Investment Consultants Market Investigation

Working paper on barriers to entry and expansion

26 April 2018

This is one of a series of consultative working papers which are being published during the course of the investigation. This paper should be read alongside the issues statement and the other working papers which are published.

These papers do not form the inquiry group's provisional decision report. The group is carrying forward its information-gathering and analysis work and will proceed to prepare its provisional decision report, which is currently scheduled for publication in July 2018, taking into consideration (among other matters) the evidence obtained, responses to the consultation on the issues statement and responses to the working papers as well as other submissions made to us.

Parties wishing to comment on this paper should send their comments to investmentconsultants@cma.gsi.gov.uk by 11 May 2018.

The Competition and Markets Authority has excluded from this published version of the working paper information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

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Introduction

1. This working paper sets out our emerging findings on potential barriers to entry and expansion in the investment consultancy (IC) and fiduciary management (FM) sectors. The assessment included in this working paper focuses on the financial and other costs of entry and expansion in the context of the other features within the IC and FM sectors.

2. We set out in turn:

   (a) Our approach to assessing barriers to entry and expansion;

   (b) Summary of our emerging findings;

   (c) Our emerging findings on:

      (i) Recent entry and expansion

      (ii) Barriers to entry - setting-up a new business; and

      (iii) Barriers to expansion - barriers to winning clients.

3. The emerging findings within this paper should be considered alongside our papers on competitive landscape, trustee engagement, and on supply of fiduciary management services by investment consultancy firms, in order to consider any potential adverse effect on competition and potential remedies. We do not set out potential remedies in this paper, as we believe relevant remedies are addressed in other working papers, but invite parties to make submissions on relevant potential remedies.

Our approach to assessing barriers to entry and expansion.

4. CMA guidelines[1] note that entry or expansion by firms, or the prospect of entry or expansion by firms within a short time, will often stimulate competition and can sometimes countervail against features which might otherwise give rise to an adverse effect on competition. A significant source of competitive discipline may therefore be eliminated or reduced if there is any barrier to market entry and/or expansion, whether an absolute barrier or some other form of restriction such as aspects of the market that deter entry.

5. There are three broad categories of entry barrier: natural or intrinsic barriers; strategic advantages of incumbents or 'first-mover' advantages; and

[1] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3 (Revised)), paragraphs 205 – 236.

regulatory barriers. We discuss aspects of each of these in the relevant section below.

6. Our guidelines explain that to assess the impact of barriers to entry and expansion, we will consider how the competitive climate within a market affects the decisions of individual firms to enter or invest in that market, taking into account the advantages of established firms.

7. We have approached our assessment by considering entry and expansion in IC and FM services through two assessments – first, the barriers to setting-up a new business (either a new firm or service line), and second, the barriers to growing that business through winning clients.

Summary of emerging findings

8. At this stage we have not identified or concluded whether there is an adverse effect on competition in relation to barriers to entry or expansion. We set out below our emerging findings based on evidence provided to date.

9. As noted above aspects of this paper overlap with analysis set out in other working papers.

Barriers to entry – setting-up a new firm

10. Our emerging finding based on evidence provided to date is that barriers to setting-up a new firm or new IC or FM service line are not prohibitively high but are greater in FM than IC.

    (a) We note that there are over 32 firms providing IC and at least 18 providing FM services in the UK with around 10 firms providing both.

    (b) Firms have used a range of entry strategies including vertical and horizontal expansion, and expansion into the UK from overseas.

    (c) Firms can choose to enter by focusing on particular client types, asset classes or strategic advice.

    (d) There are likely to be both higher costs and greater economies of scale in FM than in IC, and so greater barriers to a new entrant. We note that platform and regulatory costs may be greater for FM firms than for IC firms and that the greater breadth of activities necessary for FM may require additional expenditure relative to the scope of IC.

Barriers to expansion – winning new clients

11. Our emerging finding is that potential barriers to winning clients are potentially greater than those of setting-up a new firm or service line. Our analysis indicates that barriers to expansion may be greater in FM, even though the FM sector is expanding.

12. The importance of reputation means that while new entrants can and do win clients, increasing a firm's client base may take longer for a smaller firm than for more established participants and particularly for larger firms active in related markets. This is the case for both IC and FM services.

13. We note however, that there are some key differences between IC and FM both in relation to the nature of services and outcomes.

    (a) **Levels of switching:** In relation to IC clients, our survey found that around a quarter of schemes (27%) have switched provider within the last 5 years; in contrast only 9% of schemes have switched FM provider within the last 5 years, however FM is a relatively new service compared to IC.[2] This indicates that there are proportionately fewer opportunities in FM to win new clients and expand, though we also note there is an increase in uptake of FM.

