INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of hearing with Willis Towers Watson Limited (WTW) held on 21 November 2017

Demand side

1. WTW provided both advisory services and fiduciary management (FM) services to clients. The FM service has grown in the last few years as a result of growing demand from clients. FM provides a natural solution to some of the main issues faced by pension schemes.

2. WTW stated that FM is a combination of strategic investment advice and execution. The advisory model tends to lead to slower decision making unless clients have very high quality governance structures. One of the key elements of both investment consultancy and FM is the development of the strategic asset allocation for a client, that is the identification of the mix of asset classes that will deliver the required return within the bounds of acceptable risk.

3. WTW believed that the review is timely as the industry has developed quickly but that the relevant markets show strong competition. On the supply side there are a range of opportunities for firms to enter, expand and diversify as evidenced by the number of small firms who have entered the market in the last ten years. There has also been a growth in the role of intermediaries in tenders for both advisory and fiduciary services. Currently, WTW competes with approximately 20 rival firms in the provision of investment advisory services in the UK and over a dozen in FM.

4. WTW stated that they faced a demand side that is engaged and committed, but not necessarily resourced or skilled to manage the detail of day-to-day investment decision making. The majority of their clients are active and engaged and competitive tendering is widespread in the industry, particularly in FM. In addition, the threat of a client switching to another supplier is ever present. Many clients run annual reviews of WTW's performance to establish whether WTW's services continue to provide value for money.

5. Larger consulting firms were structured to handle large clients who need a sophisticated solution. The perception is that larger firms may not be setup to

meet the needs of smaller clients although WTW did compete for, and provided services to all client sizes.

6. While trustees were responsible for making investment decisions for the scheme, they have a duty to consult with the sponsor and will often find that the sponsor will present a critical challenge to trustees. This is helpful to trustees as it provides an additional perspective on the investment decision.

7. WTW said that they had observed an increase in the number of professional trustees in recent years. This represented a positive challenge for WTW as, for example, professional trustees work for several clients and work with multiple advisors, they see pricing from many advisors and can, therefore, ensure clients are being charged a competitive price and receiving a quality service.

8. In fiduciary management, WTW was also seeing an increase in the number of intermediary firms (seven firms at the last count) that are acting as the oversight provider of the FM services being provided.

9. WTW explained that fiduciary managers have a clear mandate and objective, so it is more straightforward to measure the performance of the fiduciary manager. Typically, this will be expressed as a level of performance over and above the liability benchmark.

10. WTW said that its FM client base is at the larger end of the market. These clients have more resources and they take governance very seriously. There is an increasing use of third party evaluators to monitor performance, but only in a minority of cases at the moment. WTW's experience was that the vast majority of their FM mandates have been competitively tendered.

11. [✄].

12. Value for money was very important when considering fee levels, particularly for FM. One of the major benefits gained from a move to FM is that this enables greater control of risk. This could be be difficult to measure and account for although WTW's reporting does allow clients to measure risk levels (expected and achieved).

13. WTW aimed to help clients manage their risks, LDI is an example of this.

14. WTW believed the CMA investigation could provide a useful stimulus to improve industry standards through its remedies.

Tendering for services

15. WTW was engaged separately by clients who require actuarial services or investment services and treated them separately. They are mindful of the recommendation in the Myners Report that it is best practice to treat these as separate appointments and have continued to do so.

16. Some clients, especially smaller clients without a professional trustee, will choose to engage a single advisor for both their actuarial and investment advisory services as they find this more efficient. Smaller schemes are also more likely to seek scheme administration from the same firm. Larger clients are more likely to have tendered for each service individually, whereas smaller clients are more likely to tender for services together. Over 50 per cent of WTW's clients for investment advisory services have been through a structured process in tendering for those services.

17. WTW generally billed clients separately for actuarial and investment advice services (and when billed together the fees for the services are separately identified). Clients may seek a multi-service discount.

18. There was an overlap between actuarial and investment advice which the CMA may have to consider if and when designing remedies. FCA regulation requires advisers to be appropriately authorised to give advice in many areas. WTW actuaries involved in giving regulated investment advice are authorised by the FCA.

19. WTW believed that its clients benefit from engaging the same firm for actuarial and investment advice, including continuity of models, of systems and scheme data and of assumptions on investment advice. The disadvantages are that there is only one firm appointed to advise the scheme and so the client does not benefit from different points of view that different firms may have.

20. WTW stated that their investment line of business has more clients in common with its actuarial practice than the other way round. WTW agreed to revert with the precise figures.

21. Larger clients tended to appoint separately for mandates for various services. WTW stated that they believe that there is likely to be a greater alignment of single providers of investment, actuarial and administration services amongst smaller clients.

22. WTW said that they engaged in more competitive FM tenders than the industry overall as they tend to work for larger clients which use intermediaries, etc.

Potential remedies

23. WTW did not believe that a structural remedy would be appropriate for the industry as it would not address the key demand side issues around bandwidth and fragmentation of the pension fund industry. Structural remedies would also harm the industry:

    (a) There is a clear link between advice and execution and breaking this link would be harmful to clients (advice that is not sensitive to the execution issues associated with implementing that advice is weaker);

    (b) A split in the services would lead to higher costs and/or lower quality, for example, the research function serves both service models, splitting the services would mean lower quality research or higher costs as duplication of research would be needed;

    (c) Advisors are better informed to advise clients on the potential execution options available to them when they have experience of FM;

    (d) Splitting the services would create additional conflicts of interest where, for example, advisory firms who do not offer FM are not motivated to recommend it to clients, even when the clients would benefit from it;

    (e) A split between advice and execution services would result in less choice of firms for clients.

