INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT SERVICES

MARKET INVESTIGATION

RESPONSE TO THE

COMPETITION & MARKETS AUTHORITY'S ("CMA")

STATEMENT OF ISSUES

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19 OCTOBER 2017

INVESTMENT CONSULTANTS MARKET INVESTIGATION REFERENCE

RESPONSE TO THE CMA'S STATEMENT OF ISSUES[1]

1. Overview

1.1 Willis Towers Watson ("WTW") is a global risk solutions business that provides a wide variety of services, including investment consultancy and fiduciary management services. Approximately [✂]% of our relevant UK investment consultancy business relates to defined benefit ("DB") pension schemes with [✂]% relating to defined contribution ("DC") pension schemes and the balance to other institutional investors. WTW wishes to actively support steps to improve outcomes for our clients and the wider investor community and is fully committed to supporting the CMA in building a clear understanding of the relevant markets and the means by which market outcomes could be improved. The key underlying goal should be to determine how trustees can best procure the advice, support and appropriate resources they need to fulfil their fiduciary responsibilities. Constraining their choice in this regard should not be the result.

1.2 WTW strongly believes that investment consultancy is a market with demonstrable competitive characteristics, both for advisory services and fiduciary management. There are a number of reasons that WTW takes this view. We summarise these in paragraph 1.8 below.

Our services add substantial value for clients

1.3 We are active in the provision of investment consultancy advisory services and fiduciary management services. Both of these are designed to meet the needs of our clients who are primarily DB pension scheme trustees. The principal objective of any DB pension scheme is to pay all of the benefits of its members as they fall due – our services are designed with this goal in mind.

1.4 Both advisory and fiduciary services are essentially at the same level of the supply chain – offering trustees either advice or, if they choose, a combination of advice and implementation services. The CMA should note, however, that there are many models for delivering the reference services, including:

(a) using advisor input for particular aspects;

(b) trustees deciding and implementing some or all aspects;

(c) varying degrees of delegation of both decisions and implementation; and

(d) the use of internal pension fund teams.

1.5 Our *advisory* services are designed to meet the needs of a wide variety of clients. Inevitably those clients that wish to implement portfolios that invest across a wide range of asset classes and make use of sophisticated risk management techniques will need significant resources and time to devote to the multiple decisions that need to be taken. Many schemes, particularly large schemes with internal resources, are well placed to do this. However, it is often the case that trustees face "bandwidth" issues, simply lacking the time and resources needed to manage a complex portfolio. This is more common for trustees of smaller and mid-sized pension funds. For these clients we either offer advisory services appropriate for implementing simple portfolios, or fiduciary management services (which were developed in response to client demand). This service model eases the bandwidth constraints associated with the more sophisticated investment approach. It does so by outsourcing a

[1] In this response and all responses to the CMA, Towers Watson Limited is the main regulated entity. We refer to both this entity and the relevant general business as "We", "Willis Towers Watson" or "WTW" throughout.

large volume of the decision making and execution work that would otherwise be undertaken by trustees themselves.

1.6 Both of these services add considerable value to clients by:

(a) helping them make better strategic investment decisions to enhance the security of their members' benefits;

(b) helping to introduce[2] new, innovative and more efficient products that increase choice; and

(c) helping to take costs out of the supply chain. In relation to fiduciary management, the aggregation of schemes gives greater bargaining power with respect to asset manager fees, to the benefit of all relevant clients.

1.7 The value that we can create for clients, on either an advisory or fiduciary basis, is a product of combining client context, strategic risk management, portfolio construction and efficient implementation.

The markets are competitive and innovative

1.8 The markets for both investment advisory and fiduciary management are very competitive. In particular:

(a) We face significant rivals in both areas. In addition to Aon and Mercer, who have similar business models to WTW, there are a number of well-established advisory firms such as Hymans Robertson and Lane, Clark and Peacock. There are also several examples of firms who have built meaningful advisory and/or fiduciary businesses from scratch over the past decade – Redington and Cardano would be the main examples. We have also seen a number of recent entrants to the advisory market such as Momentum and Xafinity who have started to build market share over the past couple of years.

(b) The number of participants in the fiduciary market has grown rapidly as asset managers have entered (LGIM, Schroder, BlackRock etc.) as well as international players who have observed the growth in UK assets and entered our market (SEI, Kempen for example). It is clear from the number of new entrants and their diverse backgrounds that different strategies can be adopted to both enter and expand in the market.

(c) Fiduciary management is a relatively recent offering in the UK, with the first large UK mandate awarded in 2011. It is a highly competitive market. New appointments only take place after competitive tenders in the vast majority of cases that we have had sight of. In addition these processes – when conducted for clients of any size – are now typically intermediated by expert third party advisers. We have bid for [✂] fiduciary management appointments over the five years to September 2017. Of these all but [✂] were competitively tendered. Moreover, we estimate that we have only been invited to bid for only about [✂]% of all mandates awarded overall in the last 5 years.

(d) Investment consultancy advisory work is also highly competitive. In our experience, clients are highly sensitive to the quality of service and price. We have therefore created a formalised feedback loop with clients in order to maintain high levels of service and address issues early. The existence of the fiduciary management model is another competitive pressure on advisory services – advisory services must be delivered to a very high standard if they are to compete with the fiduciary model. Indeed, where appropriate we proactively raise the fiduciary management service model with advisory clients. We have heard criticism in the industry of this process but the simple reality is that if we do not raise the fiduciary model

[2] Through working with asset managers to develop offerings that fill what we view as gaps in the market. Note, we do not take a fee from the asset manager for either such work or for the introduction of clients.

with our advisory clients, another firm will. As well as providing choice to the client in line with our culture and market positioning, it is part of our engagement with clients to ensure they are aware of the full range of services we offer and the benefits such services could bring. Thus, we explain the possible benefits of fiduciary management in an unbiased manner. We emphasise that clients moving to the fiduciary model almost always – in our experience – follow a competitive process. We therefore do not recognise the criticism of consultants simply "converting" their advisory clients to fiduciary clients.

(e) These competitive pressures continue to increase as more entrants come to the market and more trustee boards move to fiduciary management through formal competitive tenders.

(f) We have responded to these competitive pressures and changing client needs by being highly innovative, such as through developing a new fund platform (our nascent Asset Management Exchange (AMX)[3]) and fund of funds solutions. We have also worked with asset managers to develop new investment products that clients value, but did not previously exist.

(g) Performance data relating to our delegated fiduciary management service shows the value that we add – both for fiduciary management and investment advisory (as fiduciary management is essentially our advice executed on an unfiltered basis and without delay).