    (b) **Opportunities to develop client relationships**: In IC there are opportunities for smaller or less well-known firms to develop relationships through providing ad hoc and discrete pieces of advice. Firms may also move from advising companies (as pension scheme sponsors or on other pension-related matters) into advising the pension schemes directly or from ad hoc assignments to longer-term relationships.

    In FM, smaller, more focused, pieces of work may be available such as a mandate focused on a single class of assets. However, demonstrating capability across all relevant asset classes may take a long time, particularly given lower switching rates in FM. As a result, there is less scope for FM firms to demonstrate capability and develop reputation. This is particularly likely to be the case for firms that do not also offer IC or asset management.

    (c) **Maturity of markets:** All pension schemes have been required to obtain appropriate advice on investment decisions for over 20 years, with many schemes choosing to receive that advice from IC firms. The number of schemes purchasing FM services has increased over the last 10 years

[2] We discuss this in greater detail in our working paper on trustee engagement.

from 61 in 2007 to 805 in 2017 according to KPMG's 2017 UK Fiduciary Management Survey. This increase should therefore provide a greater number of opportunities for firms to win clients. However, the evidence we have reviewed indicates that firms with an established IC client base may have an advantage in winning new FM clients.[3]

Our emerging findings

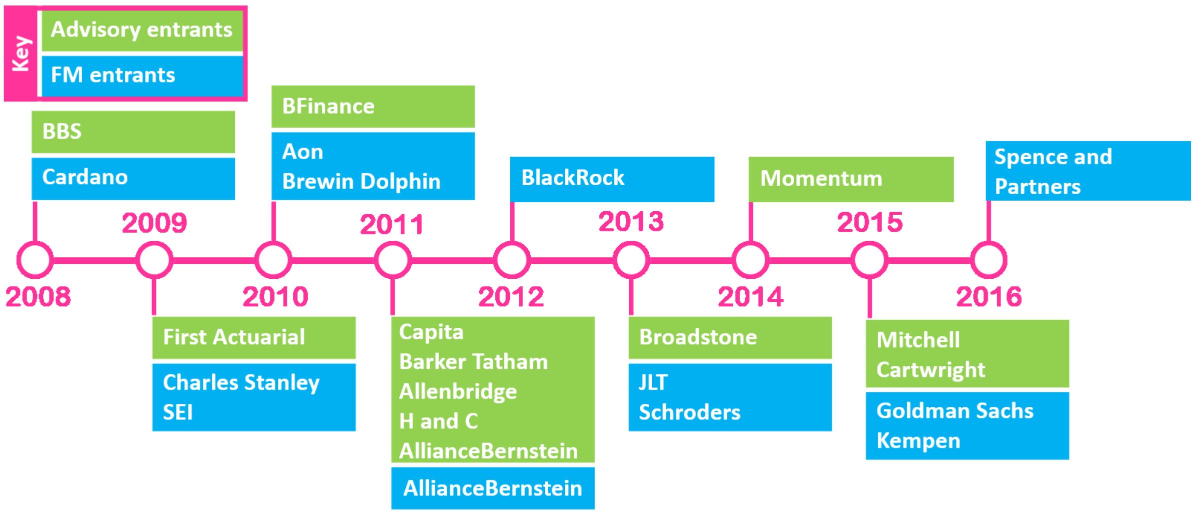
Recent entry and expansion

14. We have examined the number of firms providing FM and IC services and the scale of entry over the past ten years.

15. We have identified over 32 firms that offer IC services and at least 18 firms that offer FM services. Figure 1 shows those firms that we are aware of that have started providing either IC or FM services since 2007. The number of firms active in providing IC and FM services appears to be growing, as we have not noted firms exiting.

16. We would welcome any additional evidence on levels of entry and exit from parties.

Figure 1: Timeline of entry post 2007



Source: CMA Analysis
Note: Based on first year that revenues for relevant service recognised. CMA analysis of responses to CMA data requests and may not include all firms. Firms which first offered investment consultancy services before 2007 not shown.

[3] Based on the CMA survey, 47% of schemes buying FM first bought these services from their existing IC. Based on client-data collected by the CMA from parties, 55% of mandates were awarded to firms that were already acting as IC to the customer.

17. Investment advice has been provided by professionals for some time. However, a key driver for pension trustees to buy IC as a service was the statutory requirement for pension trustees to seek appropriate advice under the Pensions Act 1995.[4]

18. FM is a relatively new service compared to IC which has led to opportunities for entry over the last 10-15 years.[5] There has been sustained growth in the use of FM over the last 10 years. KPMG's survey indicates that there were 61 FM mandates (£12bn AUM) in 2007 and 805 FM mandates (£135bn AUM) by 2017.[6]

19. Table 1 sets out the ten largest firms by revenue in IC and FM, listed in alphabetical order. We set out further evidence in greater detail in our competitive landscape working paper.

