete picture to look at the performance of managers in isolation.

Measuring the Value of Investment Consultants

3. We believe a benchmark framework would be helpful for trustees to assess the value delivered by investment consultants

There are many instances we can evidence where we have clearly added value. In many cases, this can be quantified as hundreds or even thousands of times the fees we have charged.

Generally speaking, by far the most impactful advice that an investment consultant gives to a pension fund relates to strategic asset allocation and risk management. In the UK over the last 10 years for example, the decision on whether or not to hedge interest rate risk (and to what extent) has outweighed all other decisions in terms of the impact on pension funds' financial health.

The difficulty in an advisory space has long been coming up with objective, transparent reference measures that can capture the impact of the most important advice quantitatively through time (a "track record") and aggregate representatively across clients. We detail these difficulties in section 3. They include:

- the long-term nature of the aims of the advice (and the inherent uncertainty of outcomes when dealing with financial advice)
- lack of a clear overall counterfactual for decisions
- the difficulties in aggregating different clients
- the amount of noise that could be caused by individual clients either not following advice or taking independent actions that could influence the financial position (such as making large one off contributions)

We believe these difficulties can, and should, be overcome by the industry. A properly constructed performance benchmarking framework for advisory and delegated fiduciary mandates (separately) would benefit clients.

However, we would caution against a return to the practice of peer-group benchmarking over short periods of time. Such peer-group benchmarking was commonplace prior to the 2000's and focused attention on the wrong metrics, by focusing on outperforming the median fund rather than on meeting liabilities.

This lack of objective reference points (in our view) is one of the factors that has probably held clients back from making sound comparisons between consulting firms and getting confidence in the ability of other firms. Hence this has contributed to the status quo bias and inertia described in paragraph 1.

REDINGTON

Regulation of Investment Consultants

4. We believe it makes sense to bring those areas of advice that are most meaningful to pension fund outcomes under the FCA regulatory perimeter

As mentioned in the previous section, the most meaningful advice that investment consultants give to their clients relates to strategic asset allocation and risk management. It can be shown that interest rate hedging, in particular, has generally been one of the most significant determinants of pension fund health over the last decade.

This is supported by the responses to our survey:

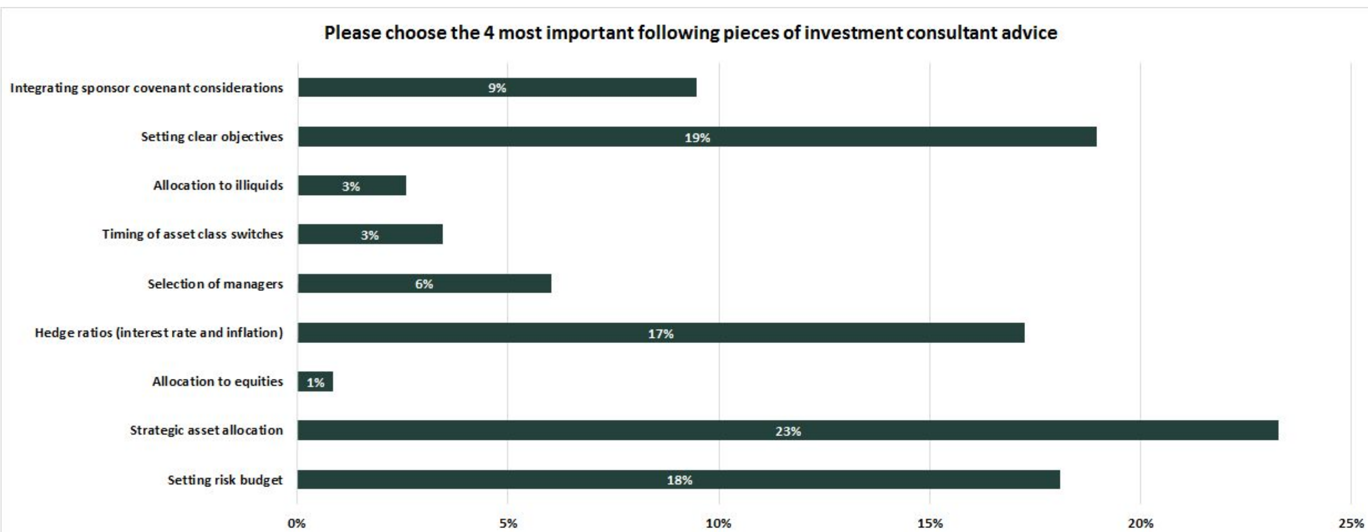

Figure 1: Survey responses ***Please choose the 4 most important pieces of investment consulting advice***

It seems logical to us that the most meaningful and impactful parts of the advice should fall under the regulatory perimeter, in addition to the current advice around manager and product recommendation.

REDINGTON

We would be in favour of bringing these parts of the investment consultant advice within the remit of the FCA. However, this would likely impose more significant barriers to new entrants in compliance with this regulation, which might be an unwanted side effect as it might discourage further new entrants.

In addition, we believe trustees and particularly Investment committees need to adopt a professional standard.

Fiduciary Management and Vertically Integrated Firms

5. We believe that either an advisory or FM approach can deliver good outcomes for pension funds. We believe that competition between the two approaches is healthy. We note that given the conflicts and incentives that can exist within a fiduciary model this carries an increased risk of clients being channeled into suboptimal solutions or not achieving the best value for money.

We also believe there is a lack of competition at the point of selection for these models (we discuss this further in section 4).

Section 1- Competition

Competition in the Market for Investment Consultancy

Based on our first-hand experiences building a business over the last decade we believe that there is not a restriction of competition today in the market for investment consultants, at the point of selection. Competition, innovation and price tension are all consistent features of the market, in our experience. Our experience includes pension fund clients across a range of sizes, but predominantly those with more than £100m in assets. A full breakdown of our client base by size is included in the appendix for reference. Our view on competition is supported by data from our online survey of trustees (below) that shows a significant majority of those decision-makers surveyed (>70%) are confident they could find a new investment consultant to fulfill their objectives if they wanted to.