The suggested structural remedy is inappropriate

1.9 Given the positive nature of competition in this market, WTW does not believe there can be any justification for a structural remedy splitting up the investment advisory and fiduciary management businesses. In fact, such a remedy would itself have adverse effects on competition:

(a) It is efficient to operate investment advisory and fiduciary management services in the same business as both can benefit from the same research function. Research and development would be of lower quality and/or more expensive for a standalone operation.

(b) As noted above, the value that we create for both advisory and fiduciary clients is a product of combining client context, strategic risk management, portfolio construction and efficient implementation.

(c) There are no material conflict of interest issues in the current model. If a client wishes to switch to fiduciary management they will, in our experience, almost always carry out a competitive tender process and receive assistance from independent third parties. In contrast, were we to offer only one solution e.g. advisory, there would be a strong potential conflict of interest – we would be economically incentivised to not refer to fiduciary management as this would mean we would forgo all possibility of future work, even if fiduciary management were the best solution for the particular client. This remedy would therefore create conflicts of interest.

1.10 We believe that client outcomes would be adversely impacted were this value-chain to be broken by a structural remedy, whether by not allowing a single firm to possess both strategic consulting skills and implementation services, or by not allowing a single firm to provide the full range of services to a client[4]. Such a move could result in:

- less differentiation and choice between strategic advisers;
- increased cost of strategic advice;

[3] http://www.theamx.com/about-us

[4] That is, any such "structural" remedy would be unwarranted and/or disproportionate.

- more of these responsibilities being delegated to the asset management community (which is unlikely to be the most economical or effective solution);
- a reduction in the quality of strategic advice; and
- a reduction in the quality of innovation, manager selection and mandate design.

Some aspects of the FCA's market study were based on misconceptions

1.11 In WTW's opinion, some views expressed by the FCA (mirrored in the Statement of Issues) do not accurately reflect the market position. In particular,

(a) WTW is not vertically integrated between advisory services and fiduciary management. It is more accurate to think of fiduciary management as being an extension of investment advisory services on a horizontal level, incorporating services that are otherwise carried out by pension fund trustees (see paragraphs 4.5 to 4.10 below). In our view, a more substantive vertical integration issue arises in relation to asset managers offering fiduciary management, but only using their own fund solutions (or very limited alternatives) to implement the mandate.

(b) There appears to be scepticism about the value of manager selection advice. WTW is of the view that value can be generated through appropriate manager selection. The FCA's analysis of this issue included significant flaws which we would be happy to discuss with the CMA in more detail. We have clear evidence that our selection of managers does lead to value for our clients given the process we follow and our results – we have shared that evidence with the CMA.

(c) WTW considers the value of gifts and hospitality across the total industry to be negligible at £40,000 in 2015, especially when considering the overall value of assets under advice in the UK market. We do not see how this limited amount of hospitality is likely to alter the independence of investment consultants. Moreover, our investment business has a clear company policy on refusing gifts (or entertainment with gifts) from any organisation providing services to WTW's clients (or passing them on to charity if impractical to return).

Other issues

1.12 Whilst the investment advisory and fiduciary management markets are competitive and innovative, WTW nevertheless believes that there are some aspects of the functioning of the market which could be improved, primarily in relation to the transparency and clarity of advice in the sector. For example, WTW considers that clients should be fully informed when particular advice is likely to generate additional (ancillary) fees for the advisor. Also, to the extent that smaller schemes are inhibited from switching due to the cost of running a tender process, standardising tender documents may be beneficial.

1.13 The CMA may wish to consider the resource devoted to Master Trusts. WTW's Master Trust is a new offering by our firm with one current full service client, which has been launched into a market with a wide range of existing offerings. The goal of the offering is to allow employers to reduce the costs of providing a trust based DC scheme, offer better governance of the scheme and allow scheme members to benefit from the lower prices available with aggregation, whilst still benefitting from the trust based structure It is hard to see how this development can be anything but pro-competitive.

1.14 Finally, while not raised by the Statement of Issues, WTW believes that the CMA should take a wider view of the potential conflict of interests resulting from firms offering the reference services using different business models. As mentioned above, there is a likely conflict of interest that exists where a firm *does not* offer both advisory and fiduciary management. Small to medium sized schemes may well greatly benefit from fiduciary management, but remain insufficiently aware of the benefits of such a solution because it is not in the interest of their incumbent advisor to raise the possibility. Also, certain asset managers are vertically integrating to become fiduciary managers but will inevitably have a bias towards their own security selection products (whereas WTW's approach is without bias in relation to choosing the security selection product as we do not have any of our own).

1.15 If the CMA does not take a broader view of the working of the market than that taken by the FCA, for example in relation to such conflicts, the inquiry risks missing some of the key issues affecting competition in this sector. We note in this regard that one of the reasons the FCA made the current reference was that they were conscious that they were not fully aware of all possible issues in the industry – a fact they made very clear in their decision to reject the UILs submitted by ourselves and other firms.

2. Our firm and the services we provide to our clients

2.1 The establishment of our investment business and its evolution over time has been driven by three key factors:

- Client demand; in terms of the range of services they require, how they wish to work with us and the increasing complexity of their requirements;
- Regulatory changes; increased demand on pension schemes, increased reporting requirements and additional strategic considerations; and
- Capital market events; movements in asset and liability values, changes in market sentiment and risk aversion all shape the nature of the services that clients are likely to require going forward.