Table 1 Firm revenues (2016)

					£m
	Firm	*IC Revenue*		*Firm*	*FM Revenue*
1	Aon	[✂]	1	Aon	[✂]
2	Cambridge Associates	[✂]	2	BlackRock	[✂]
3	Hymans	[✂]	3	Cambridge Associates	[✂]
4	JLT	[✂]	4	Cardano	[✂]
5	KPMG	[✂]	5	Kempen	[✂]
6	LCP	[✂]	6	Mercer	[✂]
7	Mercer	[✂]	7	River & Mercantile	[✂]
8	Redington	[✂]	8	Russell Investments	[✂]
9	Stamford	[✂]	9	SEI Investments	[✂]
10	WTW	[✂]	10	WTW	[✂]

Source: CMA Analysis, Parties' Data, listed in alphabetical order.

Barriers to entry – setting up a new business

20. In this section we focus on the barriers to setting up a new business up to the point of competing for and winning the first client. This may be in the context of setting-up a new firm, or the expansion into IC and FM service lines by a firm providing other existing services.

[4] Section 36 of the Pensions Act 1995.
[5] See further analysis in our Competitive Landscape Working Paper.
[6] KPMG's 2017 UK Fiduciary Management Survey https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/11/CRT086217_KPMG_FM_Survey_2017.pdf.

Natural or intrinsic barriers

21. We define natural or intrinsic barriers to entry as the costs that firms unavoidably incur when entering a market. These costs include setting-up functions such as human resources, financial systems and payroll. In the following subsections we discuss the costs of developing a research function and operating a regulatory compliance function.

22. We have not so far identified any natural or intrinsic barriers that have acted as a significant barrier to entry. We note however, that where such barriers do exist, multi-disciplinary firms may be able to take advantage of economies of scale or reduced entry costs. Any natural or intrinsic barriers faced would be common to both IC and FM firms but are likely to be greater for FM as a result of the broader range of services provided.

23. Some firms, for example, have entered the IC or FM sectors through expansion from existing actuarial or asset management services (and from IC in the case of FM). This could reduce the cost of entry, as the firms will already have the necessary support functions.

Research costs

24. To provide IC and FM services, firms need to have access to appropriate asset manager research to make recommendations to clients. Our emerging finding is that developing research capability can be potentially expensive but that firms have overcome this barrier in a number of ways.

25. We have been told that potentially significant resources are required for manager research in both IC and FM firms. Parties[7] have commented on the constraint that the lack of a research function poses on their firms.

26. Spence & Partners said that the costs of undertaking extensive manager research are high and constitute a barrier for smaller firms entering the IC market as they would find it difficult to recoup across a small number of clients. However, they noted that some outsourced options are available and they could constitute effective solutions.

27. Different firms have taken a range of approaches. For example, new entrants or small firms can choose to buy research services or data from a third party initially but may develop a dedicated research function as they expand. Some firms such as KPMG and Momentum have chosen to embed their research

[7] Momentum and Spence & Partners.

function within the IC team, with staff both conducting research and providing services to clients.

KPMG UK – expansion from pensions and professional services[8]

KPMG entered the investment consultancy sector in 2005 as an expansion of its pensions practice. KPMG said that it was not considering offering fiduciary management (FM) services to clients as it did not see FM having any fit with KPMG as an advisory firm. KPMG thought its independence as an advisor was important, especially as KPMG is the auditor of some FM firms.

KPMG told us that its approach to research was that it did not have a separate manager research team, instead all members of the investment advisory team spent 20 to 25 per cent of their time on research. KPMG believed this model meant that it was better able to communicate the advice it gives to clients. KPMG said that it did not seek to research all asset classes and did not, for example, conduct significant research on hedge funds. Its approach to research was to place more emphasis on finding the right asset class and having the right strategy in place for clients first, before helping clients through the process of selecting a fund manager to manage those assets.

28. Examples of the strategies that other parties have adopted to develop research capabilities have included:

(a) Momentum told us that it started without a dedicated research team, instead using its consultants to conduct research.[9]

(b) Cardano commented that whilst it had existing relationships with potential clients, it needed to make considerable investment in manager research as this is resource-intensive.[10]

(c) Several parties referred to the ability to buy in data or research services; although this was considered expensive, it was not considered prohibitively so.

[8] Summary of hearing with KPMG held on 14 November 2017.
[9] Summary of hearing with Momentum Global Investment Management Limited (Momentum) held on 12 January 2018.
[10] Summary of hearing with Cardano Risk Management Limited (Cardano) held on 15 November 2017.

