

Gwyneth Nurse
Director General, Financial Services
HM Treasury
1 Horse Guards Road
Westminster
London SW1A 2HQ

15th August 2024

Dear Gwyneth,

I write to you on behalf of ShareAction and the other organisations listed below to urge HM Treasury to expedite plans to regulate all activities of investment consultants.

The role and influence of the investment consultancy sector raises various concerns:

1. Under section 36(3) of the Pensions Act 1995, pension scheme trustees “must obtain and consider proper advice on the question of whether the investment is satisfactory”. Numerous reviews and market investigations have shown that investment consultants play a key role in determining the investment strategies of pension schemes.
2. Pensions schemes tend to have relatively few in-house staff and often rely heavily on advisors and investment consultants in particular. Most pension schemes have limited resources to assess the quality of the advice received and rarely switch between investment consultants.
3. The FCA currently regulates some, but not all, investment consultancy and fiduciary management activities. The fiduciary management arms of investment consultants fall within the FCA’s scope. However, consultants’ investment advice to pension trustees is generally not regulated. Investment consultancy services which are not regulated activities include advice on investment strategies, manager selection and asset allocation, advice on the suitability of a fiduciary duty management service or provider, and advice and training on the impacts of climate risks on the portfolio. The unregulated activities of investment consultants can therefore significantly influence the decisions taken by UK pension schemes. Furthermore, the line between regulated and unregulated activities is blurred, and that even when investment consultants state that they are not providing advice the asset owner will often still rely on this and make investment decisions accordingly, even when such information or advice lies outside of the FCA’s regulated perimeter. There is also a conflict of interest when investment consultants are both assessors of asset managers and seeking to provide services as the fiduciary manager of assets themselves.
4. Investment consultants played a key role in advising pension schemes to adopt liability-driven investment (LDI) strategies, which were at the heart of a pensions crisis following the impact of the Liz Truss “mini” budget on leveraged LDI products. In a subsequent evidence hearing to the Treasury Select Committee, the chief executive and the interim chair of the FCA referred to the “gap in regulation” in relation to investment consultants as being one of the problems.¹

¹ Treasury Select Committee, FCA Oral Evidence 7 November 2022 <https://committees.parliament.uk/oralevidence/11498/pdf/>

5. The investment consultancy industry has faced criticism for the use of economic scenario models which significantly underestimate both the scale of future climate-related damages and the near-term risks of such damages occurring due to the failure to include climate tipping points in their models, which may result in incorrect investment advice. The Institute and Faculty of Actuaries has stated that “Many climate-scenario models in financial services are significantly underestimating climate risk ... There is a disconnect between climate science and the economic models that underpin financial services climate-scenario modelling”, in particular because the real world impacts of climate change, such as the impact of tipping points, are largely excluded.²

For various reasons and at various times over the last ten years the FCA, the CMA, parliamentary committees and other interested parties have called for investment consultants to be brought within the FCA’s regulatory perimeter:

1. The Law Commission’s 2014 review of the fiduciary duties of investment intermediaries noted numerous concerns about investment consultants including that pension trustees rely too heavily on them; that trustees often lack the skills and experience to critically evaluate and challenge the advice of consultants; and that investment consultants have been criticised for focusing on short term returns rather than taking a holistic view of factors relevant to investment performance. The Law Commission concluded that *“the lack of regulation of investment consultants does appear anomalous, and we would ask that the Government actively monitor this area.”*³
2. The FCA’s Asset Management Market Study in 2017 also found numerous concerns including in relation to the overall structure and competitive dynamic of the investment consultancy market as well as potential conflicts of interests and misaligned incentives. The report stated *“We are recommending that the Treasury considers bringing investment consultants into the regulatory perimeter, subject to the outcome of the provisional market investigation reference to the CMA.”*⁴
3. The FCA subsequently made a market investigation reference to the CMA in relation to investment consultancy and fiduciary management services, which was the first time that the FCA had made such a reference to the CMA.⁵
4. The UK’s Competition and Markets Authority conducted a market investigation and published a 440 page report in 2018. The CMA found numerous concerns and implemented a package of eight remedies to address the adverse effects on competition that it had identified. In addition the CMA stated that to support these remedies it was making four recommendations to government and regulators, including that *“HM Treasury should pass the necessary legislation to*

² Institute and Faculty of Actuaries, July 2023, “The Emperor’s New Climate Scenarios: Limitations and assumptions of commonly used climate-change scenarios in financial services” <https://actuaries.org.uk/news-and-media-releases/news-articles/2023/july/04-july-23-emperor-s-new-climate-scenarios-a-warning-for-financial-services/>

³ Law Commission, 30 June 2014, “Fiduciary Duties of Investment Intermediaries” pages 213-218 https://cloud-platform-e218f50a4812967ba1215eaeccede923f.s3.amazonaws.com/uploads/sites/30/2015/03/lc350_fiduciary_duties.pdf

⁴ FCA Asset Management Market Study, Final Report June 2017 <https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf>

⁵ FCA 2017 Market Investigation Reference to the CMA <https://www.fca.org.uk/news/press-releases/fca-makes-market-investigation-reference-investment-consultancy-services>

*extend the FCA's regulatory perimeter to include all of the main activities of investment consultants.*⁶