2.2 This is illustrated in Table 1, below.

Table 1 - brief history of key events

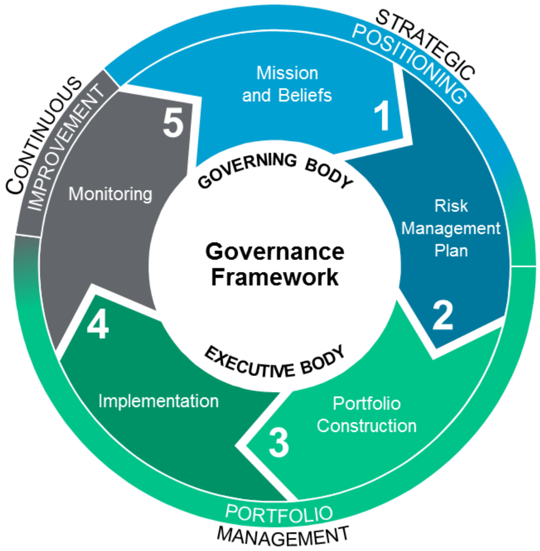
Date	Event
1989	Investment line of business set up at R Watson & Sons (rivals did similar earlier in the 1980s).
1991	Maxwell pension scandal - employing entity using and misusing pension funds.
1995	Pensions Act 1995. Re-shaped pensions regulatory landscape. • Trustees were required to seek appropriate, independent advice • The notion that a Statement of Investment Principles document must be prepared. • The Minimum Funding Requirement for DB pension schemes (rules on how much funding to meet liabilities). Created an issue for corporates as to how to manage the risk of funding level volatility.
1999	First client asks us to "take more responsibility" - not yet full fiduciary management but "implemented consulting"; the client asked for a single recommendation rather than range of options.
2001	Myners Report - made a number of recommendations (10 principles) that became best practice, e.g. that actuarial and investment consulting appointments should be separated (note, no prohibition on appointment in both areas). Also stated that trustees should take account of liabilities when setting investment policy, i.e. their specific context. This was not received wisdom at the time.
2007/2008	Global financial crisis - significant negative impact on pension schemes. Trend to liability hedging - prior to this point, too little emphasis had been on downside risk management.
2011	First client (MNOPF) requires formal full delegation - appointment by MNOPF made following a formal competitive tender intermediated by KPMG. WTW required to build infrastructure to support appointment = establishment of the fiduciary management business line.
2014	Pooled fund infrastructure launched by WTW - provides aggregation benefits for smaller schemes.
Present	Continuing low return environment. Pressure to reduce costs (fees).

Our clients, the challenges they face and the way in which they engage with us

2.3 The challenge facing DB pension fund clients is relatively consistent across the industry; namely to ensure that the fund is in a position to pay all the benefits as and when they are due. However the appropriate solution to this problem can be complicated and can vary significantly between clients.

2.4 WTW has a process of helping our clients achieve full funding that breaks down the constituent elements of the pension scheme investment process. The stages in this process are illustrated in Figure 1.

Figure 1 - Getting our clients to full funding



2.5 The 5 stages cover the following areas:

(a) *Mission and beliefs*: Helping the client to understand where they need to get to and their beliefs about the appropriate investment strategies to follow.

(b) *Risk management plan*: Comprehensively identifying the relevant risks, understanding how these may be mitigated or offset, and helping the client to reach a view as to which and to what extent these risks should be managed (which will be informed by the client's mission and beliefs).

(c) *Portfolio construction*: Identifying the balance of investments across asset classes and hedging instruments (which will be informed by the client's mission and beliefs and its risk management plan).

(d) *Implementation*: Within each asset class, selecting and appointing asset managers to invest the appropriate funds (which will be informed by the client's mission and beliefs, its risk management plan, and its portfolio construction).

(e) *Monitoring*: measuring the outcomes and reviewing whether the mission and beliefs are still appropriate.

2.6 We believe that best practice governance involves assigning responsibility of each of these stages to either a governing body (typically the strategic decision of steps 1, 2 and 5) or an executive body (typically the more time-sensitive and/or detailed decisions of steps 3 and 4). The benefits of this governance structure are as follows:

- It recognises and accommodates the different skill sets required between the strategic, portfolio management and monitoring functions.

- It allows the proper focus to be applied to each stage. In our experience, a disproportionate amount of time at quarterly meetings of pension scheme trustees/investment committees has focused on steps 3 and 4 above - portfolio construction and implementation. This has been at the expense of the key strategic stages which we believe are a much bigger driver of outcomes and therefore success.

- It promotes a greater degree of accountability, with the executive body reporting in to the governing body.

2.7 The executive body could represent an investment sub-committee of the Trustees, a full time internal investment team or a third party fiduciary manager. While the appropriate make-up of the executive body will vary from scheme to scheme, we believe that this investment process, and these governance principles, should be considered by all schemes.

2.8 The vast majority of pension schemes in the UK do not have the size to justify the costs of building an internal investment team. As such, fiduciary management is becoming an increasingly popular method for schemes to enhance their governance and support a more robust investment process. The fiduciary management model also gives rise to additional benefits and efficiencies:

(a) the fiduciary manager can aggregate funds across multiple clients, resulting in greater bargaining power with asset managers than individual pension schemes would have by themselves, and hence reduced fees. This need for aggregation in the industry is well understood – note the forced consolidation of the assets of local government pension schemes – but hard to achieve in the private sector. Fiduciary management is a very effective means of achieving this aggregation without forced scheme mergers;

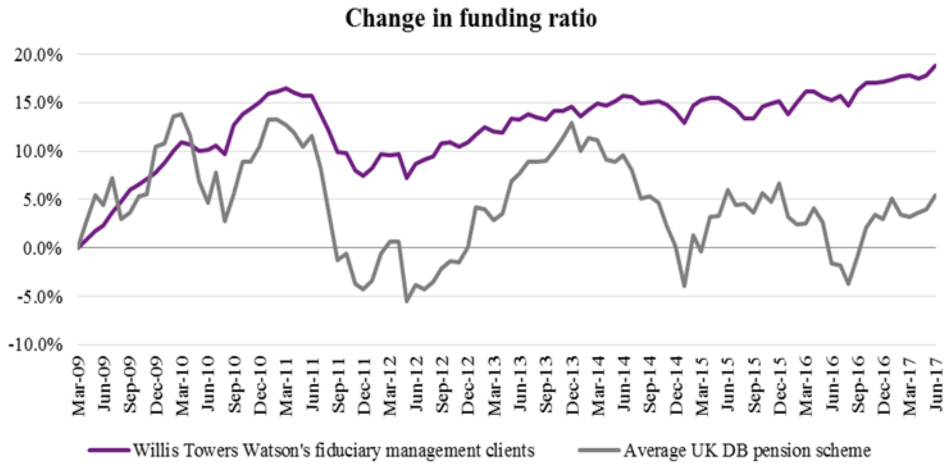
(b) the fiduciary manager can make and implement decisions on (e.g.) changes to asset allocation and manager selection without any time lag, which can improve performance;

(c) incentives are better aligned and accountability is strengthened, as the fiduciary manager is directly and observably responsible for performance in a way that is clearer than under the advisory model; and

(d) the relevant professionals are working for more than one scheme in parallel, an "economy of scope".

2.9 We believe that the fiduciary management model gives rise to material benefits for any scheme that does not have the scale (and therefore governance) to successfully implement a robust investment process themselves. These benefits are evidenced in Figure 2.

Figure 2 - improved returns and lower risk (fiduciary management)



2.10 Rather than a comparison of a fiduciary model versus an advisory model per se, we believe that Figure 2 is really a demonstration of the benefits of a more robust governance model and a more dynamic investment process. A number of large advisory clients with significant internal resource will have experienced outcomes more similar to that of the fiduciary clients (in the chart above) rather than those of the average UK pension scheme.