Redington – focusing research efforts[11]

Redington's manager research was provided by a team of 15, which it said was one-tenth the size of some large investment consultants. It had consciously adopted this approach to manage the cost of research.

In developing its research function, Redington had chosen not to research the whole universe of managers. It instead developed criteria that would allow it to identify and focus on a smaller set of managers for each asset class. It would then issue a questionnaire to a long-list of firms before choosing those on which it wanted to conduct more detailed due diligence. This approach gave it sufficient breadth of coverage across asset classes whilst allowing it to spend sufficient time on the assessment of each of those managers.

29. We have identified at least two firms which have entered the UK FM sector by expanding from overseas:

(a) Cardano was an established business in the Netherlands, with Cardano UK set up as a purpose built fiduciary manager. It did not inherit any client relationships from its parent firm.

(b) Kempen also entered the FM sector from the Netherlands. However, it did not act as an investment consultant there, instead offering advice on pension fund strategies as an integral of Kempen FM services.[12]

Regulatory barriers

30. FCA regulation applies to the principal activities which are undertaken in the course of providing FM services, but covers only partially the activities undertaken in the course of providing IC services. We explore this in more detail in our working paper on the supply of fiduciary management services by investment consultancy firms.

31. The regulatory requirements and the need to maintain a compliance function, are likely to impose some regulatory cost on firms. Russell Investments, for example, told us that regulatory costs are the biggest barrier to entry for a new FM firm.[13] However, other firms have not stated that regulatory costs are significant.

[11] Summary of Hearing with Redington held on.13 November 2017.
[12] Summary of hearing with Kempen Capital Management (Kempen) held on Friday 24 November 2017.
[13] Summary of hearing with Russell Investments Limited (Russell Investments) held on 3 November 2017.

32. We welcome further views on the scale and importance of regulatory costs and whether this differs for firms authorised by the FCA for other purposes, separately for both IC and FM services.

33. We would also welcome views on the cost of establishing and maintaining a research function within either an IC or FM firm and whether parties consider there to be a minimum viable size for this function.

Economies of scale

34. Our guidelines state that economies of scale in combination with sunk investment costs can constitute a barrier if these relate to the cost of entering or expanding in the market.[14]

35. The costs of providing advice (whether by an IC or FM firm) appear to be largely scalable as having more clients will generally require additional advisory support. However, FM provision appears to require a larger fixed cost base for a research function and this does not appear to grow in proportion to the number of clients. We note the cost of research, both in terms of establishing a sizeable research function to cover a suitable range of assets and keeping that research current. Increasing the assets under management for an FM firm will lead to higher revenue, but not necessarily proportionately higher costs.

36. Our emerging finding is that there are likely to be both higher costs and greater economies of scale in FM than in IC, and so greater barriers to a new entrant. We would welcome views and evidence on this area.

Barriers to expansion – winning clients

37. In this section we consider the barriers that firms may experience in winning new clients to expand their business. The extent to which these barriers affect firms may vary, particularly in relation to any existing client relationship acquired through the provision of other services.

Customer acquisition costs

38. Firms will need to incur various costs when competing to win new clients. These will include the cost of marketing and promotional materials, the time

[14] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3 (Revised)), paragraphs 211 – 216.

cost of staff preparing for and participating in tender processes and potentially a dedicated business development or bid support team.

39. The relative cost and importance of these activities will vary by firm and by client. We would expect that where a firm wins a new FM mandate from an existing IC client and where no formal tender process has been held that the marginal cost of winning that client would be lower than for other firms. In contrast, a smaller, less-well known firm might need to spend a greater amount of resource in developing a client's awareness of its services and reputation before being invited to participate in a tender process.

40. Although there are clearly costs to acquiring a customer, we received no evidence that these costs would be prohibitive.

Momentum Global Investment Management (MGIM) – entry with a small established team[15]

MGIM has provided investment and asset management services in the UK since 1998. MGIM entered the investment consultancy sector in 2014 by recruiting a small established team of investment consultants from Mercer. Several of these staff were subject to restrictive covenants preventing them from soliciting clients for a year after they left Mercer.

MGIM acted as a sponsor for the IC team when it entered the sector, providing it with business support in areas such as compliance, legal, admin and payroll to help the IC team enter the sector.

When it launched, the IC team already had knowledge of a wide range of relevant asset managers and products. Momentum told us that this asset management research would be difficult for a new firm to replicate without extensive prior experience.

Brand recognition and reputation

41. Brand and reputation are also important factors in the ability of a firm to expand. Current participants in the sector vary by scale, services offered and route to entry. If IC and FM services are credence goods,[16] reputation and brand may necessarily need to be relied upon by clients when choosing a provider.