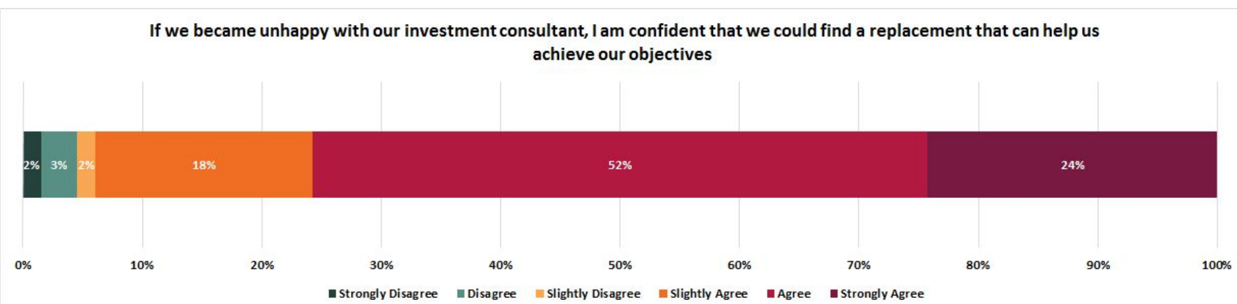

Figure 2: Survey responses: "***If I became unhappy with our investment consultant, I am confident that we could find a replacement that can help us achieve our objectives"***

We agree with the data that observes there is a concentration of market share among the largest three firms. We would suggest two good sources of data to put more colour around this point and understand recent trends:

- Spence Johnson DB Market Intelligence Report 2016
- Greenwich Associates Evaluations by UK Institutions 2016

Neither of these publications are available in the public domain, we suggest the FCA contact the firms concerned. We can provide contact details. These two surveys do agree on the identities of the largest three firms in the space but they do present slightly different pictures of the degree of concentration. We do not find this surprising as measuring this in a robust way is not a trivial thing to do: responses will differ through time and depend on the sample chosen, and larger funds may work with more than one advisor. A different picture will emerge depending on whether the market is weighted according to size, fees, or number of funds.

The Greenwich survey shows a market consisting of 16 active investment consulting firms, of which 8 had 15 or more clients within the Greenwich sample of funds.

We do **not** believe that a referral to the CMA is warranted given the current trend in competitive dynamics that we observe in the market (we describe this in more detail below). If a referral is made we think it's vital this be done in the right context. Specifically, clear consideration is given to the nature of the relationship and the dynamics that exists between trustee board, adviser and asset manager. Much of the consultant's role is to build trust with these parties and reach clear consensus on very difficult matters. This takes time, and to view competition in terms of a transactional relationship and product sales would, in our view lead to poor outcomes. We would therefore urge that care is taken to avoid regulating in order to increase competition by using inappropriate measures.

Secondly, viewing the nature of competition as static over the last decade we would view as a mistake. There have been significant improvements in competition in recent years, and the current trajectory is positive. We would urge that any remedies put in place are designed to work with and enhance the recent improvements in competitiveness, rather than inadvertently creating additional barriers to them. Given this we would challenge the assertions in paragraphs 4.16 and 4.17 of the MIR that portray the competitive dynamics of the investment consultant market as static and unlikely to change.

We would urge some caution in the way the FCA is interpreting the results of the law commission report in paragraph 4.19 of the MIR. Given that many pension funds have similar liabilities, objectives and are in similar positions it is not surprising that the advice they receive is similar. Indeed, this is right. Increasing competition with the goal of achieving a greater range of advice to funds would not in our view be consistent with better outcomes for funds or their underlying members. As mentioned previously the largest impacts on funding position historically have been achieved by making good decisions in one or two key areas of risk management and asset allocation. It would not be in the interests of funds to encourage a range of advisory outcomes for the sake of it. Consistent advice is in the interest of funds and of the overall system

We believe the concentration is explained neither by restrictions on competition nor a weak demand side. We would offer the following explanations for this concentration, based on our own experience.

- High real and perceived frictional impediments to switching.

In our experience the process of taking on a new client involves a range of tasks including: receiving, processing and reconciling data, understanding the client's history and objectives. Understanding all the key stakeholders (including both the trustees and the corporate sponsor) and their individual roles, objectives and risk preferences is also key. The role of an investment consultant is not just to put out investment recommendations in a vacuum, it is necessary to understand the complex and potentially conflicting objectives, biases, views and risk tolerances of the (generally large) number of individuals that influence the decisions taken. This is not something that can be grasped or absorbed easily from data or records alone and has to be built up through time. Our experience is that client onboarding times can be shortened, sometimes significantly so - in part due to recent improvements in technology and systems, and partly due to commitment from the client to get things done. However there is generally still a period of time in which a new consultant is getting up to speed before they can be fully effective.

Given this, it would probably not, for example, be in the client's interest to change consultants every single year or for each piece of work. In this sense the classic definition of "perfect competition" would be suboptimal in the investment consulting space (as indeed was observed by the CMA in reference to the audit space). It is therefore important to establish a reference point for what should constitute the "right" level of competition in the space, given a knowledge of the exact nature of the underlying services.

However it is clear that in practice clients have switched less often than might be expected and we often find this is because the perceived "cost" in effort and lost time is higher than the reality. Clients may also fear that a new consultant will reverse previous decisions and spend more time undoing what has previously been done to impose their own views, rather than moving forward. We believe these are largely perceived rather than real, but nonetheless perception does drive behaviour.

Our trustee survey showed that among those surveyed, however, most agreed with the statement that they would review the appointment of their investment consultant in the next 5 years, and that they could find a new investment consultant if required. This is encouraging and suggests that it is possible to address these perceived difficulties of switching.

