

CMA INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT MARKET INVESTIGATION

MERCER'S RESPONSE TO THE ISSUES STATEMENT

1 Executive summary

- 1.1 This is the response by Mercer Limited (**Mercer**) to the Issues Statement dated 21 September 2017.
- 1.2 In our experience, the investment consultancy and fiduciary management markets are competitive and are working well. We are proud of the work we do with clients, bringing our intellectual capital to bear for them through a range of approaches: access to our tools and research; provision of investment advice; and fiduciary management services. Clients choose how they work with us and we are very conscious that if we do not provide a good service they can, and will, go elsewhere.
- 1.3 In summary, our response to the CMA's three proposed **theories of harm** is as follows:
 - **Informed and diligent demand side:** Our experience is that pension scheme trustees are capable and diligent. We strive to provide information to our clients in a form that allows them to understand and challenge investment advice and decisions on behalf of their pension scheme beneficiaries. Some trustees, especially of smaller schemes, may have limited resources - mainly in terms of available time - and as a result may struggle to manage the detail of all of the decisions they need to make and to act promptly in response to market events. Such clients in particular have benefitted from fiduciary management services, where they delegate the implementation of their strategic investment decisions to a fiduciary manager. This has allowed them to use their limited time more effectively.
 - **Well-managed conflicts of interest:** There are conflicts of interest in this sector, as in most professional services sectors. We take steps to mitigate the conflicts we face - including by not managing assets ourselves but advising on third party asset managers for our investment advisory clients and selecting third party asset managers for our fiduciary management clients. To the extent we cannot avoid conflicts we have policies in place to disclose them to clients and to manage them. Importantly, mismanagement of conflicts of interest would be damaging to our brand and reputation in the market – and consequently to our ability to compete.
 - **Manageable barriers to entry and expansion:** This is an evolving and competitive market, with constant innovation. Clients regularly run formal tenders as well as less formal market testing processes. As a result, competition and competitive incentives are consistently present. To the extent barriers to entry and expansion exist, the number of competitors we regularly face - including recent entrants who often compete against us in tenders - show they are not significant and can be overcome.

1.4 At the outset, we also make two important points that go to **procedural fairness** in this investigation:

- **The need for a fresh start:** We ask that the CMA conducts its own analysis based on the information that we and other market participants are providing as part of the extensive data gathering process. The FCA carried out only limited work in respect of investment consulting and fiduciary management services (focussing its resources on the asset management market at the heart of its study) and we have significant reservations about the robustness of its analysis, particularly in respect of manager selection and competition among asset managers. As such, we consider that it would be inappropriate for the CMA to attempt simply to update or extend the FCA's work. Our views on how the CMA should best measure market outcomes are contained in the Annex to this response.
- **The risk of pre-judging the outcome:** We note the CMA's clear statements that it should not be taken to have pre-judged the outcome of this market investigation by including a long-list of potential remedies at this early stage, in accordance with the new market investigation guidance. Notwithstanding these assurances, we consider that it is premature, even under the new regime, to dedicate any time or resource to analysing potential remedies – particularly the more interventionist measures – before the CMA has the opportunity to assess the evidence. It also carries a number of risks both for the CMA and for participants in the market: most obviously, that it risks pre-judging whether there is an adverse effect on competition (AEC) in this market.

1.5 In this response, we start by describing our experience of how the market operates and what the evidence demonstrates (Section 2). We then address the scope of the investigation (Section 3); our position in response to the three theories of harm (Section 4); and some initial observations about the long-list of potential remedies (Section 5). In the Annex we set out our views on how the CMA might approach measuring market outcomes.

2 Our experience of how the market operates

2.1 We explain below our understanding and experience of the market. Over the course of this market investigation, we will provide evidence to show that:

- (a) We create value by helping our clients make effective financial decisions about complex pension and investment issues.
- (b) As intermediaries between clients and asset managers, we help drive competition in the asset management market and other adjacent markets.
- (c) The investment consultancy and fiduciary management markets are competitive: we compete vigorously to retain existing clients and to win new ones, and we need to innovate constantly to compete better.
- (d) Competition means we have strong incentives to manage conflicts effectively; any damage to our reputation from actual or perceived conflicts would harm our competitive position.