[15] Summary of hearing with Momentum.
[16] That is, where it is difficult to determine its quality and value for money even after purchase due to the bespoke nature of such services and the uncertain impact of the service provision.

42. There is further analysis of these issues in our working paper on information on fees and quality. The emerging finding of that analysis points to barriers that prevent customers from accessing the necessary information to judge value for money in IC and FM services and in the absence of this information, brand and reputation may play an increasingly important role in choice of firm.[17]

43. In the IC and FM sectors, larger firms are perceived to be more experienced and have greater brand recognition. We have heard from several parties that a pension trustee will often prefer to choose a large, well-recognised brand on the grounds that 'no-one ever got fired for choosing IBM'.[18]

44. The extent to which brand recognition acts as a barrier will be determined by the behaviour of trustees when conducting tender processes. The CMA survey found that the median number of FM providers invited to submit a tender or proposal was three; as was the median number of FM providers who responded to the invitation.[19]

45. Barnett Waddingham told us that for them, the greatest challenge is getting invited to bid for, and subsequently to be awarded, larger contracts. They also said that trustees at the larger pension schemes appear to be more comfortable working with larger IC firms.[20]

46. Momentum stated that they recognise that - as a small firm[21] - in order to be awarded new mandates, it had to convince potential clients that size didn't matter, and that the attributes of a smaller firm can sometimes be an advantage. It found that feedback from potential clients who did not award them the mandate was, most often, that the successful firm was a bigger or more experienced firm – and therefore perceived to be a safer option.[22]

47. Firms in adjacent sectors, such as asset management may present as credible alternatives in future as a result of strong brand recognition and investment knowledge and expertise.

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[17] CMA working paper on Information on fees and quality.
[18] Summary of hearing with Momentum.
[19] Source: CMA survey, questions L6. '*In total, how many providers did you invite to submit a tender or proposal?" and L8: "How many tenders or proposals did you receive?'. Estimations are based on the sample of 119 FM clients who knew the number of FM providers they invited to submit proposals and the sample of 116 FM clients who invited proposals and knew how many FM providers submitted them.*
[20] Summary of Hearing with Barnett Waddingham held on 12 December 2017.
[21] Momentum considered that: a small firm would have less than 50 investment staff; a medium sized firm would have between 50 and 200 and a large firm would have over 200 investment staff.
[22] Summary of hearing with Momentum.

48. Recognition in the market place can have a compounding effect. Once a large tender opportunity is won, a firm is likely to be able to attract further larger funds to its portfolio. Redington, whose founding members specialised in risks to pension funds, established itself in 2006 and by 2010 had managed to secure some very large pension scheme contracts.[23]

Redington (pt. 2) – niche advice expanding over time

Redington was established just over 10 years ago by two individuals working in the field of pensions risk management in an investment bank.

They established Redington having devised a framework for the intensive management of risk for pension schemes, with a specific focus on inflation and interest rate hedging. The founders felt that inflation and interest rates were the two largest inherent risks to pension funds but had not to that point received sufficient attention.

As a result of its clients being relatively well-hedged Redington believed its clients' performance through the financial crisis of [2008] had strengthened its reputation, allowing it to win larger clients than initially anticipated.

Its core client type was UK defined benefit pension scheme trusts. It initially worked with sponsoring employers, often looking at schemes in parallel to a scheme's own consultant. As the IC services grew in breadth, it began to tender for pension schemes.

Redington did not begin to fully expand its research function until some years after it had been established. As the firm developed its research capability to cover the full spectrum of asset classes, it was able to expand into a full-service investment consultancy. Redington told us this expansion allowed it to participate in a wider range of tender processes.

Redington told us that it had successfully won a range of business and believed that brand and trust are both important factors for successful firms in the IC sector. Redington's view was that, although there are some benefits arising from having scale, being a pure IC firm gives it objectivity and independence.

49. We invite views from parties on whether there are any differences in the importance of brand recognition or reputation to pension schemes of different sizes or in different circumstances.

[23] Large Clients would typically be those with over £1 billion AUA/M.

Strategic advantage of incumbents

50. In addition to the general importance of reputation, incumbent firms (that is those currently providing any of a range of services to a given client) may experience a particular competitive advantage that may act as a barrier to expansion for other firms.

51. There are two possible ways in which incumbents appear to have an advantage:

   (a) The general ability to get initial access to a client to directly promote either their IC or FM services because of an existing business relationship, such as actuarial services, asset management or other professional services.