We would observe that the Order resulting from the CMA investigation to the audit space imposed a maximum tenure of 10 years with the requirement to make a statement after 5 years as to why the appointment was not being reviewed. These timescales are already consistent with our experience with what happens in the investment consultant space, which are also supported by the results of our survey.

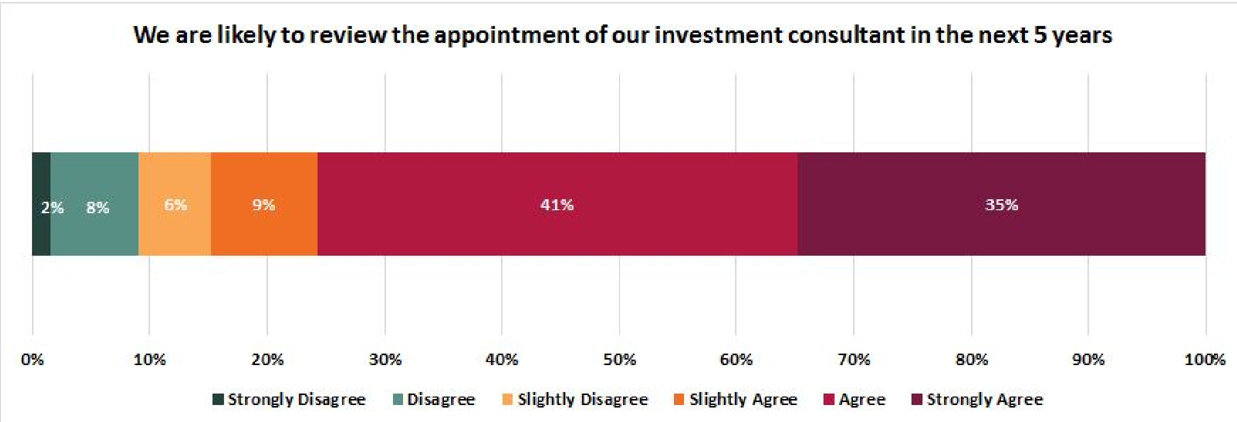

Figure 3: Survey responses: "***We are likely to review the appointment of our investment consultant in the next 5 years***"

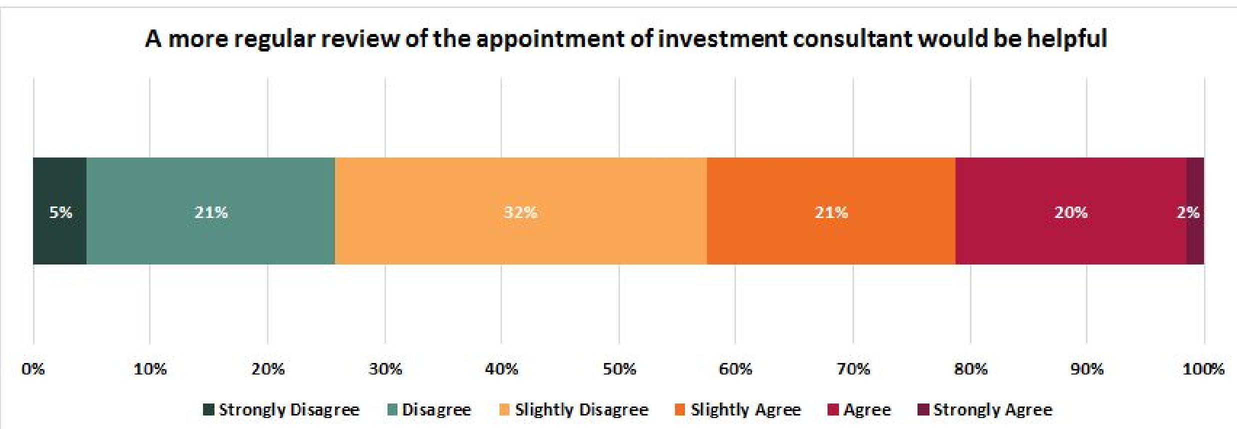

Figure 4: Survey responses: "***A more regular review of the appointment of the investment consultant would be helpful***"

- The relational nature of the consultant service, including the role of trust and the assurance provided by brand name and case-study evidence

Fundamentally consulting is a relational service, as distinct from (for example) asset management, or other more transactional-focused industries (as noted in paragraph 3.17 of the MIR). It is relatively well known that behavioural factors mean that people will change relational service providers (eg a doctor or lawyer) less frequently than transactional providers. This means that both provider and client will make a substantial upfront and ongoing, investment in relationship - and not unreasonably so - which naturally means that an expected tenure of a period of years would be reasonable.

We would go further on the relational nature than is explicitly touched upon in paragraph 3.17 of the MIR: The role of trust is also crucial. For a consultant to be effective in guiding a trustee board toward making the right decisions they must be trusted, and this takes time to build up. A client contemplating a switch to a new consultant rightly asks themselves the question “will I be able to develop trust in the new individual, and firm?”. Ultimately this could lead to a bias toward retaining an incumbent. Particularly so in a domain with high complexity and uncertain outcomes, such as financial advice.

Part of the role of a consultant is also to provide ***assurance*** around particular strategic decisions and risks. Running a pension fund is by no means a risk-free business so the consultant is required to give the client confidence in the strategic recommendations and the chosen way forward, indeed in practice this arguably tends to be as important as the nature of the investment recommendation itself. We believe there is a large role here played by brand-name in heightening the level of assurance given to the client. To some degree this is not unreasonable - credentials do matter and professional service firms more generally by and large depend on the quality of their advice for their continued commercial success. It will always be harder as a new entrant in a professional services market to establish such credentials which are necessary before winning business, and indeed this has been our own experience. A new entrant into such a market naturally faces a catch-22 of having relatively few case study clients and "war stories" with which to evidence their credentials or ability to deal with particular specific situations and clients in a similar position. The statement "we've done this all before, for clients exactly like you - you are in safe hands" is powerful in giving clients confidence, and perhaps not unreasonably so. But it creates a natural bias toward those firms that have existed for longer.