A We create value by helping our clients make effective financial decisions about complex pension and investment issues

2.2 We offer high quality advice on investments backed by extensive research across a broad range of asset classes and asset managers and - for those clients who choose this option - the ability to delegate (to a greater or lesser degree) the implementation of their investment decisions to us. Each client is different and will need a bespoke solution to best achieve its investment objectives. Our breadth and depth of expertise and experience means we can work with each client to tailor a set of services that supports their objectives.

2.3 The services we provide for our clients can be seen as a spectrum: “*let me do it*” (we provide the client with research and analysis tools to enable them to design their own strategy); “*help me do it*” (we employ our intellectual capital and expertise to advise the client on the choices they may make, and the client takes the decisions); and “*do it for me*” (we implement the client’s investment strategy on its behalf through fiduciary management, in which case we are guided by the advice we would otherwise have given them).

2.4 We do not manage assets – meaning we do not pick or hold individual stocks (or other assets) to include in a fund. We use third party asset managers.

2.5 The key area of advice in any investment consultancy mandate is the determination of an appropriate investment strategy. For clarity, by investment strategy we mean the allocation of assets to different asset classes including risk hedging instruments. While a lot of attention is given to the selection and review of asset managers to implement the chosen investment strategy, this is a part - but only a part - of the overall advice we give.

2.6 Running a pension scheme – ensuring the scheme has invested its assets and managed its liabilities to be able to pay pensions as they fall due over time – is a complex task. We exist to assist our clients to navigate these complexities and to make the most effective financial

decisions possible. We have deep expertise in pensions and investments through our actuarial heritage as well as our well-established investment consultancy business of over 40 years' standing. We use that expertise, and constantly innovate to provide new services, so as to tailor and deliver high quality advice to clients.

2.7 We also provide better value and quality to clients by offering a broad range of services:

- (a) We draw on our investment in intellectual capital and international expertise, utilising economies of scale and scope to offer clients both investment consulting and fiduciary management services more efficiently. Our manager research, for example, is employed across the spectrum of services described in paragraph 2.3 above and covers approximately 6,000 asset managers and over 30,000 investment strategies.
- (b) Our Master Trust offering draws on Mercer's experience in the much more mature Australian DC market.
- (c) Our scale means that we can stay at the forefront of issues critical to pension funds by investing in research, thought leadership and specialist analysis. This gives clients the ability to select the most efficient and effective service for them to solve a broader range of issues – such as cashflow challenges, as described in more detail in paragraph 4.15 below.

2.8 Our pension scheme trustee clients need to balance risk, returns, and liquidity requirements as they manage their pension plans. The varied nature of these factors for each individual scheme makes it challenging to measure easily the performance of investment consultants. Risk is especially challenging to manage, and is critical to each pension scheme reaching its particular goals. However, it is very difficult to measure, even *ex post*, whether risk has been effectively managed. Notwithstanding these challenges, we will demonstrate through evidence that clients achieve better outcomes - and can better deliver on their commitments to their plan beneficiaries - when they work with us.

2.9 In the Annex we set out some views on how the CMA might go about measuring performance in this market, as well as examples of the evidence that supports the better outcomes we achieve.

B As intermediaries between clients and asset managers, we drive competition in the asset management and other adjacent markets

2.10 We use our scale and expertise for the benefit of our clients by driving competition in the asset management and other adjacent markets, including for DC pension administration providers and custodian services. This has several dimensions:

- (a) We reduce entry barriers in the asset management market by conducting due diligence on a broad range of asset managers and strategies. As a result, we promote quality and choice in the asset management market – for example, by taking steps to assess and rate new managers quickly where they bring value to the market.
- (b) We increase the range of choices available to our clients. Our global reach and expertise give our clients access to asset classes that might otherwise be unavailable to them (as

they would not have the resources to investigate them on their own). This in turn helps our clients build more diversified portfolios and promotes innovative asset management solutions and asset types.

- (c) We negotiate better deals for our clients, driving down asset management fees. This is particularly true in the fiduciary management market (where clients have delegated asset manager selection and negotiation to us rather than implementing our advice themselves), where we can demonstrate the direct benefits we achieve in terms of lower asset management fees for our clients. For example, while a client with £50m assets under management would typically pay at least [X] basis points to access passive equities and gilts, they can do so through Mercer's fiduciary management solutions for [X] basis points.¹
- (d) We drive competition in other adjacent markets – for example, by having three alternative DC pension administration providers for our Master Trust we are able to ensure that our potential clients can make a competitive selection for this service.