   (b) The more specific situation in relation to IC-FM firms providing IC advice to a client considering FM. In such cases, once an IC relationship is established, the incumbent firm may then be in a strong position to sell that client FM services.[24]

52. As set out above, reputation and relationships are a strong feature of the sector. Experience and contacts in the sector are perceived by some firms as important for firms entering IC and may be a way to demonstrate credibility. Russell Investments believed that the most significant barrier to expansion of FM activities is that access to clients is restricted due to the presence of IC-FM firms who have a 'trusted adviser' status.[25]

53. Firms with existing relationships in adjacent or vertical markets may have a competitive advantage in entry.[26] The CMA survey of trustees found that 77% of schemes that bought IC services receive other services from the same provider, the most common service being actuarial services (55%) or scheme administration (52%). However, this in part may reflect the number of investment consultants that offer other associated services and that schemes may purchase services from multiple providers.

54. The insertion of a time-limited non-solicitation clause of staff and clients in many employment contracts can slow down the ability of those staff to perform revenue generating activities in the first year of operation at new or competing firms. However, after the period of non-solicitation, these individuals are able to benefit from the reputation and relationships they had

[24] We discuss this is further detail in our working paper, supply of fiduciary management services by investment consultancy firms https://www.gov.uk/cma-cases/investment-consultants-market-investigation#working-papers.
[25] Summary of hearing with Russell Investments Limited (Russell Investments) held on 3 November 2017.
[26] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3 (Revised)), paragraph 217 - 221.

built up at their former firm. One entrant which had been subject to these restrictions said they were not an unreasonable imposition.[27]

55. The CMA survey of trustees found that just under a third (32%) of trustee boards that buy IC services ran a tender or invited proposals in the last 5 years.[28] Stamford noted that a key challenge was obtaining 'air time' with trustees. Stamford believed there was a natural bias towards the larger consulting firms due to the 'comfort factor' associated with them. Without the opportunity to engage directly with trustees this bias could be difficult to overcome. This particularly applied to the larger pension schemes.

56. The number of schemes purchasing FM services has increased over the last 10 years from 61 in 2007 to 805 in 2017.[29] This increase should therefore provide a greater number of opportunities for firms to win clients.

57. However, the evidence that we have reviewed suggests that around half of FM mandates have been awarded to the incumbent IC provider. Based on the CMA survey, 47% of schemes buying FM first bought these services from their existing IC. Based on client-data collected by the CMA from parties, 55% of mandates were awarded to firms that were already acting as IC to the customer.[30] Therefore, incumbent IC firms appear to have a greater opportunity to expand their FM client base.

58. This could in part be due to the customer practices when first buying FM. In the CMA survey, around a third of trustees said they asked a third-party to run a tender process when first entering FM, while half of trustees said they received some form of third-party support (in the form of advice or running a tender). Around a quarter of trustees said they ran a tender or invited proposals without external help.[31]

59. Regardless of whether a scheme ran a tender process to choose its FM provider, the CMA survey found that 74% of trustees said their scheme used the same provider for both IC and FM. This may be due to an incumbency advantage enjoyed by IC firms even where there is a formal tender process.

60. Russell Investments said that they have much less interaction with clients who have an existing relationship with a consultant also providing FM services.[32]

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[27] Summary of hearing with Momentum.
[28] We discuss this in greater detail in our working paper on trustee engagement.
[29] KPMG's 2017 UK Fiduciary Management Survey https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/11/CRT086217_KPMG_FM_Survey_2017.pdf
[30] Working paper Supply of fiduciary management services by investment consultancy firms.
[31] Ibid.
[32] Summary of hearing with Russell Investments.

Cardano – international entry with experienced UK individuals

Cardano was established in the Netherlands in 2000 offering a combined IC and FM service before it entered the UK in 2007, at which point FM services were not widely offered by the larger firms. The firm has targeted its services exclusively to pension funds, and typically those schemes which had assets of at least £150m in FM and £2bn in IC.

The UK firm was established by several experienced investment consultants, each with around 10-15 years of experience in the market. Cardano told us this experience brought credibility with it and that personal relationships, developed with prospective clients while working at previous firms, had helped Cardano to be invited to participate in tender processes.

It had however taken Cardano around two years before it tendered for its first full FM mandate. Cardano had won clients but had not to date replaced an incumbent FM provider.

Opportunities to participate in tender processes

61. The opportunity for IC and FM providers to bid for a tender can arise in two ways;

(a) firms may tender for services to 'test' the market against the incumbent IC or FM provider, with a view to potentially switch provider; or

(b) when procuring a service for the first time. The duration of any mandate is not usually fixed. It will vary from client to client, but BBS and Russell Investments told us that most appointments last for at least three to five years.[33, 34] This is of particular relevance for FM.