Several of these points are echoed in the CMA Provisional Findings Report[1] into the market for audit services to FTSE 350 firms, and we would agree there are parallels with the marketplace for investment consulting. However we would argue that these are not unreasonable biases on decision making on behalf of trustees and that the time spent investing in relationships by both sides is both valuable and should not be underestimated.

- Benefits of scale associated with larger firms, particularly the ability to support other multiple specialist functions, including the need to be able to research asset managers across the whole spectrum of asset classes.

Firms with larger blocks of business are naturally able to support more specialist research functions, and support greater investment into R&D generally. It is our experience that there is an expectation on behalf of buyers that investment consulting services (including, for example asset & liability modelling, strategic investment advice and manager selection) are delivered in a "bundled" approach by a single firm. There are circumstances where this could be quite beneficial to the underlying client, particularly in the context of the restricted governance capabilities of many pension funds, so we would argue that this is a nuanced point and not necessarily indicative of negative competition and "harm" to underlying consumers.

---

1 https://assets.publishing.service.gov.uk/media/5335473540f0b62d78000007/provisional_findings_reports.pdf

In particular it is common practice for trustees to receive manager research and strategy implementation advice from the same consultant that provides strategic advice and asset liability modelling. Our experience is that typically a tender for investment consulting to a medium or large pension will have a significant weighting to manager research capability. Firms with large blocks of business can more easily support the investment required to research the full range of global strategies and managers that are available. Conversely, small and growing firms will find it much harder to offer a deep research capability. Asset classes such as LDI, absolute return or illiquid credit all require quite different skill sets to research effectively.

We believe our own experience may be helpful on this point. Today, we have a dedicated manager research team of 15, out of a total firm headcount of 100. It has only been in the last several years as we have grown to our current size that Redington has finally been able to offer manager research across every asset class.

In our experience the need to “bundle” manager research advice across all asset classes alongside strategic investment advice (notwithstanding that strategic advice is vastly more impactful on outcomes) has probably been the single biggest factor restricting the growth of our business over the last decade. We would argue that the bundled nature of the consumption of investment consulting services creates a benefit to scale and therefore a barrier to entry beyond that which is ascribed to reputation alone in paragraph 3.16 & 3.17 of the MIR.

One change in the marketplace that can work to reduce the manager research “hurdle” for newcomer firms is clients getting comfortable with appointing separate consultants for strategic vs manager advice (“unbundling”). Our experience is that some clients are comfortable doing this, particularly the larger funds and this has allowed us to win business in the strategic advisory space without coverage of the manager research universe.

In our experience these arrangements can work well, but they are not without potential risks: namely that rival consultants attempt to “score points” with unnecessary challenge of each others' advice, which can waste time and block decisions, the need for multiple consultants to become familiar with the fund's data/details and the possible increase in fees (although this does not have to be a given).

This "unbundling" of different parts of the advisory service is however likely to only realistically be an option at the larger funds, given the well-documented constraints on governance that many smaller funds face (see for example the PLSA Task force DB Interim report[2]).

There are also other specialist areas that require larger firms in order to be able to support them such as buy-in/buy-out transaction teams. The presence of these additional specialist areas can also be attractive to potential clients, again favouring the larger firms whose larger blocks of business can support more specialist functions, and the investment into R&D.

Increasingly investment consultants face a rising tide of complexity in terms of the strategies and potential solutions that funds are able to deploy - over recent years this has proved to be to the benefit of underlying members. In the face of this investment in research teams and specialist functions is logical and indeed a beneficial feature of what larger and more established firms are able to offer, albeit this may create barriers to entry for smaller firms.

- The difficulty in creating objective performance comparisons between consultants

This is covered in more detail in section 3 but it does - in our view - also partly explain the status-quo bias exhibited by many clients. In the absence of firm data it can be hard to take a decision to change the status quo, as it cannot be objectively proven that you would have been better off with another advisor (in contrast, for example, to asset managers). This issue has enforced the natural status-quo bias that exists.

[2] http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/0597-DB-Taskforce-Interim-Report.aspx

To support the argument that there are competitive tensions in the market we would note that our experience is that both innovation and price tensions exist among consulting firms.

Examples of innovation include:

1. Digital tools. The role of increasingly sophisticated and user-friendly tools and apps to support and deliver consulting advice has increased significantly in recent years, with this frequently being a point of competition and differentiation among firms. These tools have evolved in recent years from being heavily spreadsheet-driven to being web and cloud based, with a much greater emphasis on clarity and usability. This has been to the benefit of underlying members, as decision makers are able to interrogate proposals "live", take in more up-to-date information to inform decisions and marshal data from a more disparate array of sources.
2. Investment strategy. Increasingly investment strategies that were considered niche or specialist are being "institutionalised" with guidance and direction from consulting firms, including ourselves and forming part of DB pension fund portfolios, to the benefit of underlying members. Examples of this include: absolute return strategies, and illiquid/opportunistic credit strategies.

Section 2 - Consultants as Gatekeepers

We believe the role of an Investment Consultant is to select managers to fulfill the strategic objectives of the client, within the asset classes and strategies chosen as part of the strategic asset allocation. This includes ensuring all clients get value-for-money.

We are interested in net of fees outcomes, and the ultimate value delivered to the client.

We don't think it is possible, or right, to focus on fees in a vacuum.

In our role as gatekeeper our aim is to identify the most compelling manager propositions within the asset classes that we have selected to fulfill the strategic objectives of the client, and access these propositions at a fee that leaves the largest possible share of value in the hands of the client. One key metric that we focus on is the "Manager's Share of Value Add" - MSVA. We define this as equal to: ***The Manager's fee take as a % of the strategy's targeted (ex-ante) performance in excess of the relevant benchmark.*** We aim to achieve MSVA ratios of 15-20% in the asset classes that we allocate to, which are below levels considered norms for the industry. We avoid asset classes where it becomes clear we are unlikely to achieve our target levels for MSVA.