C These markets are competitive: we compete vigorously to retain existing clients and to win new ones, and we need to innovate constantly to compete better

- 2.11 We face constant pressure from competitors to keep and win clients. Tenders are a regular feature of the market and in addition we pursue many more leads, which often involve informal market testing or benchmarking. In some segments (for example Master Trusts) formal tenders overseen by third party “ringmasters” (i.e. professional evaluators, such as Muse) are now standard, and we see that approach being pursued more widely throughout the market.
- 2.12 Where clients decide to stay with us this is because we work hard to meet their needs on a cost-effective basis. Given the long-term nature of pension obligations and the attendant liabilities that our clients must manage over long time horizons, it is essential to provide consistency of advice and execution. If we do not meet their expectations they can easily leave and some do.
- 2.13 Fees are an important aspect of competition and we feel constant pressure to offer value for money. For this reason, we ensure that our offering is keenly priced – as demonstrated by a recent survey finding that our fiduciary management fees were among the lowest across the market.²
- 2.14 As we offer a broad range of services, we compete with different organisations across elements of that range:
 - (a) We compete with established investment consultants, including Aon Hewitt (Aon) and Willis Towers Watson (WTW), but also firms such as Hymans Robertson and Lane Clark & Peacock.

¹ As explained further in our response to Questions 38 and 40 of the Market Information Request (MI Request).
² Ernst & Young, 2015 Fiduciary Management Fees Survey. See further page 32 of our response to Questions 30-32 of the MI Request in respect of fiduciary management.

- (b) Smaller consultants have made material headway in entering and expanding in the investment advisory market. For example, Redington was founded around 10 years ago from a background outside traditional investment actuarial or consultancy services. It is now a recognised and established provider in the market, and a competitor that we face regularly in tenders and pitches.
- (c) For investment advisory activity, a further substantial and expanding competitive threat has emerged from the growth of fiduciary management activities in the UK. Over 15 firms are now active in fiduciary management services and actively target DB pension funds, with recent entrants including Legal & General Investment Management (LGIM), which entered fiduciary management in 2015.
- (d) There are a large number of master trust providers – including both specialist organisations such as NEST and major insurance companies (such as Standard Life and Legal & General).

2.15 The pensions market is continually changing and throwing up new challenges for trustees, and we must be alert and imaginative in responding to them by proactively developing new solutions. We seek to develop innovative solutions along each aspect of the journey that trustees face in meeting investment objectives. Recent innovations include the Mercer Pensions Risk Exchange, our monitoring and pricing platform that brings together pension funds seeking to transfer risk to insurers in the bulk annuities market.³ This is important because it brings transparency of pricing to a market where it was previously difficult for pension funds to understand and capture opportunities.

D Competition means we have strong incentives to manage conflicts effectively; any damage to our reputation from actual or perceived conflicts would harm our competitive position

2.16 As is typical in professional services sectors, conflicts of interest are common in this market. Whether a provider offers multiple services or a single service, they may face some degree of conflict. In the latter case, a key conflict is that the single service provider is disincentivised from bringing other services which they do not offer to their client's attention lest the client switches away.

2.17 As a provider of multiple services we recognise that conflicts may arise. However, offering a range of services allows us to provide clients with a choice of solutions, and they benefit from access to our capabilities across the range of what we do. Our approach therefore is to hold ourselves to the highest professional standards in advising our clients, and we manage any conflicts that arise ethically and pro-competitively.

2.18 We have strong systems and standards to promote compliance and a cultural commitment to maintaining those standards. We have taken certain decisions which enable us to avoid conflicts; examples of policies that we apply to minimise the risk of conflicts include:

³ See <https://www.uk.mercer.com/what-we-do/wealth-and-investments/mercerc-pension-risk-exchange.html>.

- (a) we do not act as an asset manager: we recommend third party asset managers to our investment advisory clients and (depending on the level of delegation we have been granted) select third party asset managers for our fiduciary management clients, and we look across the whole market to do so;
- (b) we have clear procedures in place where we introduce fiduciary management or our Master Trust to an existing client - we will not advise on or compare competing solutions; and
- (c) we do not act as a ringmaster in the investment advisory and fiduciary management markets in order to avoid conflicts between this role and our role as a potential service provider.