62. In relation to IC clients, around a quarter of schemes (27%) have switched provider within the last 5 years. In FM, only 9% of schemes have switched provider within the last 5 years. This difference may partly reflect the fact that FM is a relatively new and emerging industry. However, we still find that FM switching rates are lower than IC switching rates when we attempt to account for this issue.

63. Table 2 below sets out the number of FM and IC tender processes that firms have participated in in the last three years. For the 21 firms for which we hold

[33] Summary of hearing with Russell Investments.
[34] Summary of hearing with BBS Consultants and Actuaries Ltd (BBS) held on 7 November 2017, 'New contracts tend to be for a for a three to five year timeframe. BBS stated that they had a duty to remind clients that they should regularly review their performance'.

data, there is significant variation in the number of tender processes that the firms participated in. These ranged from fewer than ten to over 400.

Table 2 FM and IC tender process participation 3 years (in alphebeticised order)

Firm	*Number of tenders*	*Firm*	*Number of tenders*
Aon	[✂]	BlackRock	[✂]
Barnett Waddingham	[✂]	Cambridge Associates	[✂]
First Actuarial	[✂]	Capita	[✂]
Hymans	[✂]	Cardano	[✂]
Kpmg	[✂]	Charles Stanley	[✂]
LCP	[✂]	JLT	[✂]
Mercer	[✂]	Kempen	[✂]
Redington	[✂]	Schroders	[✂]
River & Mercantile	[✂]	Spence & Partners	[✂]
SEI Investments	[✂]	Xafinity	[✂]
WTW	[✂]		

Source: CMA Analysis, Parties' Data, listed in alphabetical order.

64. Our dataset does not allow us to identify whether a given tender process related to IC or FM services, nor the scale or scope of the engagement. It does however indicate that although firms may have opportunity to participate, it is the largest firms that participate most frequently.

65. The cost of bidding for tenders is not seen to be prohibitive to entry by parties but a firm's rate of expansion may be affected by its ability to finance and afford staff time in participating in multiple tenders. For FM mandates, the selection process could take up to a year and therefore the costs incurred may be considerable.[35] For smaller firms there will necessarily be greater restrictions on the number of tender processes that firms have the capacity to engage in.

66. A firm will need to balance the cost of participation against the likelihood of winning and the financial or other rewards when deciding which tender processes they should participate in. This would impact the rate of expansion for a given firm. The benefits of winning a client of a certain size or profile, for example, may be perceived to have significant additional reputational effects in being able to demonstrate experience when competing for other similar clients.

67. Hymans said that the cost of participating in a tender is high relative to the revenues earned. Therefore Hymans sought to participate in new business

[35] Summary of hearing with Punter Southall Limited (Punter Southall) held on 23 November 2017.

situations which are driven by a need for change and the prospect of a long-term relationship, rather than simply for due diligence purposes where the client is entirely satisfied with the incumbent.[36]

68. Russell Investments said that, in 2017, they had responded to five to ten separate invitations to tender to provide FM services from third-party evaluators and up to five without. They said that the number of FM contracts being tendered had been growing in recent years.[37]

69. Therefore, as more firms choose to adopt FM services, the number of opportunities to win a contract and the associated revenues available may also be increasing. However, incumbent IC firms may retain a particular benefit.

70. We have no evidence on the extent to which firms are invited to tender as a result of an existing client relationship, but we have identified the proportion of tenders participated in where a firm did have an existing relationship. Table 3 sets out our analysis of the tender data we hold. This data nevertheless indicates some firms participate in a far greater number of tenders where they have a pre-existing relationship.[38]

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[36] Summary of hearing with Hymans Robertson LLP (Hymans) held on 15 November 2017.
[37] Summary of hearing with Russell Investments.
[38] This may simply reflect overall scale of those firms, and multiple firms may have relationships with the same clients.

Table 3 FM and IC tender participation, existing relationships and success rates 3 years

Firm	*Number of Tenders*	*% relating to existing Clients*	*% of tender won*	*Tenders from existing clients*
Aon	[✂]	[✂]	[✂]	[✂]
Barnett Waddingham	[✂]	[✂]	[✂]	[✂]
BlackRock	[✂]	[✂]	[✂]	[✂]
Cambridge Associates	[✂]	[✂]	[✂]	[✂]
Capita	[✂]	[✂]	[✂]	[✂]
Cardano	[✂]	[✂]	[✂]	[✂]
Charles Stanley	[✂]	[✂]	[✂]	[✂]
First Actuarial	[✂]	[✂]	[✂]	[✂]
Hymans	[✂]	[✂]	[✂]	[✂]
JLT	[✂]	[✂]	[✂]	[✂]
Kempen	[✂]	[✂]	[✂]	[✂]
KPMG	[✂]	[✂]	[✂]	[✂]
LCP	[✂]	[✂]	[✂]	[✂]
Mercer	[✂]	[✂]	[✂]	[✂]
Redington	[✂]	[✂]	[✂]	[✂]
River & Mercantile	[✂]	[✂]	[✂]	[✂]
Schroders	[✂]	[✂]	[✂]	[✂]
SEI Investments	[✂]	[✂]	[✂]	[✂]
Spence & Partners	[✂]	[✂]	[✂]	[✂]
WTW	[✂]	[✂]	[✂]	[✂]
Xafinity	[✂]	[✂]	[✂]	[✂]

Source: CMA Analysis, Parties' Data, listed in alphabetical order.

