

### Summary

- There are concerns that consultancies also offering fiduciary management or master trusts will suffer from conflicts of interest, advising their clients to use their own products.
- Consultancies have addressed these concerns through measures such as increasing the transparency of procedures and recommending clients undertake a full tender process. However, there are concerns that mandates are being awarded without a full tender.
- Using the same company for multiple uses can result in cost efficiencies.
- Consultancies that do not offer other services may be perceived as more independent for clients. However, there are concerns that they may not be willing to recommend a competing consultancy's fiduciary management offering or master trust.

# The big three on trial

**➤ The weight of opinion against perceived conflicts of interest among consultants offering products looks likely to lead to FCA regulation. David Rowley looks at both sides of the argument**

The pensions industry is currently full of accusations and counter-claims about conflicts of interest among the big three consultants that offer fiduciary management or DC master trusts. The burden of proof lies with the consultants. So much so that Aon Hewitt, Mercer and Willis Towers Watson recently joined forces to present a joint submission to the FCA, whose strongly worded *Asset Management Market Study* hinted at regulation tackling conflicts of interest around fiduciary management.

### The case for the prosecution

The big three consultants are accused of profiteering from inert clients who lack the time or resources to challenge them. They are also accused of distorting the market, so that clients do not get full choice of solutions.

What is most shocking is the accusation that some consultants are no longer acting in the best interests of their clients.

AMNT co-chair David Weeks reports that a common objection among his members is consultants setting up scenarios or making recommendations where the best resolution is to use a product created by the consultants. "They take a fairly jaundiced view of that," he says.

Former Aon and Mercer DC consultant, Paul Macro, now working for Isinglass Consulting, says: "A few years ago the idea of a consultant selling something was an anathema, but now some have sales targets and sales credits."

While Barnett Waddingham senior partner Nick Salter says: "If I am required to sell product there is a danger when I talk to that client that I try to persuade myself that I can squeeze my client into that product, rather than taking the proper line of what is best for them."

These accusations are not wholly fair, as there are many within the big three consultants who are reportedly terrified of creating such conflicts of interest to the extent that they undersell products such

as their firm's master trust.

However, there is a further insidious point to conflicts of interest; the accusation from fund managers that consultants are taking their ideas.

Since leaving Willis Towers Watson a year ago, Nico Aspinall has been largely working with fund managers creating propositions for the DC market. Many such managers are concerned at these ideas being stolen and replicated in master trusts.

"The premium for innovation is being eroded by this conflict. These asset managers want to spend three years researching ideas, developing a product, getting a track record and launching it, but they feel that if they sell it through the big three there is a reasonable chance they will nick it, select another manager and lose the AUM."

Aspinall has heard of managers running factor-investing products who feel their ideas have been replicated in this way.

The feelings have been exacerbated by feedback to the FCA's *Asset Management Market Study* from fund managers who feel they face greater scrutiny on fees and performance than fiduciary managers. Notably, the report notes some consultants charge ad valorem fees for their fiduciary management services, which comes at a time when many consultants are campaigning against such practices from fund managers.

### The case for the defence

There is nothing legally wrong in choosing a product offered by its consultant as long as the board can evidence they did so for the right reasons rather than rubber stamping something put before them, says Sackers partner Janet Brown.

Part of creating that evidence might be running a tender for the product in question.

"Some trustees will say thanks for that and we will now go out and tender

it because we want the audit trail and we want to have confidence that was the right decision to come to," she says.

Brown notes that not all boards had the time or money to run a tender. However, she said there was also a duty on consultants helping clients manage this conflict of interest. Standards here can vary.

"I have seen trustees get quite aeriated when the consultant has not even realised that he or she will have to address the conflicts issue," she says.

To its credit, Mercer has an extensive document on its website that addresses how it deals with conflicts of interest. It says it seeks to manage conflicts of interest through disclosure, policies and procedures, while being committed to conducting business ethically and transparently.

It also points out that while

Mercer might earn more revenue from its products it is "assuming more responsibility".

One of the ways Mercer lives by this is refusing to conduct searches for fiduciary managers or DC master trusts for its clients. The firm's DC and financial wellness leader, Brian Henderson, says if Mercer chooses itself after carrying out a market search that would not be a good look, though other consultancies do this. Where clients ask for this service then firms such as Muse Advisory will conduct the search independently. He adds that part of the philosophy is that "if you come to Mercer you get Mercer".

Henderson answers the charge of not allowing the DC master trust to be researched by its competitors. This did happen after it was launched five years ago he says, but now its diversified passive building block style of its asset

allocation is more widely known, Mercer has relaxed that approach.