2.19 Further, we have built our brand and reputation on client service and building trust with our clients is essential to this. As a result, if we were to fail to manage conflicts of interest effectively the damage to our brand and our business could be substantial and wide ranging, so we have a strong incentive to do this well.

2.20 We set out below more detail on a number of these points in response to the questions raised in the Issues Statement.

3 Scope / approach of investigation

3.1 Paragraph 18 of the Issues Statement asks whether to include institutional investors other than pension schemes (such as for example charities and insurance companies) within this investigation. We agree with the CMA's proposal of focussing its resources on the core area of workplace pension schemes. Our experience is that while we provide investment advice to other types of client, their needs tend to be substantially different from pension schemes. For example, insurance companies:

- (a) have no statutory obligation to take investment advice;
- (b) work under a different regulatory system (falling with the scope of the Prudential Regulation Authority) from that which applies to pension schemes; and
- (c) typically have extensive specialist in-house investment capability such that they only outsource the provision of investment advice where there is a specific need (such as for a particular project).

3.2 Charities are subject to a different regulatory system (the Charities Commission) and tend to have smaller portfolios of assets than pension schemes. Again, they will often only take advice when they need to do so for a particular project.

3.3 As a result, the characteristics of these clients tend to be substantially different and issues are unlikely to be common across different types of client.

3.4 In paragraph 30 of the Issues Statement, the CMA asks for views on how this investigation should build on previous reviews of the sector. The CMA should conduct its own fresh analysis

from the information we and other market participants are providing as part of the extensive data gathering process, rather than trying to update or extend the work previously done by the FCA. We have significant reservations about the analysis conducted by the FCA in respect of investment consulting and fiduciary management services, particularly in respect of manager selection and competition among asset managers. We set out our views in more detail in the Annex.

- 3.5 In paragraph 34, the Issues Statement sets out five “key characteristics” of investment consultants which the CMA intends to consider in assessing the nature of competition in the market, and asks for comments on the importance of these characteristics. We agree that these are relevant areas for investigation, but we suggest that the CMA considers carefully their relative importance. In our view:
- (a) The role of trustees is critical to the operation of the market. We address their role at paragraph 4.2 below, where we explain that their capability, incentives and relationships with other market participants are key to the demand side issues that the CMA is considering.
 - (b) We consider that the varying sizes of pension funds affect how trustees typically perform their role (with smaller funds tending to be less sophisticated and having fewer resources) - but we do not consider that client size in and of itself is a key characteristic of this market. The varying types of pension fund, and their different requirements, should be borne in mind by the CMA.
 - (c) We agree that understanding how to assess pension scheme performance is important to the CMA’s understanding of the market. We provide comments on this in the Annex. The critical issue here is that, in relation to DB schemes, “success” is reaching a fully funded position so that the fund can pay pensions to its members, and that is what Mercer strives to help its clients achieve. This involves, very importantly, dealing with risk as well as identifying potential returns. If two schemes both achieve their goal, the outcome may be the same, but the route, risk exposure and time scale taken by each scheme to reach that destination may be very different. The level and importance of how a scheme has managed its risk exposure is difficult to measure.
 - (d) Our view is that there is no “lack of clarity” in the definition of investment consultancy services and fiduciary management services. We are very clear with our clients about the services we are providing, and the contractual terms on which these services are being provided.
 - (e) We do not regard the regulations and legislation surrounding pensions as a major factor influencing competition in the market, although the CMA will need to keep in mind the substantial upcoming changes being introduced by the FCA’s package of remedies in the asset management market and MiFID II.

4 Theories of harm

- 4.1 We set out below our initial observations in respect of the three theories of harm described by the CMA.