There are broadly two approaches to negotiating fees at a high level as a consultant:

a. Client base-wide fee proposals which benefit all clients together
b. Individual negotiations which will generally benefit larger clients disproportionately.

We have a range of clients in terms of size (see appendix for the distribution of our clients by size), although overall our client base is weighted toward the larger end. Our observation in the industry generally is that smaller clients have less bargaining power on their own and therefore more often than not pay “rack rate” for investment management (the full undiscounted cost with no allowance for bargaining power). Frequently we find that when bargaining power is brought to bear fees can be achieved that are below the “rack rate”. Our approach is to negotiate on behalf of all the assets on which we advise, hence ensuring a good deal for clients of all sizes.

It is worth noting that a world in which fee negotiations are prioritised disproportionately risks a number of poor outcomes, not least that this would naturally favour a more oligopolistic industry environment where the handful of large competitors control all the assets and can negotiate most aggressively on behalf of their aggregate client base.

As a whole, our philosophy is to try and identify the strongest propositions, and then access them at a fee that we believe leaves the highest possible share of value add in the client’s hands.

The industry as a whole has historically believed an appropriate MSVA to be in the 20-30% share. We believe that this is too high, and have frequently negotiated for MSVA of 15-20%. Where we encounter asset classes that we are unable to find compelling propositions that meet our target MSVA we are prepared to avoid the asset class altogether. For these reasons we have largely eschewed hedge fund and private equity offerings as we believe the manager alpha shares are inappropriately high.

For example below we show data for a recent review of our preferred offerings in the Absolute Return Bonds space, where we illustrate the improvements in MSVA that we were able to drive through negotiation.

Figure 5: Representation of the Absolute Return Bonds Manager universe, performance targets and fees as a percentage of value add (MSVA), initial and negotiated positions. Redington preferred managers are circled.

Focusing hard on these target ranges for MSVA has several consequences, for example it means we have to work harder to consistently find new offerings which we believe can assist our clients, and equally it can mean that we have to reject managers with high asset concentrations from our peers who do not negotiate as hard on fees as we do, because we are unable to negotiate fees in the appropriate context as mentioned above).

From time to time we encounter compelling propositions which are capacity constrained, or where negotiation for various reasons is more challenging. In these circumstances, we again approach negotiations with the MSVA target above in mind, and will walk away from opportunities where we cannot reach a mutually acceptable outcome.

Although this can at times mean challenging relationships with our supply chain, we believe that asset managers respect our core values of being responsible open and clear. We were named by asset managers as the “most likely to embrace new ideas” by a survey of asset managers in 2015, and we believe that asset managers in turn are more open with us as to their best new ideas, because we do not operate as a fiduciary manager, and therefore are not at risk of disintermediating the manager in exploiting the idea.

We would note that the opportunity set of investment strategies used today is far richer and more complex than it was in the past. This means straightforward comparisons framed from the perspective of long-only equity managers vs benchmarks are frequently less relevant. This is because many mandates are absolute return or total return focused (hence aligning more clearly with the strategic needs of the underlying client).

Section 3 - Benchmarking Consultants

We believe a benchmark framework would be helpful for trustees to assess the value delivered by investment consultants

There are many instances we can evidence where we have clearly added value. In many cases, this can be quantified as hundreds or even thousands of times the fees we have charged.

As mentioned in section 1, we do believe that the lack of objective reference comparisons for the historic performance of a firm's recommendations is one of several factors that contributed to clients switching consultant less often than they might have, and we believe that an effective development of such a comparison as an industry standard would overall be beneficial to clients - as noted in paragraph 4.23 of the MIR (however we would note the attendant risk of clients chasing past performance). We believe this is a challenge that the industry should address, and indeed we know of initiatives in train to do so. However there are several major difficulties with measuring "performance" in a fair, comparable and objective way.

One major difficulty is that within the domain of investment consulting advice we are by nature dealing with uncertain outcomes - the best investment advice is not certain to lead to a good outcome and vice versa. This is further complicated by the fact that the outcome (which we would most like to measure) is frequently the result of a "triad" of factors: one of which is the advice itself, but the others being the ability of the consultant to present the advice and influence the client to adopt it, and thirdly the inclination of the client to follow the advice or otherwise. These all add up to making the outcome or "performance" of the advice hard to observe, and not necessarily the best indicator of the quality of the advice.

We believe the difficulty in assessing the advice is inherent to the nature of the service itself, and not indicative of a competition issue as suggested in paragraph 3.2 of the MIR.

The temptation in these sort of situations is to use observable proxies for the advice (for example the performance of recommended managers against benchmarks, as these are readily available), but while certain factors might be highly available they may not be the best to evaluate against, and emphasising their importance may lead to suboptimal behaviours.

The difficulty of objectively evaluating the value added by an investment consultant is supported by the results of our survey, which indicated a mix of answers to the question of whether an individual had a clear sense of the value added or detracted - with a slight bias to agreeing with the statement that the individual had a clear sense of the value added. There is cause for optimism however as 20% of those surveyed indicated agreement or strong agreement with the statement, which suggests it is a soluble problem.

