INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of hearing with Aon Hewitt Limited (Aon) held on 22 November 2017

Demand side

1. Aon told the CMA that the UK pensions market is very important, with Trustees taking decisions that significantly impact both sponsors and members. Trustees and their advisors take their responsibilities very seriously.

2. Aon believed that clients have benefitted from high levels of competition in the market, with a wide variety of providers, with a diversity of models, that Trustees and sponsors can choose from. If Trustees choose to appoint a provider (and they do not need to do so), they do not have to consider Aon. Aon believes it is incumbent on Aon to demonstrate the value of its offering: if Aon does not, it will lose clients.

3. Advisors played a critical role in helping trustees establish a coherent investment strategy and then turning that strategy into an effective portfolio. Aon believes it has significantly improved the outcome for pension scheme through investing to better reflect particular scheme's circumstances and risk profiles. Advisors help trustees achieve value for money for their scheme, not least by moderating the fees of asset managers.

4. On whether asset allocation or manager selection is the more important driver of return, Aon noted it generally agrees with the often quoted statistic that 90% of a pension scheme's outcome is due to its asset allocation strategy. Formulation of strategy drives the bulk of the return. The bulk of Aon's work was, however, driven by implementing that strategy.

5. The development of fiduciary management had been welcomed by many trustees as enabling effective implementation of investment strategies. This is particularly the case for those schemes that might not otherwise have had a level of resources that would allow them to achieve the same results. Aon believed that fiduciary management can give pension schemes better outcomes and at a lower cost. The scale brought by fiduciary management allows Aon to exert pricing pressure on asset managers. For example, Aon

has secured around a [✂] per cent discount on equity manager fees for its fiduciary clients.

6. Aon's clients regularly reviewed its performance. At any one time, Aon estimated roughly around [✂] per cent of Aon's customers are engaged in some level of review of services. Over the last five years around [✂] of Aon's clients had retendered as part of the review process. Aon told the CMA that very few new appointments are awarded without having first gone through a competitive tender.

7. Oversight of Aon's activities was carried out by the Trustees, though they may take some input from the sponsor. Although Trustees were independent, they will consult with the sponsor, for example there is a regulatory requirement to consult with the sponsor around setting the strategy.

8. Aon saw professional trustees across around half its client base; there was no direct correlation between having a professional trustee and the size of the client. Trustee boards are structured on the basis of ensuring they deliver effective challenge to their advisors, and will appoint a professional trustee if it will help them to deliver this objective. Aon believed that the professionalism of trustee bodies has improved substantially over the last few years.

9. Aon's experience was that trustees waste no time in letting Aon know if Aon's service has fallen below the standard expected, or if competitors have overtaken them. It is easy for trustees to switch providers and the process is relatively straightforward. For fiduciary management, switching involves moving the assets and so a transitional plan of around 3 – 6 months is needed but this should not be a costly exercise as transfers can happen at net asset value.

10. Across 5 years, [✂] percent of tenders Aon was involved in were competitive. Aon agreed this is higher than figures reported by KPMG. Aon's experience is not consistent with KPMG's findings and Aon invited the CMA to pick this up with KPMG.

11. Aon could not recall a recent occasion where it had an existing relationship with a client as an actuary and was appointed as investment consultant without a tender. There are tenders for the joint provision of actuarial and investment consultancy services, but these were in Aon's experience less common than separate tenders.

Advisory and actuarial services

12. Pension schemes looked at their requirements for actuarial advice differently to their requirements for investment advice and typically contract separately for the two services (although they may joint purchase or purchase a bundled solution). It was sometimes difficult to separate where actuarial services stop and investment services begin.

13. Some clients will place considerable value in the same firm providing both services whereas others will intentionally choose separate firms or place no benefit in consistency across the two. It could be more efficient for one organisation to provide both as you reduce / eliminate duplication of effort. For example, the same modelling can be used across both teams. Trustees also do not need to draw a dividing line between what the actuary does vs. the investment consultant. There may also be an improved effectiveness of the relationship as the Trustees have one relationship to manage and may have more leverage to negotiate terms and conditions as they are purchasing more services.

Potential remedies

14. On monitoring and benchmarking performance, Aon's view was that investment performance should be measured where accountability lies. For fiduciary management, where responsibility for asset allocation is delegated, this allows the opportunity to measure performance and quality of service provided by the fiduciary manager. For investment consultancy, while assessing performance may be more challenging, liability benchmarking at a scheme by scheme level would be sensible.

15. There were also softer, qualitative measures of performance e.g. communication, understanding of clients' needs etc. that should be taken into account alongside quantitative measures.

16. Aon supported benchmarking that reflects the actual performance of assets vs liabilities and this should be done on a consistent basis. Aon is actively participating in IC Select's initiative to develop comparable standards and said it would also be prepared to participate in an industry standards body. Aon applied the standards set out in its proposed undertakings to the FCA earlier this year and publishes performance of its fiduciary management service on its website and see this as a good starting point for a broader industry standard.

17. Aon thought the Pensions regulator (TPR) could play more of a role in enhancing trustee accountability. For example, there could be a requirement

for a Chairman's statement accounting for key investment decisions through the year with reference to risk and returns, and greater transparency on fees paid by the scheme.

18. Aon believed that prescriptive processes for retendering of services could raise a barrier to switching if it is not sufficiently flexible. They thought there should be a regular review of performance, but this should be flexible to allow clients to review performance when they need to. Clients need to be able to measure the potential benefits of any review against the costs, otherwise there is a risk that smaller clients being forced to carry out reviews may be left with a sub-optimal solution. Assuming the CMA found there is harm to remedy, there would also be some fundamental questions to address in defining the parameters of a mandatory tendering remedy e.g. what is investment consulting (given it is not a formalised appointment)? What would a formal review entail? What about clients whose preference is to purchase across actuarial and investment consulting?