71. We have not assessed whether having an existing relationship affects performance in a given tender, but at a firm level, there does not appear to be a link between the overall success rate and the proportion of clients a firm has an existing relationship with. Of the 21 firms in our dataset, success in tenders ranged from 13% to 55%, with success rates not directly linked to the number of tender processes participated in or the scale of any existing client base. It is not clear whether the variance in success rates across firms affects a given firm's strategy in bidding for work.

72. What is notable however is the absolute number of tenders that firms have participated in where there was an existing relationship. In this analysis both [✂] and [✂] participated in over [✂] tender processes each where there was an existing relationship. Both [✂] and [✂] had participated in over [✂] tender processes with existing clients. The other [✂] firms[39] in our data set had only

[39] Excludes firms for which this is not applicable.

participated in between [✂] and [✂] tender processes held by existing clients. This dataset does not allow for confirmation of whether firms were included as a result of existing relationships but does indicate an overall incumbency effect.

73. We recognise however, that for firms only providing FM services, that the number of processes they are invited to with existing clients may naturally be lower as a result of not offering multiple service lines to develop relationships and that FM is a relatively new service.

74. If firms are assumed to achieve equal success rates regardless of client relationship, it would nonetheless indicate that larger, more established firms active in other services are more readily able to win new clients and that this pattern is likely to be even greater for FM.

Switching rates

75. A further potential barrier to expansion is the rate of switching by clients with incumbent providers. The impact of this will, however, depend on the overall level of uptake of a given service in a market. Our working paper on trustee engagement sets out relevant evidence and indicators of engagement and switching costs in more detail.[40]

76. Perceptions of switching costs may affect client behaviour in relation to the frequency of formal tender processes or the propensity to switch which in turn will affect the opportunities that firms have to win new clients.

77. Punter Southall commented that switching is easier for IC than for FM as it can be costly for firms to move assets. We have been told that the costs in FM can range from £120,000 to £1 million for a scheme of £100 million and the process can often take up to a year. This could be a barrier to a firm's ability to attract clients that were already with an FM provider. As noted previously, around half of schemes appoint their incumbent IC provider when purchasing FM services[41] for the first time and furthermore switching rates are lower in FM than IC (9% vs 27%) and even when seeking to adjust for new mandates (17% vs 30%).[42]

[40] CMA working paper on trustee engagement.
[41] CMA working paper on Supply of fiduciary management services by investment consultancy firms.
[42] CMA working paper on trustee engagement.

Perceptions of conflicts of interest and benefits of bundling

78. There are some potential barriers which may act in opposite directions depending on client preference. We note the potential tension between the perception of any potential conflict of interest arising from offering both IC and FM and the potential benefits of offering multiple, possibly bundled, services.

79. For example, some parties[43] believe that their clients prefer that they do not offer FM in addition to their IC service, as this reduces the conflict of interest possibility. This could then limit a firm's willingness to expand into FM services, given the potential conflicts associated with offering both IC and FM services to a client.

80. KPMG also said[44] that it was not considering offering FM services to clients as it did not see FM having any fit with KMPG as an advisory firm. KMPG said that its independence as an advisor was important, especially as KPMG is the auditor of some FM firms.

81. Several firms offer a range of service lines to clients which allow bundles of services to be purchased from the same provider, either incrementally or at the same time. Some firms, such as SEI offer an integrated IC-FM service whereas many firms providing both IC and FM to a client have separate agreements in place for each service.

82. Any client perceived benefit of obtaining multiple services from the same firm could however act as a barrier to expansion. First, firms which do not offer multiple services may find themselves at a competitive disadvantage in tenders. Second, the costs of entry to multiple service lines will be greater and expansion may be slower than for established multi-service line firms. Third, where clients have a preference for buying multiple services from the same firm, the aggregate switching cost will likely be greater than the switching cost of any given services.

83. We are keen to receive parties' views on both the benefits to clients of receiving multiple services from firms and how such arrangements may act as a barrier to expansion in practice.

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[43] Momentum and Punter Southall.
[44] Summary of hearing with KPMG LLP (KPMG) held on 14 November 2017.