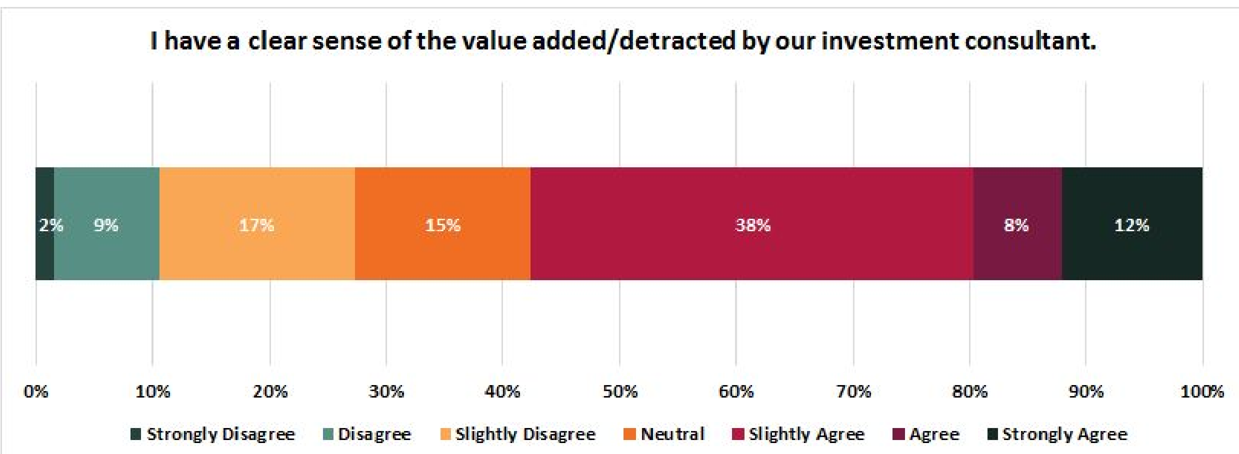

Figure 6: Survey responses: "***I have a clear sense of the value added/detracted by our investment consultant***"

We believe there are broadly two approaches that could be adopted to creating objective reference points that better facilitate comparisons between consulting firms (with the objective of catalyzing a greater degree of switching):

1. A standardised approach for aggregating each consultant's client base to create a representative track record. This might be similar to the "GIPS" standards that were adopted for asset management in the 1990's. We note that there are considerably more complications and difficulties associated with creating this sort of track record for consultants as opposed to asset managers. We note some of the difficulties and possible practical ways forward below.
2. A "big data" approach where the funding levels for ALL funds are made available each year, tagged according to the consultant that advises them as well as other factors such as fund size. The most obvious current source of data that does something close to this is the PPF 7800 index, and we believe this could represent a good starting point with some improvements to the data collection and the way in which it is made available. In theory such a big-data database could be quite powerful for trustees to interrogate to get a sense of how other funds similar to themselves have performed. It would also be quite instructive to look at the dispersion of client outcomes within each consulting firm, as this is likely to be as important a metric to prospective clients as the average outcome delivered.

Below we describe some of the difficulties and possible practical solutions to option (1).

Difficulties

- Choice of reference variable

In order to define a track record a "reference variable" needs to be chosen to be tracked through time. To be useful, this should relate to the ultimate objective of the advice, and to be practical it needs to be measureable in a reasonably objective way through time. For pension funds deciding on this reference variable is not as straightforward as it might seem. The ultimate objective is around paying pensions over a long future period of time.

Our survey of pension funds shows that "***progress toward objectives"*** is rated as the most important measure against which to judge the performance of the investment consultant, by the trustees that completed the survey. However, objectives are typically far off (the long term funding objectives of pension funds could be up to 20 years away) meaning that tracking over shorter periods of time - even a year or so may not provide a reliable indication of progress, given the number of factors influencing - and hence the noise inherent in - a measure such as funding level.

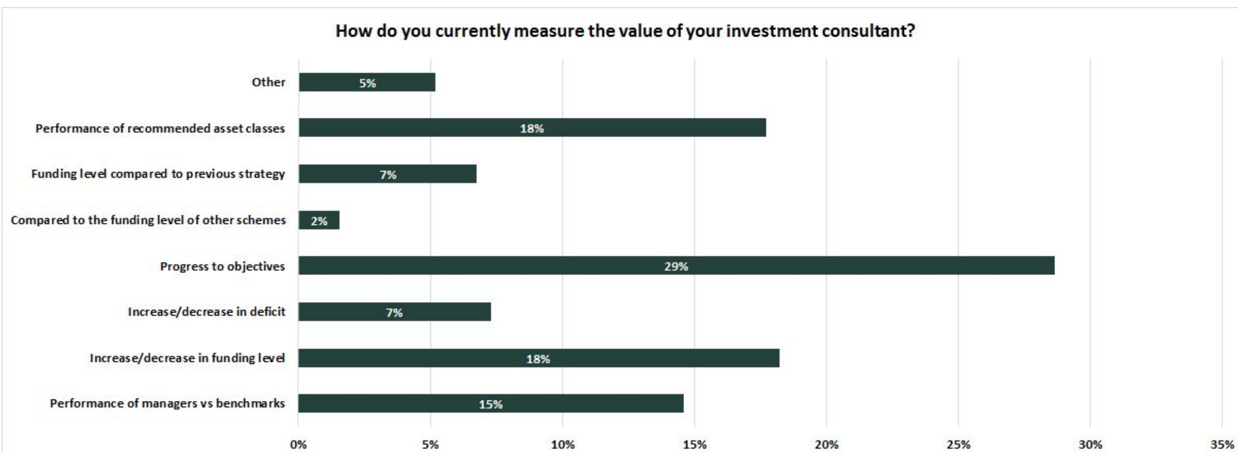

Figure 7: Survey responses: "***How do you currently measure the value of your investment consultant"***