2.11 Because a number of our largest clients do have all of the necessary capabilities and infrastructure, we continue to play an important advisory role in (predominantly) the key strategic stages of the investment process.

2.12 We believe it is very important that we have a business structure that allows clients to have real choice in the way they work with us, and for us to have the ability to add value to each of our clients in one or more stages of the investment process.

2.13 We also believe it would be disadvantageous to pension schemes to not allow an investment consultant to provide both strategic advice and implementation services to clients. This is for the following reasons:

- It reduces the flexibility and choice that pension scheme trustees currently have in terms of the different approaches that investment consultants offer.
- We do not believe that a robust or dynamic investment strategy can be set without reference to or knowledge of the available implementation options (i.e. manager capacity, manager fees, outperformance potential) and current market pricing.
- If, hypothetically, the extreme decision was taken to not allow firms to have both strategic capabilities and implementation services (on either a fiduciary or advisory basis) then this could result in:

  a) less differentiation and choice between strategic advisers;

  b) increased cost of strategic advice (if the adviser continued to maintain manager and asset research resources to feed into the strategic advice);

  c) more of these responsibilities being delegated to the asset management community (which is unlikely to be the most economical or effective solution); and

  d) a reduction in the quality of strategic advice.

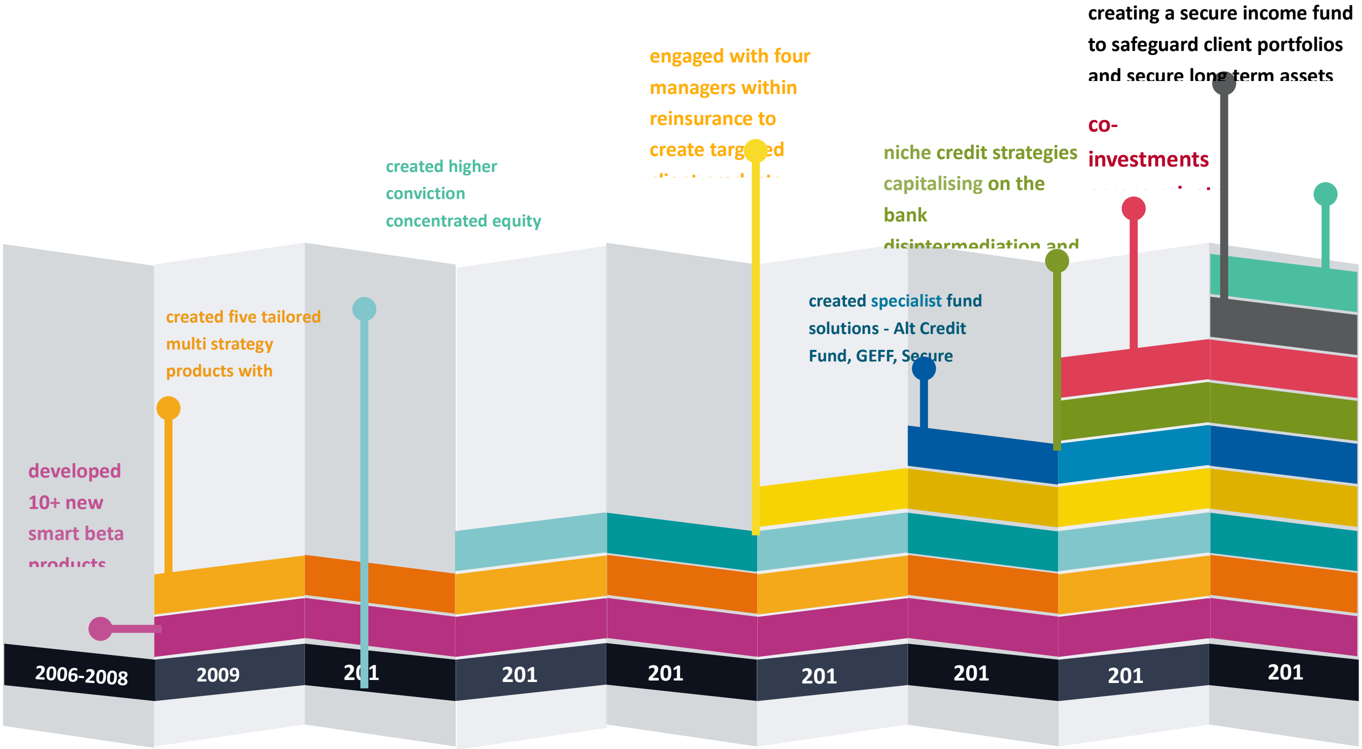
2.14 Some of these issues might be avoided if a single firm could provide *either* strategic advice or implementation services to clients. However, this would still be disadvantageous to pension scheme outcomes and hence not warranted. In particular:

- If presented with an asset allocation to populate with managers, without sufficient context of the overall objective and portfolio, then the total portfolio will become a series of building blocks, rather than a total return solution. The ‘manager selector’ will be focussed on short term performance against a series of indices, rather than building a portfolio of asset managers who (in aggregate) will generate a total portfolio return required to meet the long term funding strategy. Put simply, active equity managers should not be employed to outperform an index; active equity managers should be employed to provide a material, positive contribution to the return required to pay pensions. Any such remedy would be likely to produce adverse incentives in this regard.

- The successful innovation we have witnessed in developing new and beneficial solutions for pension schemes (not just WTW clients) as illustrated in Figure 3 has been the result of *combining* client context and demand with the knowledge and relationships we (and other consultancies) have with the asset management community. If either of those parts were to be removed / separated then we fail to see how the level of innovation experienced to date could be maintained going forwards.

- Since 2009, we have actively worked with over 100 managers to innovate. This has included identifying an opportunity set, collaborating with a manager to design an appropriate fund, closely working with a manager on seeding or structuring a new fund and/or negotiating attractive terms on behalf of our clients. The outcome is that we offer competitive fee discounts without compromising quality and consistently provide clients with new and better solutions. Examples of these are shown in Figure 3.