Aon Hewitt head of fiduciary business Sion Cole argues the case for consultants offering fiduciary management.

He admits it introduces a conflict of interest, but says it removes others.

One example of this is that clients of Aon Hewitt have a choice of pure advisory, fiduciary management, or somewhere inbetween.

"With that range, we have less conflicts of interest than someone who only offers a particular service," he says. "They can engage with us in a way that suits them."

However, Cole acknowledges that a relative lack of transparency on fiduciary management performance from the big consultants has gone some way to exacerbating the public debate on conflicts of interest.

"Both fees and transparency is something we can all do better on," he says. "We can share more information."

Such transparency has fallen into the 'too hard for now' box, due to each client having different risk tolerances and performance benchmarks.

Cole, however, suggests that more performance information around how much those targets are being met across all clients could be shared.

He also philosophises on the negativity coming the way of the big three consultants. "I am less concerned about what our competitors or market participants say than with how the pension schemes view the solutions," he says. "That is the voice that matters." It would be remiss, he says, of Aon not to innovate and develop solutions that improve how pension schemes are run and which improve funding levels.

LifeSight (the Willis Towers Watson master trust) head of proposition development David Bird touts a similar line about the skill set in consultancies being well placed to help.

"We're better placed to fill the governance gap that is appearing as some





employers seek to move away from being a provider of pensions themselves," he says.

An article on the Willis Towers Watson website by Craig Baker emphasises the benefits of a consultant offering product as creating an "alignment of interests".

Baker writes: "It would be too easy to react to the growing concerns around conflicts by not raising solutions that would genuinely be in the best interests of a client simply to avoid an awkward conversation or perhaps jeopardise the existing relationship."

There is some merit to this defence, says PTL managing director Richard Butcher. While, he firstly points out the standard line that conflicts of interests need to be managed and mitigated, he also says there can be advantages. "There are the economies of scale of having more than one service provision [from a consultant]. It is not all black and white," he says, adding that the economics of the industry mean that schemes cannot expect to retain the quality personalised consulting they used to enjoy without a price.

For such reasons, Pinsent Masons head of strategic development for pensions Robin Ellison thinks any such FCA regulation will be a mistake, as it will restrict innovation in the market place. He says the FCA is wrongly trying to turn a business into a profession, and that the business consequences of a consultant offering products is far from

proven.

"The big three consultants have to make a commercial decision about whether their clients would be frightened by conflicts of interest or not," he says. "The market will decide what is right in the end."

#### Regulation on the way?

Despite such protestations, there is widespread acceptance that the FCA will act to restrict conflicts of interest in this area. This strongly worded passage appeared in its interim report for the *Asset Management Market Study*. "Performance and fees of fiduciary managers appear to be among the most opaque parts of the asset management value chain. A lack of publicly available, comparable performance information on fiduciary managers also makes it hard for investors to assess value for money."

Figures marshalled to back up this position were that 58 percent of schemes select the fiduciary arm of their existing investment consultant or actuary and that 75 percent of such mandates were awarded without a fully competitive tender in 2014.

One can speculate on what action the FCA will take. LCP partner Mark Nicoll sees the FCA insisting on arms lengths arrangements between consultants and fiduciary managers. "They will probably be required to set up standalone businesses with Chinese walls," he says, adding that they should follow global performance standards too.

Macro says some of consultants may be thinking one step beyond this. In the less lucrative DC consulting space, he sees some firms concentrating on offering master trusts. "Once you have enough clients moving across to master trusts there is no longer any consulting that needs to happen," he says.

#### Do independents win?

Nicoll says that in the past six years LCP has doubled the number of clients to 600, with a large proportion coming from the big three consultants. The trigger is often

unease at being asked to consider moving to the use of internal funds as part of a fiduciary management arrangement.

A secondary reason has been the replacement of a favoured consultant, who has been moved to work for the fiduciary management team, with a less experienced person. "They are not getting the same calibre of person," says Nicoll.

Barnett Waddingham senior partner Nick Salter agrees with these trends, saying: "We have no reason to sell you something you do not want."

Salter says his firm explored setting up a fiduciary management operation and liked the look of the profit margins that could be made, but saw too many downsides for their consulting business. One of those downsides was the ability to be able to assess the fiduciary management market.

Salter says: "We have to talk to all the fiduciary managers. They know we will not pass on any information to our clients, they know we are not a threat."

The message to market is a strong one, but there is a flaw in it, according to Macro.

"Barnett Waddingham, LCP or Punters have an independent view but I find it difficult to see them putting forward the Aon or the Capita master trust, because it just feels odd putting your client with the opposition side," he says. "It potentially opens the door to other services."



Written by Gill Wadsworth, a freelance journalist