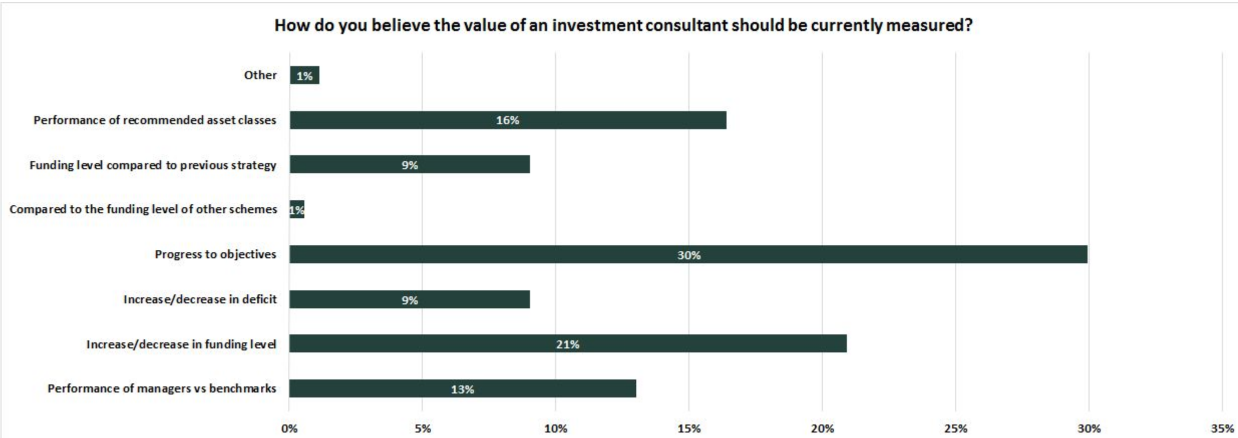

Figure 8: Survey responses: "***How do you believe the value of an investment consultant should be currently measured"***

There are also likely to be other objectives around managing risk and ensuring or increasing member security which are also very important. It is not straightforward to capture these concepts into a single variable that can be measured objectively through time. The funding level of a pension fund (the assets divided by the present value of the liabilities) is an obvious choice but it is by no means perfect for these purposes. The discount rate used to measure the liabilities would need to be standardised and ideally not change through time - in practice discount rates are neither standard across the industry nor constant through time. The funding level is clearly related to the ability of the fund to pay future benefits, but it is not necessarily the best indicator of that. The funding level can be volatile, and is also subject to change from factors outside the control of the consultant (in particular, contributions).

- Aggregation of track records

Assuming an appropriate reference variable can be agreed upon, track records of individual clients need to be aggregated in a consistent and complete way. The construction needs to try and avoid cherry-picking and to allow for survivorship-bias if possible. The method of weighting different track records needs to be decided upon, with weighting by size not necessarily being the best option (as this would create a bias to the track records of the largest clients). There will naturally be a lack of homogeneity in a consultant's client base, in terms of factors such as: the risk budget or return target, and the attitude to hedging interest rate risk. It would be inappropriate to aggregate track records for clients aiming for low returns with those needing higher returns, for example, as this would not make a helpful comparison for other clients. Equally, given that moves in interest rates (and the extent to which this has been hedged) have been the major driver of pension fund health over the last decade, it would create unhelpful noise in the data if funds with different levels of interest rates were aggregated.

- The influence of factors outside the control of the investment consultant

A number of factors outside of the control of the investment consultant could have a material effect on the measurement variable chosen. For example, a client might reject or otherwise not implement the advice given, or a sponsoring employer might make much larger or smaller contributions into the fund, which could well have an impact on the measure chosen.

When an investment consultant is first appointed it can take a period of time, perhaps months or longer to allow sufficient decision-making to effect all the changes that might bring the fund's strategic position in line with that consultant's desired position. During this period of time it is unclear whether it is "fair" to include this fund in the track record of that consultant (it is generally standard for asset managers to have a "performance measurement holiday" when they take on a new mandate and shape it to their desired portfolio).

- The difficulty of finding a suitable reference to track performance against

There is not a natural benchmark against which to track the performance of a pension fund's funding level or other equivalent measure of its financial performance. At the same time it is hard to find an objective **counterfactual** against which to compare the performance or impact of a consultant's decisions. Pension funds aren't in competition against each other, hence comparisons to market averages tend to be less relevant, and may encourage the wrong behaviours, but at the same time it might provide a reasonable counterfactual. Tracking the performance of a previous strategy compared to a new strategy is an obvious way of tracking the impact of a recommendation, but multiplying this across even a moderately sized client base would lead to a plethora of comparisons which are not necessarily easily aggregated.

Suggestions

We believe that the following should form part of the principles of an industry-agreed standard pro-forma for creating track records of pension fund advice.

1. Stratification

Care should be taken to avoid proliferation of different comparisons, but some stratification into fundamentally different homogeneous groups is necessary. It seems to us that the most important groups to distinguishing are in terms of risk budget or return target (perhaps high, medium and low, defined according to some suitable metric). It may make sense to specify a minimum number of funds within each track record category to try and ensure that idiosyncratic factors that could create noise in the track record are averaged out, at least to some extent.

2. Consistency

There needs to be an agreed-upon convention for funds entering and leaving the track records such that historical integrity is preserved and survivorship bias is avoided. Funds that are under a fully or partially delegated solution should be separated from those in a fully advised solution. There needs to be some consistent methodology applied to adjust for the level of sponsor contributions, otherwise the performance of those funds that have high or low levels of sponsor contributions will skew the results. It has to be noted that this is somewhat unsatisfactory as it will then be hard to avoid the tracked performance measure deviating in practice from the fund's actual performance.

3. Relevance

Metrics need to be tracked which are relevant to trustees and would help them envisage the results they might have achieved with a different advisor. This would help facilitate better comparisons between advisors. A funding level, calculated according to projection and discount factors within some agreed upon range (such as gilts + 0.25% - gilts +0.75%) could be the best compromise here.

We also believe there should be a metric alongside this that tracks member security. One proxy for the controllable aspect of this is a quantitative measure of the riskiness of the investment strategy relative to liabilities. The standard deviation of funding level changes over the previous 3 year period would be a good example.

4. Spread of Outcomes

We believe it is important to capture the spread of outcomes experienced within a consultant's client base, as this is often reflective of the consistency by which a consultant's house views on investment process, strategic asset class allocation and risk management get implemented into client portfolios. The spread of outcomes should be a useful tool alongside the average outcomes to interrogate a consultant's track record from a client perspective.