24. WTW stated that introducing mandatory switching would have some severe unintended consequences: for example, schemes could be forced to incur cost and disruption of changing their portfolio, because they would be forced to change an advisor whom they may have been perfectly happy with.

25. WTW would see no reason to object to mandatory tendering of full, or partial, FM mandates, particularly at key triggers such as when setting up a new contract. However, WTW thought that a de minimis limit should be included as it would be disproportionate to impose such a costly practice at the smaller end of the market or for very small partial mandates awarded by larger schemes.

26. WTW supported greater transparency over performance of FM services. They had been working with IC Select which is looking to create a set of industry wide FM performance standards similar to the controls and procedures of the CFA’s global measurement performance standard. WTW understands that the standards for FM will be formalised at the start of next year and these may become a kitemark for FM providers. But WTW does not suggest that past performance should be the only measure clients use to choose a FM provider

– just as in asset management, past performance is not a reliable guide to the future and may have been driven by 'luck' more than 'skill'.

27. An industry-wide performance measure for investment consultants is more difficult, as it would need to identify how much of the performance was driven by the advisor and how much was a product of the decisions of the client. It would also need to be clear whether the consultant was responsible for the whole scheme or just parts of it.

28. WTW thought client ratings of advisers' service could have some use – with measures such as responsiveness, innovation, etc.

Fees and profitability

29. WTW stated that they are very transparent with the fees they charge clients and would struggle to be more transparent. Fees are agreed in advance with the client and all invoices are in line with the agreed fee where the client wishes to pay a fixed fee. Where clients wish to pay by the hour, WTW is transparent on hours spent and the associated charge-out rates

30. For FM, WTW pointed out that where clients invest in pooled funds they generally do not pay by invoice, however, WTW carefully explains the fee structure for pooled funds to clients before they enter these arrangements.

31. WTW pointed out that FM fees are a small component of the value for money and value creation that the client gains from the relationship. Clients benefit from the move to FM as the client gains from better process and reduced risk.

32. WTW stated that the group overall aimed to generate a profit margin [✂]. Within the WTW business, as long as margins are maintained, the P&L holder has authority to decide on the individual strategy of that part of the Group. Specific funding for projects outside of the P&L can be obtained from the business.

Conflicts of Interest

33. WTW stated that, whilst they believed that competition in the industry is working well, there are areas where it could be improved. One such area would be to reduce the perception, or reality, of conflicts of interest and some greater transparency measure around performance and cost. Firms should have robust processes in place to manage conflicts of interest. WTW would welcome steps to strengthen industry practice, such as developing industry standard approaches to conflict management and disclosures to clients, to further improve professionalism in the industry and protect clients.

34. WTW believed that advisory firms which do not offer FM face a potential conflict in whether to recommend FM or not. They should be under a duty to act in the best interests of their clients and outline the benefits of FM in an appropriate manner even where they do not provide FM.

35. WTW stated that they did not have any relationship with asset managers that could lead to a conflict of interest. WTW receives some income from asset managers, but that this does not relate to any consulting to asset management businesses. WTW runs the Thinking Ahead Institute, which was set up as a not-for-profit think tank funded by WTW in the main but by also subscription from members. Those members are about 50 per cent asset managers and 50 per cent owners of pension funds and other big institutional asset owners who all pay a subscription fee to be a member. That is the explicit revenue WTW receives from asset managers

36. WTW stated that its 'fund of funds' represents an investment product that is akin to some similar products run by asset managers, so it competes with them in this limited respect. Another part of WTW is also developing a platform (Asset Management Exchange (AMX)) which could be a disruptor in the asset management industry as it aimed to reduce operational inefficiency (WTW is the legal owner of AMX, but the individual funds are managed by asset managers and WTW's rating team is independent of, and separate from, AMX). This platform could ultimately have 100s of products on it and would be kept separate from WTW's manager recommendation activity.

37. WTW has had for many years a consistent policy and clear rules in relation to gifts from asset managers which are not allowed and corporate hospitality which is only allowed for industry networking occasions which have been cleared by WTW's compliance. WTW's policy allows for business meals or coffee meetings with asset managers (as this can be valuable for a due diligence process) but such interactions are limited per manager.

Barriers to entry and expansion

38. WTW pointed out that Momentum is a good example of a recent new entrant into the market. Momentum was established only two years ago (led by an individual – formerly with a large consulting firm - with a strong personal brand and strong relationships) and is effectively competing for business. WTW believe that credible new entrants can claim market share by focussing on investment strategy, not manager selection, and therefore not requiring much manpower resource.

Master trusts

39. WTW stated that its entry into master trusts was driven by client demands following regulatory change. When WTW is advising clients on master trusts, it is clear and upfront with clients that WTW offer a master trust. All WTW master trust clients were won via competitive tender. The client of a master trust is the body corporate, not the trustees.

40. WTW was a very small player in master trusts. Master trusts were a very competitive market (some 70 players) with the demand side made up of companies which are strong buyers. They are well regulated by the Pensions Regulator.