A Demand side and information issues

Customer characteristics and engagement [Issues Statement paragraphs 48-54 and 58-59]

- 4.2 Our experience is that trustees are diligent and capable, albeit that they vary considerably in terms of experience, expertise and time available. All trustees have taken on a responsible role, often without compensation, in order to achieve good outcomes for their pension scheme members and they have fiduciary duties to discharge. Their level of engagement should be considered against that background: this is not a retail market, but a market where institutional investors seek professional advice.
- 4.3 Further, as noted by the CMA, some trustees are also scheme members.⁴ As well as their fiduciary duty, this gives them strong personal incentives to ensure the scheme receives the best investment advice.
- 4.4 Typically, trustees of larger schemes seek less active external support and do more themselves. It is more likely that larger schemes will have investment sub-committees, professional trustees, and they may have access to additional resources such as in-house investment teams (whether they sit within the pension scheme or sponsoring employer structure). These larger and better resourced schemes are less likely to use fiduciary management, but some of these may choose a degree of delegation – for example in respect of a specific asset class which is a part of the scheme's portfolio.
- 4.5 Smaller schemes tend to have fewer resources than larger schemes, particularly in terms of time available to consider investment matters. It is for this reason that trustees of smaller schemes are more likely to opt for fiduciary management. However, this is not to say that smaller schemes necessarily have less expertise than larger schemes; this depends very much on the skills and experience of the individual trustees.
- 4.6 Irrespective of their size, we make considerable efforts to support trustees in understanding the issues they face and the options open to them, including by providing a range of training sessions and materials.⁵
- 4.7 Nevertheless, trustees face substantial challenges in dealing with the range of decisions they need to consider when making investment choices for their scheme. Recent industry research indicates that almost three quarters of trustees spend five hours or less per quarter on investment matters.⁶ In light of this, it is not surprising that fiduciary management is an area of substantial growth, since it has the significant advantage of freeing up trustee time to focus on high-value strategic matters rather than on the implementation of investment decisions.

⁴ Issues Statement, paragraph 59.

⁵ More details on the training we offer will be provided in our response to the MI Request (Question 28).

⁶ Aon Hewitt Fiduciary Management Survey 2017, page 4, provided as part of Mercer's response to the off-the-shelf information request (OS Request).

4.8 Trustees often interact with various advisers to the company, which equips them to challenge their investment consultant. Companies do not have “weaker incentives”⁷ to obtain value for money from investment consultants. Companies have a legal obligation to support DB schemes by way of the employer covenant, and it follows that in our experience companies have strong incentives to obtain value for money and do so by supporting price negotiations with consultants on behalf of trustees, often augmented by internal procurement capabilities. The separate advisers to the company may include:

- (a) In-house expertise: Some large companies have an in-house investment team. This team can provide challenge to the investment consultant advising the trustees as well as potentially building relationships with alternative advisers.
- (b) The company’s own investment consultant: The company may itself take investment advice from time to time (this is more common for specific projects than as an ongoing retainer). The relationship between the company and its investment adviser will be a potential competitive constraint on the investment consultant appointed by the trustees, since the company’s adviser may challenge the advice the trustees have received from their investment consultants.
- (c) The scheme’s actuarial consultants (including the Scheme Actuary): The scheme’s actuarial consultant may give a view on investment decisions and strategy. A single consulting firm may be appointed to provide investment and actuarial services, although these are usually separate appointments following the recommendations made in the Myners Report.⁸

Barriers to switching and tendering [Issues Statement paragraph 57]

4.9 Clients can, and do, switch providers. The evidence shows that:

- (a) Tenders take place frequently, indicating that the time and cost associated with this process does not deter trustees – in addition we pursue many more leads, which often involve informal market testing or benchmarking.⁹
- (b) Tenders are taken seriously and are becoming increasingly professional: third party evaluators or “ringmasters” are often involved in the tender process, especially for master trust and fiduciary management appointments. These players have a strong commercial incentive to promote tendering.
- (c) The decision to move to a fiduciary management offering (or, in DC, a Master Trust) can be a trigger point for tendering: this shows that the innovations in the market, offering new solutions, can be a catalyst for driving competition.

⁷ Issues Statement, paragraph 59.

⁸ Please see <http://uksif.org/wp-content/uploads/2012/12/MYNERS-P.-2001.-Institutional-Investment-in-the-United-Kingdom-A-Review.pdf>.

⁹ Full details will be provided in our response to Question 72 of the MI Request.

- (d) Changing investment adviser does not involve high switching costs: due to the nature of the services provided, it is usually possible to switch consultants within a few months of making the decision to change (if not sooner).