5. Independence

Ideally data should be supplied to a third party to enable independent calculation (or at least verification). Ideally, the names and contact details of funds in a consultant's track record should be all that is supplied to the independent third party calculation agent, at the point of entry (or exit) from the consultant's track record, who then obtains the relevant underlying fund data periodically (from custodians or other providers).

Our survey suggested that those trustees surveyed were clear that the most relevant metric for evaluation of consultants is progress toward the fund's objectives, and that by and large consultants were currently being evaluated according to these metrics.

Section 4 - Vertically Integrated Business Models & Fiduciary Management

We believe that either an advisory or FM approach can deliver good outcomes for pension funds. We believe that competition between the two approaches is healthy. We note that given the conflicts and incentives that can exist within a fiduciary model this carries an increased risk of clients being channeled into suboptimal solutions or not achieving the best value for money.

We also believe there is a lack of competition at the point of selection for these models. We agree with the observations in paragraphs 3.9 and 3.10 in the MIR document.

There is a clear delineation in the marketplace between consulting firms that offer fiduciary management (FM) and those that do not.

We do not offer fiduciary management. Our business is based around making the case for an advisory solution for pension fund trustees, where they can achieve their goals of member security, without giving up control.

We believe FM can deliver good outcomes for funds. We feel it is healthy that there is competition and choice between the advisory approach we represent, and FM approaches.

However, there are two key areas of concern:

1) Given the incentives that exist, there is a risk of clients being "shoe-horned" into investment solutions provided by their current advisor that are suboptimal for their needs.

2) In addition, we believe that effective competition does not exist in practice at the point-of-sale of FM. Frequently, FM is presented as an extension of the advisory approach of a consulting firm. In practice, the right move would be to consider a range of both advisory and FM approaches.

We believe further investigation into the competition for FM mandates at the point-of-sale is warranted, both in examining the extent to which there is competition between multiple different advisory approaches and FM, and between individual providers in the FM space.

Our survey of trustees showed a clear concern with the vertically integrated business models of other consulting firms. This is consistent with anecdotal experience.

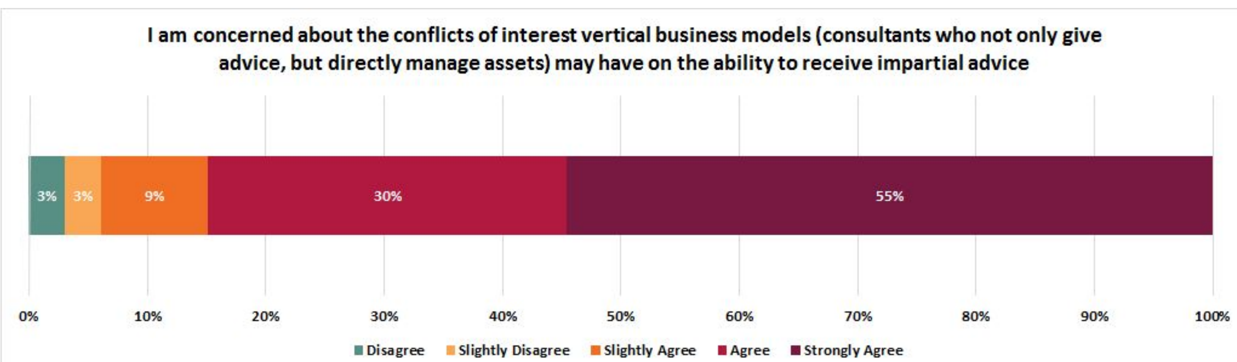

Figure 9: Survey responses: "***I am concerned about the conflicts of interest vertical business models (consultants who not only give advice, but directly manage assets) may have on the ability to give impartial advice"***

REDINGTON

Appendix

Appendix A - Redington total client distribution by size and type

Current Client Base Range	Totals	Full Consultant to Trustee	Trustee Project	Sponsor Project	Non-Pensions Project	Total
> £1Bn	40	11	16	9	4	40
£500m - £1Bn	4	3	0	0	1	4
£100m - £500m	14	9	2	2	1	14
£50m - £100m	3	3	0	0	0	3
< £50m	9	4	1	1	3	9
Other	5	1	1	1	2	5
Total	**75**	**31**	**20**	**13**	**11**	**75**

Appendix B - Absolute Return Bonds Universe fee negotiations data

Reference	Return Target over LIBOR	Quoted AMC	Quoted MSVA	Negotiated AMC	Negotiated MSVA
A	3.00%	0.50%	17%	0.40%	13.33%
B	3.00%	0.75%	25%	0.55%	18.33%
C	3.00%	0.40%	13%	0.23%	7.67%
D	3.00%	0.55%	18%	0.55%	18.33%
E	2.00%	0.50%	25%	0.50%	25.00%
F	4.00%	1.00%	25%	1.00%	25.00%
G	2.00%	0.65%	33%	0.33%	16.50%
H	2.50%	0.55%	22%	0.42%	16.80%
I	1.50%	0.35%	23%	0.25%	16.67%
J	3.00%	0.35%	12%	0.30%	10.00%
K	3.00%	0.50%	17%	0.50%	16.67%
L	2.00%	0.40%	20%	0.34%	17.00%
M	3.00%	0.55%	18%	0.44%	14.67%
N	2.00%	0.50%	25%	0.36%	18.00%
O	3.50%	0.74%	21%	0.55%	15.71%

Contacts

Dan Mikulskis | Head of DB Pensions

dan.mikulskis@redington.co.uk
Redington
Austin Friars House
2-6 Austin Friars
London
EC2N 2HD

Mitesh Sheth | CEO

mitesh.sheth@redington.co.uk
Redington
Austin Friars House
2-6 Austin Friars
London
EC2N 2HD