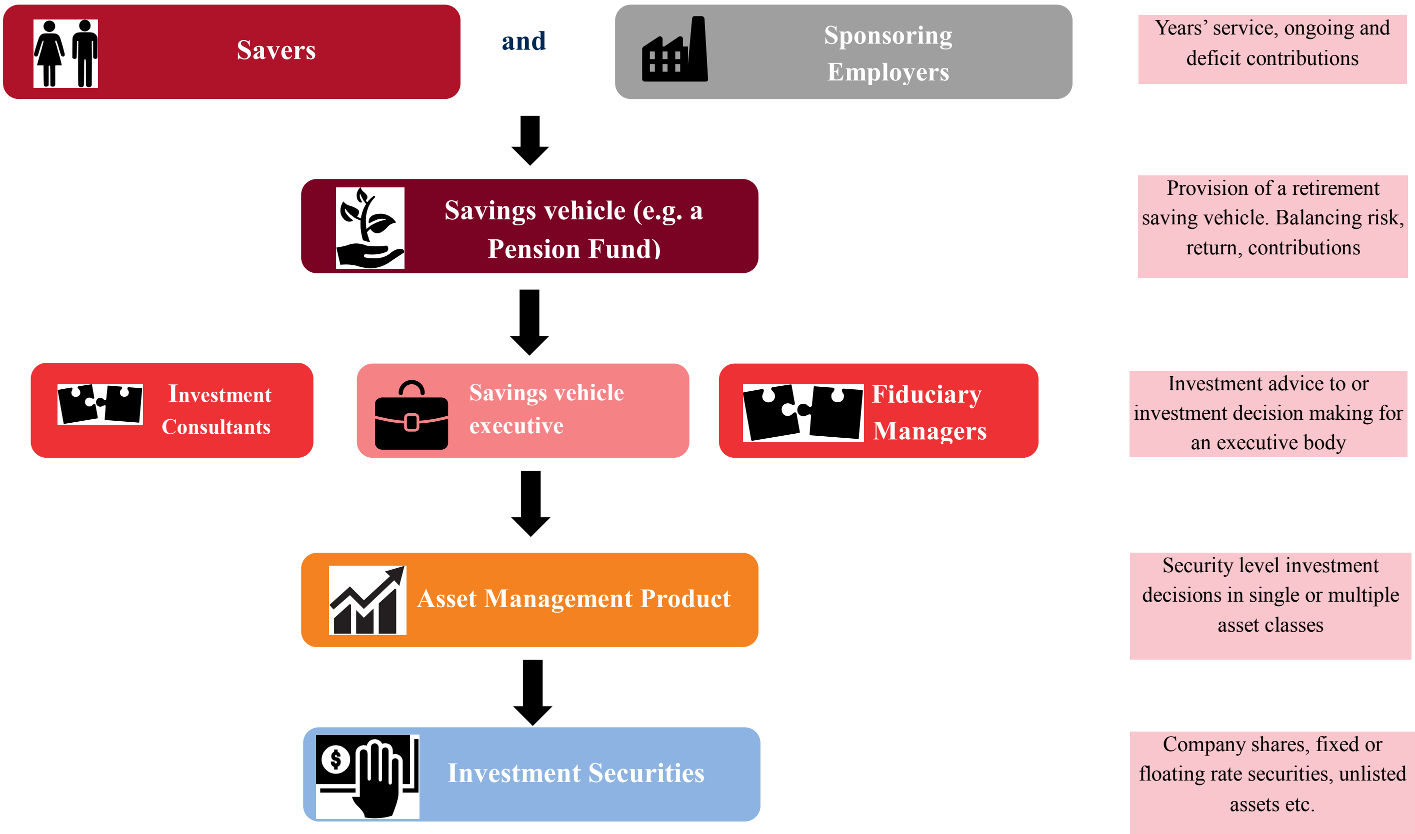
Figure 3 - selected innovative new investment opportunities created for clients



3. The structure and competitive nature of our industry and our services

3.1 The FCA raised a number of issues relating to the vertically integrated nature of the market. However, the FCA's description did not accord with WTW's understanding of the market in many ways. We have set out in Figure 4 WTW's perspective on the general structure and stakeholders in the pension fund investment chain.

Figure 4 - key stakeholders in the pension fund investment chain



3.2 The relationship between investment consulting services (whether investment advisory or fiduciary management) is a horizontal one. Each of these services helps the trustees to make and implement high-level decisions about where to invest its assets. Investment consultants do not then invest the assets – these decisions are taken by asset managers. Importantly the value of assets flowing through to the asset management community *is identical* regardless of whether advisory or fiduciary services are employed.

The evolution of competition in the market

3.3 The competitive nature of the market is illustrated by a number of the client-led changes that have occurred in the market, including the growth of fiduciary management and the innovation that has taken place (see, for example, Table 1 and Figure 3 above). The introduction of fiduciary management services has naturally led to a reduction in DB advisory revenues. As a result, we are under continued and consistent pressure to maintain quality and provide competitive fees in our DB advisory service.

3.4 Another significant competitive trend is the use of tender procedures and the rise of competitors. Over the last 5 years, a variety of bidders have been successful in winning advisory mandates, while we have been successful in around [✂]% of the tenders in which we participated (which are a subset of all tenders). This is illustrated in Table 2 below.

Table 2 - competitive dynamics, 5 years to September 2017, advisory

Advisory (DB, DC and Corporate)		**Successful bidders**
Total competitive tender process wins	[✂]	Hymans, Redington, P-Solve, Aon, JLT, LCP, KPMG, Mercer, Barnett Waddingham, Cardano, SEI, Redington, First Actuarial, Momentum, Dalriada, Conduent
Appointments without tender	[✂]	
Total competitive tender process losses	[✂]	
Losses without tender (scheme closures, buy-outs etc)	[✂]	

3.5 We also face (and initiate) switches to fiduciary management.[5] Once the client has decided to switch to fiduciary management, the appointment process is typically very competitive (no matter the "incumbent" advisor), with most appointments arising from a formal competitive tender and – for clients of any scale – being intermediated by expert third party advisers. Our success rates are illustrated in Table 3. As we have been asked to participate in only [✂] of around 250 appointments in the last 5 years (based on KPMG data) our share of wins by number of mandates is around [✂]%. The range of successful bidders is clearly beyond the "big 3".

Table 3 - competitive dynamics, 5 years to September 2017, fiduciary management

Full Fiduciary		**Successful bidders**
Total competitive tender process wins	[✂]	Aon, Mercer P-Solve, SEI Quantum, Cambridge, Russell, GSAM, BlackRock, LGIM, Cardano, SECOR
Existing clients	[✂]	
New Clients	[✂]	
Total wins outside tender (note 2 of these were intermediated)	[✂]	
Total competitive tender process losses	[✂]	
Existing clients	[✂]	
New Clients (includes advisory tenders where fiduciary proposed and rejected)	[✂]	

[5] Indeed, if an incumbent advisor does not raise the issue of fiduciary management, the risk is the client will find out about it in any event, potentially putting the existing investment advisor at a disadvantage for the subsequent fiduciary management appointment. This means that incumbent investment advisors who offer both investment advisory and fiduciary management services are likely to wish to tell their clients about the existence of fiduciary management services. This incentive does not apply to incumbent investment advisors who do not offer fiduciary management services.