4.10 This is not a market where we would expect clients to switch frequently (or rapidly after selecting an advisor). The investment journey that clients undertake is a long one, and for clients to decide after a few months to change their investment consultant would be rare (and likely due to an early breakdown in the relationship or external factors). As the CMA rightly notes, there is a disadvantage in losing the experience and expertise of a consulting team when a client switches providers but we do not believe that this is a substantial barrier to switching.

4.11 In practice, we would usually expect an appointment to be tested after three to five years – indeed, most trustees have a formal cycle for reviewing adviser appointments. This testing process may not always be with a formal tender exercise; but some level of market testing, perhaps through a less formal process, would be typical.

Complexity [Issues Statement paragraphs 60-61]

4.12 Historically, a pension scheme could have managed with a simple portfolio comprised of equities and bonds. However, there are several reasons why this is no longer the case:

- (a) reduced returns on traditional asset classes;
- (b) increased longevity leading to greater liabilities;
- (c) low interest rates leading to higher valuation of liabilities; and
- (d) changes to the regulatory framework, such as in relation to annuities for DC schemes.

4.13 The situation is particularly challenging for trustees of DB pension schemes, many of which have closed to new members, to new contributions, or are in the process of being wound up. In fact, 47% of DB plans are now cashflow negative: that is, monthly outgoings to meet pension payments are higher than monthly contributions into the scheme, leading to a continuous cash demand on the asset portfolio.¹⁰ As DB schemes mature, the need for effective risk management of the value of assets in relation to liabilities becomes increasingly important.

4.14 As a result of these factors, a simple approach likely would not now deliver the results required to pay pensions for the scheme members, either in terms of achieving sufficient returns or in terms of managing risks. As a result, pension schemes are actively looking for ways to improve their returns and manage their risks – and in practice this means turning to alternative investment classes such as private markets, and more refined investment techniques such as liability hedging.

4.15 Our experience is that, rather than looking to develop new techniques and approaches in isolation, frequently clients approach us looking for holistic solutions to the issues they face. An

¹⁰ See “Mercer European Asset Allocation Survey 2017” included as appendix 16.01 to our response to the MI Request, although please note that this figure is based on UK schemes only.

example of our innovation is Cashflow Driven Financing, where we were first to pioneer an implementation approach for a DB pension scheme in the UK. Our client's scheme needed to substantially reduce the volatility of its performance, while also achieving increased cashflows to pay pensions. We combined our actuarial, de-risking and hedging expertise, together with delegated solutions capabilities, to design and implement a solution that significantly improved the scheme's performance relative to its previous strategy. Our work – together with the client's endorsement – resulted in Mercer winning industry awards in 2016. So in our experience, developing more complex solutions is driven by client demand.

4.16 At paragraphs 60 and 61 of the Issues Statement, the CMA explains its current thinking on complexity and invites comments on the feasibility and value of additional work on this area. We believe that there are several reasons why this is not a productive area for further work.

(a) We do not believe there is a reliable, verifiable basis on which to determine whether a firm's investment advice to an individual client or, more generally, across the client base is overly complex:

(i) It would not be possible to define an objective benchmark that takes into account the changing circumstances, capabilities and needs of different clients, and the changing investment environment.

(ii) Without a reliable benchmark, it would not be possible to draw fair or accurate conclusions, and there would be a high risk of errors. For illustration, investment advice recommending a single asset class, with a single asset manager, may look 'simple', but it would not properly diversify the risks the scheme faces. Diversification of risk across asset classes and asset managers is critical, even if the result is to make the advice appear more complex.¹¹ It would clearly be inappropriate to misdiagnose necessary diversification as complexity.

(iii) The amount of diversification necessary will also change over time depending on the circumstances of the client.

(b) The changing circumstances of our clients' needs and market circumstances mean we must continually innovate in the services we offer and ideas we bring to clients. This innovation may appear to introduce complexity – new choices for the client that they have not seen before – however this is precisely the value we bring and what our clients expect.

B Conflicts of interest

4.17 We have set out our position on conflicts of interest in paragraphs 2.16 to 2.19 above. We will provide full details of our internal policies and procedures in our response to the MI Request, as well as explaining how they apply in practice to particular cases.