5. Following the CMA's market investigation the FCA wrote to the CMA in 2019 and stated that: *"We support the recommendation to extend our perimeter to capture the full scope of investment consultancy services. We agree that due to the size of the market for investment consultancy services a small change in the quality of service provided could have a significant impact on savers' retirement outcomes. We also note the broad support from across industry for an extension of our perimeter to capture investment consultancy services."*⁷
6. The government's response to the CMA from HMT, DWP and TPR noted the CMA's recommendation to extend the FCA's regulatory perimeter to cover the activities of investment consultants and stated that *"HMT will consider this recommendation and consult in due course"*.⁸ The DWP continued with other recommendations but HMT has not progressed work on the expansion of the FCA's regulatory perimeter.
7. In its Perimeter Report updated in April 2024 the FCA reiterated its support for investment consultants to be brought within its remit. *"In our Asset Management Market Study, we identified serious concerns about competition in investment consultancy and fiduciary management. This is something we highlighted again in the context of the Liability-Driven Investment work in 2022. We referred these sectors to the CMA for a detailed investigation. The CMA recommended that investment consultancy services should be brought within our supervisory remit. Before the pandemic, the Treasury had planned to consult to bring these services into our perimeter. The Treasury had to put this work on hold in light of other key priorities such as its response to coronavirus. While we note the decision on when to restart this work is a decision for the Treasury, we continue to support these services being brought into our perimeter."*⁹
8. Following the LDI crisis the Work and Pensions Committee launched an inquiry in October 2022, publishing over 75 written evidence submissions and holding five oral evidence sessions. The Committee's report stated that *"We heard, including from the FCA itself, that in some cases investment consultants were giving standardised advice, rather than thinking through what was best for the individual pension fund. Given the complexity of the decisions trustees are required to make, this is a concern. The Government should bring forward plans for investment consultants to be brought within the FCA's regulatory perimeter before the end of this Parliament."*¹⁰
9. Also following the LDI crisis, the House of Lords Industry and Regulators Committee wrote to Andrew Griffith (Economic Secretary to the Treasury) and Laura Trott (Minister for Pensions) stating *"While some of the work of investment consultants is currently regulated, it is problematic that they are not fully regulated as part of the regulatory perimeter, especially in relation to their advice to schemes on their investment strategies, for which they should not be able to disclaim*

⁶ CMA "Investment Consultants Market Investigation Final Report 12 December 2018", Page 21, paragraph 76, first bullet point https://assets.publishing.service.gov.uk/media/5c0fee5740f0b60c8d6019a6/ICMI_Final_Report.pdf

⁷ Letter from the FCA to the CMA dated 21 February 2019 <https://www.fca.org.uk/publication/correspondence/cma-market-investigation-investment-consultancy-fiduciary-management-services.pdf>

⁸ Government response to the CMA dated 12 March 2019 <https://www.gov.uk/government/publications/investment-consultants-market-investigation-response/investment-consultants-market-investigation>

⁹ FCA Perimeter Report July 2022 <https://www.fca.org.uk/publications/annual-reports/perimeter-report>

¹⁰ House of Commons Work and Pensions Committee Report on Defined benefits pensions with Liability Driven Investments", HC 486, 23 June 2023, Paragraph 10 and paragraphs 100-105 <https://committees.parliament.uk/publications/40563/documents/197799/default/>

liability. The Government should ensure that investment consultants are brought within the regulatory perimeter as a matter of urgency.”¹¹


10. The Work and Pensions Committee recently held an oral evidence session on fiduciary duties. Concerns about investments consultants were raised by a number of CSO attendees and also by industry attendees.¹²
11. Sir Stephen Timms, Chair of the Work and Pensions Committee then wrote to Paul Maynard, Minister for Pensions. Sir Stephen noted in his letter that his committee had previously recommended that investment consultants be regulated. *“In our report on Defined benefit pension schemes with Liability Driven Investments, we recommended that the Government should bring forward plans for investment consultants to be brought within the FCA’s regulatory perimeter in this Parliamentary session.”¹³*
12. Paul Maynard stated in his response to Sir Stephen Timms that *“it is my understanding that HM Treasury intend to consult on the Competition and Market Authority’s recommendation that investment consultants be brought within the FCA’s regulatory perimeter.”¹⁴*

ShareAction urges HM Treasury to expedite plans to regulate all activities of investment consultants. Other organisations who join us in calling for the regulation of investment consultants include:

- Mick McAteer, Co-Director, Financial Inclusion Centre, former board member FSA/FCA and Chair of the FCA’s External Risk and Strategy Committee
- Janice Turner and Maggie Rodger, Co-Chairs of the Association of Member Nominated Trustees
- Charlotte O’Leary, CEO, Pensions for Purpose
- Tony Burdon, CEO, Make My Money Matter
- Richard Folland, Head of Policy and Engagement, Carbon Tracker
- Steve Coulter, Head of Economy, Green Alliance
- Jeff Twentyman, Founder, Seefair Limited

I would greatly value the opportunity to meet with you to discuss the need for the regulation of investment consultants. I look forward to your response and will be pleased to liaise with your office on suitable dates for a meeting.

Yours sincerely,



Catherine Howarth
Chief Executive, ShareAction

¹¹ Letter from the House of Lords Industry and Regulators Committee to Andrew Griffith and Laura Trott, 7 February 2023, <https://committees.parliament.uk/publications/33855/documents/185115/default/>

¹² House of Commons Work and Pensions Committee oral evidence session on fiduciary duties, HC 486, 21 February 2024 <https://committees.parliament.uk/oralevidence/14325/pdf/>

¹³ Letter from Sir Stephen Timms, Chair of the Work and Pensions Committee to Paul Maynard, Minister for Pensions, 17 April 2024 <https://committees.parliament.uk/publications/44325/documents/220225/default/>

¹⁴ Response from Paul Maynard to Sir Stephen Timms, Chair of the Work and Pensions Committee, 17 May 2024 <https://committees.parliament.uk/publications/44937/documents/222957/default/>