4. Comments on Specific Issues Raised in the Statement of Issues

4.1 It can be seen from Sections 2 and 3 above that WTW considers the investment advisory and fiduciary management industries to be competitive. However, we recognise that there are challenges associated with ensuring that the right level and type of resources are deployed in managing institutional investment portfolios. This has led to a trend towards some fiduciaries (e.g. pension fund trustees) outsourcing certain "bandwidth heavy" decisions that in turn has led to a new competitive dynamic as various parties compete for that outsourced partner role. In our opinion, understanding the full dynamic of that competitive environment is critical to a successful MIR.

4.2 WTW makes the following comments in respect of specific issues raised/aspects of the Statement of Issues. We have not commented exhaustively on all aspects of the Statement of Issues but would be very happy to discuss particular issues with the CMA in further detail. No inference should be drawn from a lack of commentary on any particular aspect of the Statement of Issues.

CMA's approach to the investigation

4.3 As regards the CMA's question on whether the focus should be extended to include other types of institutional investors, such as charities, insurance companies and endowment funds, these other types of investors make up a very limited part of WTW's investment business. Therefore we support the CMA's intention to focus on pension schemes.

4.4 In respect of types of schemes, WTW agrees with the CMA's proposed focus on workplace pension schemes, as opposed to individual savings or pensions, and also agrees with the CMA's proposal not to focus on "micro" schemes.[6] In our experience, these schemes do not typically use investment consultancy services and/or fiduciary management services. WTW therefore agrees with the CMA's proposed focus as set out in Paragraphs 18 and 19 of the Statement of Issues.

Market characteristics and outcomes

Vertical integration

4.5 The CMA states that "*consultants are both distributors for – and competitors to – asset managers*".[7] This statement does not reflect the factual position. WTW is not a "distributor" for asset managers; we receive no fees from asset managers and, indeed, look to negotiate their fees down for clients. As such, we do not consider this to be a sensible way to look at the role of investment consultants/fiduciary managers. Rather, we advise clients on – amongst many other things – the selection of asset managers. This means that we are, at most, a route to a sale or means of introduction from an asset manager's perspective. We are, in our fiduciary management role, a purchaser of asset management product on behalf of our clients, i.e. a *buyer* of rather than a *competitor* for asset management services. The fiduciary management service is a form of delegation of responsibilities historically dealt with by trustees (in other words, a horizontal transfer of activities) and is not a (vertical) replacement for asset management: see Figure 4. Some asset managers are now starting to provide fiduciary management services and are becoming vertically integrated. In this sense (but only in this sense) are the two competing.

4.6 Some of the strategic advice that we give might subsequently lead to the client choosing to invest via a WTW investment vehicle. While WTW has developed several fund of funds[8] solutions (including a global equity focus fund, a diversified multi-asset fund, two liquid alternative funds, and an alternative credit fund),[9] the underlying investments in these funds are made by third party asset managers chosen by us for their expertise and value for money. These funds of funds have several benefits for clients –

[6] Paragraph 19, Statement of Issues

[7] Paragraph 20, Statement of Issues

[8] Note, we refer to 'fund of funds' and 'pooled' solutions interchangeably.

[9] https://www.willistowerswatson.com/en/press/2016/06/Willis-Towers-Watson-launches-high-active-share-fund

they pool together ideas that we have found particularly compelling, they allow for reduced fees through the aggregation of funds across multiple clients, and they allow trustees to avoid much of the implementation and execution burden of investing in several separate investment vehicles. These fund of funds solutions compete with other fund of funds products offered by asset managers. However, WTW's role is limited to designing the overall solution and choosing the asset managers who will deliver it (who are selected as the best available in each area, so are generally from different firms), rather than in making stock selection decisions. Our client engagement model ensures that clients are aware of what is advice and what is a change in our contractual relationship with them. No feature giving rise to an AEC therefore exists as a result.

4.7 Any direct competition between fiduciary managers and asset managers is therefore limited to two areas:

(a) the design of fund of funds solutions; and

(b) direct competition in the fiduciary management market as a result of asset managers starting to offer fiduciary management (and so becoming vertically integrated).

4.8 Thus, while some asset managers do offer fiduciary management services, it is probably more accurate to say that asset managers are starting to compete with investment consultants rather than the other way around. WTW notes that asset managers acting as fiduciary managers typically allocate capital to their own security selection products, and that this is an area of potential conflict that should be included in the CMA's review. The CMA will need also to consider whether such vertically integrated structures are clear on their costs and returns to clients, and in particular on whether they are truly allocating capital to best in class asset managers given the inherent bias to in-house products.

4.9 A business model that can be thought of as more directly comparable to fiduciary management is the internal team approach (where a pension fund appoints its own Chief Investment Officer ("CIO") and staff to make decisions). We note that this model has a limited number of examples in the UK pension fund industry but is very common in savings systems where greater aggregation or sheer size is achievable (in the United States fiduciary management is referred to as "Outsourced CIO" to reflect the fact that it is a model that replaces the in-house team). [✂]

4.10 WTW considers that it is important that the MIR process considers all the business models – including the in-house model – used to provide the reference services, otherwise any proposed interventions to improve market outcomes might not cover all the participants in the market. If so, this could result in client confusion and undermine confidence in the reference markets to the detriment of both clients and providers alike. Moreover, if the MIR process omits certain business models from its consideration, it runs the risk of missing important lines of inquiry, and of biasing the competitive process away from "reference" business models to other business models – even though these other business models may not be superior, and may provide inferior outcomes for clients in many situations.

Master trusts

4.11 The CMA states that consultants are "*distributors for and competitors of providers of DC pension products*" as they offer their own defined contribution products, in particular Master Trusts.[10] As noted above, Master Trusts (a way of aggregating schemes in a DC context and also reducing the implementation and execution burden) are an extremely small part of WTW's business at present, with currently just one full service client.

4.12 Further, WTW does not agree with the CMA's characterisation of it as a "distributor" of providers of DC pension products. While we advise clients on the design and set-up of pension schemes, including the selection of funds to be offered, it is not accurate to characterise us as a distributor of DC pension

[10] Ibid.

scheme products. We advise on whole of market options and do not get paid by the DC pension product for any recommendation.