¹¹ This is evidenced by our experience in fiduciary management. Our implemented approach may appear complex – it is likely to involve more asset managers, asset classes, hedging strategies and action than trustees may undertake (or even have access to) on their own. But we believe this apparent complexity is the appropriate way to grow clients' assets under management successfully and with risk diversified. [3<] we would gain no additional benefit from making our approach unnecessarily complex.

Moving clients into in-house products [Issues Statement paragraphs 66-71]

- 4.18 In paragraph 66, the Issues Statement raises the specific issue of potential conflicts arising where investment consultants “recommend” their own in-house fiduciary management or master trust solution. The evidence will allay any concerns in this respect: in particular around (i) Mercer recommending its own in-house solutions; (ii) clients not appreciating that advice may not reflect the whole market; or (iii) clients not having sufficient information to assess value for money.
- 4.19 Our approach is to provide a range of methods for our clients to access our intellectual capital – access to research and tools, investment advice, and fiduciary management. We have no internal policies regarding the sale of one particular approach over others – the services that our clients purchase from us are their choice, and their options are made clear to them. [X]
- 4.20 [X] Switching to a master trust solution is not a decision that companies take lightly and tenders are absolutely standard around these decisions, often with the support of a third party ringmaster.
- 4.21 Similarly, in our experience, a decision to adopt a fiduciary management solution is not taken lightly by pension trustees, who will take the following steps before making a move to fiduciary management:
- (a) Usually over an extended period of time, trustees will carefully compare fiduciary management solutions against ‘the default’ of continuing with the approach they apply already, using their existing internal capabilities with advice from investment consultants.
 - (b) Before pursuing a fiduciary management approach, trustees will typically seek advice from their investment consultants on whether such an approach would be appropriate, and the majority of trustees will further consult (and involve) third party evaluators and seek out the views of existing users before selecting a fiduciary management solution.
 - (c) Once a fiduciary management solution has been selected, the trustees will then be required to enter a contract for these services and complete a substantial amount of documentation (almost always with the involvement of their legal advisers, and with the revised fee basis negotiated and documented explicitly) before the fiduciary manager will be in a position to start delivering its services.

Outside business relationships / gifts and hospitality [Issues Statement paragraphs 72-75]

- 4.22 The evidence demonstrates that revenues from other services and, separately, gifts and hospitality do not have an effect on the provision of our investment advice. Our asset manager rating process is robust and independent, and conducted by a dedicated team. Asset managers are measured against specified criteria, and proposed ratings are subject to challenge and review.

- 4.23 In addition, we have clear policies in respect of gifts and entertainment: these may only be accepted at low levels and within specific boundaries.¹² This is directly contrary to the FCA's suggestion of there being "a strong culture of gifts and entertainments" in the sector, which we do not recognise.¹³

C Barriers to entry and expansion [Issues Statement paragraphs 77-80]

- 4.24 The number of firms competing for investment consultancy and fiduciary management services, and the fact that some are relatively new to the market, demonstrates that any barriers to entry are surmountable.
- 4.25 To the extent barriers to entry exist, we believe these are limited to two areas, as follows:
- (a) establishing a brand and reputation, based on experience and a demonstrable track record; and
 - (b) using benefits of scale – both to achieve keener pricing and to invest in innovative and specialist areas.
- 4.26 This is not a concentrated market. The level of tender activity provides opportunities for firms to expand, and the success of some firms in doing so demonstrates that barriers to entry and expansion should not be overstated.
- 4.27 As explained in paragraph 2.14 above, we face a range of different competitors across the investment consultancy and fiduciary management markets. Some firms compete across the full range of services, while others operate in a particular segment – but this position is constantly changing, with players expanding in different segments to take advantage of new opportunities. In investment advisory, we are aware of over 30 providers, the top 15 of which we would regularly compete against (although the smaller firms would also compete strongly for smaller mandates and project work). In fiduciary management, we are aware of more than 15 providers, of which slightly more than half come from an investment consultancy / actuarial background, and the rest of which are asset managers.

5 Potential remedies

- 5.1 We appreciate that the CMA now considers remedies at an earlier stage of the market investigation process under its revised guidance, with the intention of streamlining the overall process.¹⁴ However, we are concerned that the CMA appears to have already carried out work in respect of remedies, such that:
- (a) we and other parties could expend significant time and resources on remedies at this early stage which subsequently turn out to be wasted effort depending on the ultimate finding concerning any AEC; and/or

¹² See our response to Question 99 of the MI Request.