The well-functioning market

4.13 The CMA notes (as is standard for Market Investigations) that the benchmark against which it will assess an AEC is that of a "*well-functioning market*".[11] The CMA goes on to set out some of the factors it will assess in this regard, such as quality of services and fees.[12]

(a) WTW considers that the CMA must approach the counterfactual analysis with caution and clarity. There is always a danger in identifying the "well-functioning market" that an authority sets an unrealistically high bar that could never in practice be attained even if there were no AECs. Setting such an unrealistically high bar can also lead to frustration on the part of market participants where remedies do not achieve the scale of benefits anticipated.

(b) In the investment context, the CMA should guard against the danger of using the benefit of hindsight when assessing the outcome of historic investment decisions. The nature of investment is that it is forward-looking, but that markets are inherently uncertain. Perfect foresight is not possible and the CMA should be cautious about suggesting that the fact that no prediction of the future has ever been completely true means that there is some feature of the market that gives rise to an AEC.

(c) Financial markets also evolve and innovate, and strategies that are now commonplace were not in existence in the past. It would not be reasonable, for instance, to suggest that in the 1980s there was a problem in the operation of pension funds because they did not generally use liability-driven investment (LDI) approaches – these ideas and products were only widely adopted more recently[13].

(d) Moreover, unless any analysis is related directly to the level of competition, it is unclear what the CMA should draw from it. For instance, suppose the CMA were to find, following the FCA's analysis, that the investment consulting industry as a whole were unable to predict outperforming asset managers net of fees, (note that even if this were the case at the industry level, WTW considers that it has been able to do this). Carrying out this analysis at an industry-wide level provides no information on whether there is any competition concern. It could just be that this is an essentially difficult task in a world where asset managers also do not outperform the market on average net of fees (as also found by the FCA). Instead, to understand whether there is any competition issue (and hence any AEC), the CMA would need to investigate how the outperformance expectation relates to the level of competition faced by the firm providing manager selection services.

(e) WTW therefore recommends that the CMA consider its proposed analyses carefully in order to determine what it would realistically expect to see in a well-functioning market, and to ensure that the analyses shed light on whether there are any competition issues that could reveal the existence of AECs.

Promoting competition between asset managers

4.14 WTW welcomes the observation that the CMA proposes to explore the extent to which investment consultants are driving competition between asset managers, as we believe this is an important part of our role.[14] We are of the view that there is significant value in our manager selection activity. As part

[11] Paragraph 35, Statement of Issues

[12] Paragraphs 38-39, Statement of Issues

[13] Certain of the comments at the Site Visit, for instance around why pension funds did not use more LDI after the financial crisis, could be taken to suggest that the CMA is at risk of judging the performance of the industry with the benefit of hindsight.

[14] Paragraph 38 (b), Statement of Issues

of this, we assist clients in understanding fees charged by asset managers and how these affect the net returns clients can expect. We disclose the fees charged by asset managers prominently as part of our advice on the selection of asset management products, and have a team that focuses on cost and value of these (sometimes complex) fee arrangements. We also rate asset managers according to their future ability to beat their performance benchmark *after* fees, which provides improved transparency for clients. [15] We note that there may be some scepticism about the value of manager selection. It will be helpful for the CMA to make clear statements on this if, as we believe will be the case, the CMA is persuaded that investment consultants such as WTW can provide value through manager selection.

4.15 These factors are particularly important in a fiduciary management role where WTW is directly responsible for maximising returns *net of all costs*. As fiduciary manager, WTW is able to bundle fiduciary management clients' assets together in order to generate buying power and economies of scale, and so drive better commercial terms from asset managers.

Other issues

4.16 In respect of asset allocation advice, WTW agrees with the CMA that this is a particularly challenging area in which to undertake quantitative analysis.[16] WTW is very happy to discuss what may be feasible with the CMA, but notes that by its nature the quality of asset allocation advice is very difficult to assess given that there is no obvious single counterfactual. WTW agrees with the CMA that in general the quality of fiduciary management services is easier to assess quantitatively given its multi-dimensional nature, as demonstrated at the Site Visit.[17]

4.17 WTW notes the CMA's intention to explore whether consultants are making "excessive" profits.[18] As the CMA is aware, this is always a very challenging and difficult assessment, and has led to controversy in previous Market Investigations. In the present case, we anticipate a number of difficulties that may mean a full assessment may not be possible. The main issues relate to the lack of any identifiable capital base for the reference services, and the identification and measurement of intangible assets, which are by far the most important assets in professional services industries such as investment advisory and fiduciary management. These concerns are set out in greater detail in our response to the Initial Financial Questionnaire.

4.18 WTW strongly agrees with the CMA's recognition that a key focus of its analysis will be on impacts to end consumers.[19] WTW considers this aspect to be crucial to the CMA's analysis, and considers it important that both the CMA and market participants retain this focus throughout the course of the Market Investigation. It is our view that we are adding value through managing risk and innovating, and reducing costs for pension schemes, to the benefit of end consumers.

4.19 WTW notes the CMA's contention that trustees vary substantially in terms of their background, experience and skills. In WTW's experience, it is not so much an issue of experience and skills so much as the fact that trustees often do not have the bandwidth and/or scale to be able to devote sufficient time to all the issues they must address.[20]

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[15] WTW understands that not all IC providers explicitly include fees in their rating process.

[16] Paragraph 38 (c), Statement of Issues

[17] Paragraph 38 (d), Statement of Issues

[18] Paragraph 39, Statement of Issues

[19] Paragraph 25, Statement of Issues

[20] We note that TPR has introduced a free training system – the Trustee Toolkit https://trusteetoolkit.thepensionsregulator.gov.uk/) – which covers all aspects of running a pension scheme, although the TPR has frequently been reported as being disappointed with low levels of trustee take-up and completion. Most recently TPR CEO Lesley Titcomb was quoted as saying "*Some schemes have a proactive approach to trustee training but our research has shown there are persistent knowledge gaps amongst pension board trustees, especially regarding pension law and investments*" (TPR Press Release PN16-10 (7 March 2016) http://www.thepensionsregulator.gov.uk/press/pn16-10.aspx)

- *Hypotheses for investigation (theories of harm)*

4.20 The CMA sets out three categories of theories of harm it has identified at this early stage: demand side and information issues; conflicts of interest; barriers to entry and expansion.[21] WTW agrees with the grouping of the three identified categories.

- *Demand side and information issues*

4.21 WTW does not consider that there are substantial problems arising from a lack of information in this sector. The existence of third party intermediaries of various types (e.g. assessors of fiduciary management tenders) is an illustration of how the market has responded to meet client needs.