¹³ Issues Statement, paragraph 74.

¹⁴ *Updated guidance on the CMA's approach to market investigations: consultation response*, 5 July 2017 (CMA62resp), paragraph 1.1.

- (b) the CMA could err by pre-judging the existence of an AEC.¹⁵
- 5.2 The CMA considers that its longlist of remedies is “purely hypothetical” at this stage. We understand this to be a reassurance that the CMA is attempting not to pre-judge the outcome of the market investigation. However, a detailed list of remedies with a description of “how they might work in practice”¹⁶ does not give the impression of being wholly hypothetical [§<]. We believe that the CMA should take note of this - and in this investigation (and those taking place in future) take additional steps to make clear that these remedies are no more than hypothetical. This could be done, for example, by:
- (a) placing the remedies in a separate document or annex headed “Hypothetical Remedies”; and/or
- (b) avoiding publishing such detailed long-lists of remedies at an early stage, and identifying only types or categories of remedies for consideration.
- 5.3 As regards the long-list of possible remedies, to the extent these are drawn from or otherwise follow the UILs put forward by Mercer, WTW and Aon, we are of course willing to engage in further discussion with the CMA to explain the rationale behind them, and, indeed, the challenges involved in designing them.¹⁷
- 5.4 However, a number of the remedies that have been listed by the CMA do not stem from the UILs, including some which could have very significant implications for our clients, our business and the market. In particular, the structural proposals set out in paragraphs 120 and 131 of the Issues Statement could have far-reaching consequences for the participants in the market, for services to clients and to pension scheme members.
- 5.5 We do not believe that there is any justifiable basis for these possible remedies to be even considered at this stage of the process. We are not aware of any evidence that has been made available to the CMA that could justify such intrusive and restrictive remedies. Indeed, even if the potential concerns identified in the Issues Statement were to be substantiated - which for the reasons set out above, we do not believe will be the case - they would not be sufficient to justify the imposition of such interventionist and intrusive remedies. In the circumstances, we consider that the CMA should not progress any further with these potential remedies unless and until the CMA has a significantly greater understanding of the market (at which time we believe the possibility that such remedies would be considered appropriate will in any event fall away).
- 5.6 It is of course the case that any intervention in the market carries the risk of unintended consequences, particularly in a market such as this which is developing rapidly. Fiduciary management is growing at a significant pace - a 2016 survey by KPMG, for example, estimates that fiduciary management services have grown over ten-fold in the past decade (based on

¹⁵ We note that during the consultation process in respect of the revised guidance, a number of parties raised these and similar concerns, see e.g. the City of London Law Society Competition Law Committee’s *Response to the Consultation on Updated Guidance to the CMA’s Approach to Market Investigations* (in particular, paragraphs 9(A) and 12) and the CMA’s *Summary: roundtable on the updated guidance on the CMA’s approach to market investigations held on 29 March 2017* (in particular, paragraph 7).

¹⁶ Issue Statement, paragraph 87.

¹⁷ We would also refer the CMA to the explanatory submissions sent to the FCA at the time – in particular Mercer’s submission of 20 February 2017.

AUM or mandates).¹⁸ New solutions such as master trusts are rapidly gaining ground, while the DB segment is facing new changes and challenges from wider market conditions. There is therefore a real risk that interventions could unintentionally restrict or divert the pro-competitive development of a market which is working well – particularly by distracting businesses from their core roles of providing value for clients and innovating to constantly improve their offerings.

- 5.7 Further, as explained in paragraph 2.10 above, our activities in the investment consultancy and fiduciary management markets also have the benefit of driving competition in the asset management market. As a result, making changes in these markets may put those competitive benefits at risk (especially if the proposed remedies are being supported by the large asset managers).
- 5.8 For these reasons, we would invite the CMA to focus at this stage of the investigation on fully understanding the features of the market. When the evidence of competition in the market has been considered and assessed, it may be that there is no finding of an AEC. Only if the CMA provisionally finds an AEC after reviewing all the evidence, should the CMA then move on to assess the potentially appropriate and proportionate remedies to address it. This could be conducted in a more efficient and effective manner by considering a shorter and more focused list of remedies at that stage.

¹⁸ Provided as part of Mercer's response to the OS Request.