4.22 However, WTW does consider that additional measures could be taken to further improve transparency and comparability in the market, which can help trustees of schemes of all sizes to discharge their duties even more effectively. For instance, while we consider that our fees and performance measures are clear and transparent to trustees, we do consider that clarity and comparability of information on investment consultants' fees and performance could be improved.[22] We encourage the CMA to consider the issue of ancillary follow-on fees that may be generated by advice; appropriate up-front communications to clients may be needed to highlight this potential conflict.

4.23 The CMA plans to undertake a more systematic quantitative review of the accuracy of information presented by investment consultants.[23] WTW considers that this is likely be very challenging and resource-intensive for both the CMA and market participants. We would therefore encourage the CMA to scope any such review in a proportionate and efficient manner, and reflect carefully on findings and benefits that could arise from such an analysis, before considering whether to embark on any such exercise.

4.24 In respect of barriers to switching and tendering, the CMA states that it may be difficult and costly to tender for investment consultancy and fiduciary management services.[24] However, while these exercises will naturally involve some costs, it is not WTW's experience in the investment consultancy market that tender exercises are overly costly to trustees. It is almost always the case that fiduciary management appointments that we participate in are competitively tendered ([✂]% of all bids we have been involved in in the last 5 years have been competitively tendered). Nevertheless, smaller schemes may well benefit from standardised tender documentation being available.

4.25 The CMA asks for views on the feasibility and value of additional work around complexity, such as assessing whether some strategies may be inappropriately complex.[25] WTW considers that such an assessment would be extremely challenging. In particular, it is difficult to see how "inappropriately complex" could meaningfully be defined, given that strategies will vary on a client-by-client basis depending on their characteristics and requirements.

4.26 This is an example of the general issue of defining what a “well-functioning market” would provide, as discussed in paragraph 4.13 above. It may well be the case that clients would ideally prefer simple solutions. But if their needs are not best met by a simple solution, it is not a market failure – indeed it is the appropriate market response – to identify a more complex solution as being the appropriate answer. WTW would also draw the CMA's attention to the benefits of what may be viewed as "complex" advice i.e. the portfolios that we implement for fiduciary management clients, as compared to the average investment portfolio implemented by a DB pension scheme. Our experience is that

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[21] Paragraph 43, Statement of Issues

[22] Paragraph 55, Statement of Issues

[23] Paragraph 56, Statement of Issues

[24] Paragraph 57, Statement of Issues.

[25] Paragraph 61, Statement of Issues

such portfolios improve the chances of members' benefits being secured and lower the contributions that sponsoring employers need to pay towards the running of the pension schemes.

- *Conflicts of interest*

a. *consultants moving clients into fiduciary management/their own master trust offering*

4.27 WTW notes that this statement is a mischaracterisation of the facts. We do not "move clients into" other products. It is almost always the case that, when we tell clients about a different product that might better meet their needs, clients carry out a competitive tender for that service, typically with the assistance of an expert third party.[26] We emphasise that clients moving to the fiduciary model almost always – in our experience – follow a competitive process: in processes where we have participated, we are successful in around 1 in 4 tenders. We therefore do not recognise the criticism of consultants simply "converting" their advisory clients to fiduciary clients.

4.28 However, as a matter of principle, we believe that it is to the benefit of our clients and the competitive process that we continue to develop innovative new products. WTW would be concerned if an outcome of the MIR were the dampening of the incentives for industry participants to innovate.

4.29 WTW also considers that the existence of any such conflicts is likely to be limited (certainly in WTW's own case), and easily resolved by industry standards around disclosure and transparency. As noted above, WTW has proposed a requirement for the industry to ensure that this process is fully understood by clients moving from one model to another, and that clients are aware that best practice in such a move is to competitively tender and monitor the appointment.

4.30 WTW also considers that there are substantially greater potential conflicts of interest that arise from asset managers vertically integrating into fiduciary management, and from investment advisory only firms not communicating the benefits of fiduciary management to their clients. Moreover, there may also be conflicts of interest that arise if investment advisors and fiduciary managers receive payments from asset managers in respect of being on shortlists of recommended firms (for clarity, WTW does not receive any such payment).

4.31 As such, we believe that the CMA should consider potential conflicts of interest widely, looking at all business models in the investment consultancy market. If the CMA agrees with this, one possible remedy would be to require unbiased advice on fiduciary management to be given by all firms.

4.32 The CMA should note that, in terms of the commercial relationship with our clients, our only source of remuneration is from our clients and not, e.g., from fees/commission generated from asset managers. More generally, the majority of our fees are on a fixed-fee basis, with "time cost" and performance related arrangements becoming less common.

b. outside business relationships with asset managers

4.33 WTW does not recognise the CMA's concern regarding outside business relationships with asset managers but will work with the CMA to examine the identified issue in further detail. In particular, we charge our investment consulting clients directly and do not generate consulting fees from asset managers.[27]

c. *gifts and hospitality*

4.34 WTW considers the value of gifts and hospitality across the total industry to be negligible at £40,000 in 2015, especially when considering the overall value of assets under advice in the UK market. We do not see how this limited amount of hospitality is likely to alter the independence of investment

[26] See further WTW's Response to the Annex E, Market Information Request Questions 30-35

[27] We do obtain a very small amount of fees from asset managers in relation to a "think tank" that relates to the industry trends.

consultants. Moreover, WTW has a clear company policy on refusing gifts (or entertainment with gifts) from any organisation providing services to WTW's clients being returned or passed on to charity if impractical to return.

4.35 This results in the level of gifts and hospitality being minimal for WTW. For example, the value of business lunches attended by WTW staff in 2015 with investment managers was less than £3,000 over all our relevant employees (c. 400). WTW staff also attended around 10 industry related conferences that were organised by investment managers. WTW does not believe that these levels of hospitality create any material issue. Indeed, WTW's culture and, we believe, the culture of the industry as a whole is to put clients first.

Barriers to entry and expansion

4.36 The investment consulting industry as a whole is rapidly evolving, presenting a range of opportunities for both WTW and rival firms to enter, expand and diversify. A number of smaller investment consulting firms have taken advantage of these opportunities and have significantly expanded their presence in all areas of the industry over the last ten years. Consequently the most significant barriers to expansion that WTW faces today stem from competitive pressure applied by both new and existing rivals for all the investment consulting services it provides.

4.37 These conclusions apply to both advisory and fiduciary management services. WTW does therefore not believe that barriers to entry and expansion in the reference markets are such that they impede effective competition from taking place. Moreover, the introduction of new products and services such as fiduciary management is helping to increase switching and competition, and providing opportunities for entry and expansion to new market participants.

WILLIS TOWERS WATSON

19 OCTOBER 2017