19. Aon strongly opposed structural separation of advisory and fiduciary management services. Aon believes investment consultants offering fiduciary management have created significant value to clients. Divestiture will lead to the removal of one of the models that clients currently have to choose from. It will increase the costs of the services provided, it would lead to future consolidation and even less choice and introduce other potential conflicts, which could prove detrimental to trustees.

Fees and profitability

20. Aon said it does not have a single approach to fees. Aon will use fixed fees, time cost and performance fees. On performance fees (which may be used in fiduciary but are rarely seen in advisory), there will be a base fee together with a performance fee linked to performance against the liability benchmark.

21. Aon commented that there is not a single approach to fee structure across the fiduciary management space and this makes it difficult for Trustees to compare the fees of different advisors. Aon supported greater transparency and comparability of information on fiduciary management fees. Aon believed that all firms should present fee information in a consistent way at a total level detailing: the cost of fiduciary; the cost of underlying managers and the transaction costs. These fees should be reviewed on an annual basis so that the client is clear how the actual fee compared to the initial estimate.

22. Aon has seen 'most favoured nation' (MFN) clauses with asset managers. Aon considered they are less common now and their value can be limited as they can be circumvented.

23. Aon added that MiFID and the FCA's market study remedies will require asset managers to disclose more information on their fees which was a good thing. Aon noted it is participating in the FCA's institutional disclosure working group.

24. Aon measured profits internally by looking at revenue minus direct and most indirect costs. Aon allocates shared costs broadly according to headcount or revenue. Aon does not use ROCE as a standard way of running its individual business units.

25. Aon's margins for investment consultancy and fiduciary management in 2016 – 17 [✄]. Aon noted it considers its market is competitive. Aon's margins for investment consultancy have [✄].

Conflicts of interest

26. Aon had a clear conflicts policy in place. In particular, with relevance to the Market Investigation, Aon:

(a) introduced fiduciary management services to clients, but did not recommend it;

(b) did not explicitly incentivise its consultants for making fiduciary management sales; and

(c) monitored compliance with the conflicts policy closely.

27. As part of its investment consultant role, Aon could recommend to clients that they could adopt a fiduciary management approach. But this will be the client's decision to implement that recommendation. Aon would introduce their fiduciary management service to clients, but not recommend it over other providers' offerings.

28. Aon did not recognise that a culture of gifts and hospitality exists in this sector today. Notwithstanding this, Aon recognise the potential for conflicts to arise, as they do across all professional services. Aon believed that, as with all professional service areas, all businesses should be encouraged to adopt a high standard of ethical behaviour.

29. Aon has tightened its gifts & hospitality policies: previously asset management researchers had tighter commitments, but now all staff are bound by these. They confirmed that they do not accept gifts from asset managers but they do give clients some hospitality subject to approval above certain limits. Aon believed there is a place for hospitality with clients to assist in building the

client relationship, however Aon does not allow gifts or hospitality when they are in the midst of a proposal or a review of services.

30. Aon earned revenue from investment firms’ pension schemes, but not from asset manager seminars and other activities. Aon’s manager research team operates separately from the client teams and would not know, for example, the revenue received from any clients whose products they are researching.

31. Aon confirmed that it did not operate a ‘pay to play’ model.

32. Professional trustees who worked for an investment consultant did not favour their former employer, however they will bring experience and familiarity with particular suppliers with them, who they may be comfortable working with.

33. Consultants should be focused on delivering value for clients; Aon believed that it can deliver value to clients by doing more for them. Aon’s consultants had objectives linked to the amount of revenue and the commercial engagement that Aon has with a client. However, this is driven by Aon’s ‘client promise’ that they will always act to meet the needs of the client.

34. Aon believed that investment consultant firms with no fiduciary management offering also had a conflict because they have a commercial incentive not to introduce fiduciary management. Aon thinks that conflict can be addressed through greater transparency: disclosure of what implementation services an investment consultant does and does not offer and publishing of conflict policies.

Barriers to entry and expansion

35. Aon’s experience, in line with the FCA’s findings, was that barriers to entry do not appear to be high. There have been successful new entrants in the industry in recent years.

36. Aon recognised that on asset allocation, the principle hurdle for new entrants to overcome is around modelling tools. Aon pointed out that there are products available to rent or buy which give new entrants the necessary strategic capability and tooling is becoming cheaper.

37. Aon also noted that competitors, such as Redington and Momentum, have successfully entered and grown in the market (principally around a starting point of strategic advice).

38. On examples of innovation, Aon pointed to innovative approaches both in terms of investment strategy (e.g. LDI, diversified growth funds, Smart Beta, factor investing) and in terms of implementation (e.g. fiduciary management).

Investment consultants play an important role in taking new concepts, which are initially expensive and the domain of larger clients, and finding ways of scaling those down to the benefit of smaller clients.

39. Aon confirmed that it does not include lock-in clauses for set time periods in its client contracts and there is no penalty or notice period for termination. Aon added that trustees don't have to make a formal appointment of Aon; some come to Aon on an ad hoc basis.

Master trusts

40. Aon's DC consulting team advises on scheme design and is run entirely separately from Aon's DC product teams. It advises clients on what is an appropriate strategy for the pension scheme and this could include recommending a master trust. Processes are in place where Aon's master trust (or another Aon DC product) is being considered for inclusion in a selection process. Aon would point out there is a wide range of master trusts that a client could choose from, but will introduce the Aon master trust as an option. It is a client choice whether to include the Aon product and the potential conflict will be made clear.

41. There has been a lot of focus on master trusts but Aon noted group personal pension plans and stand-alone trusts far outweigh master trusts (although there is a lot of expected growth in the master trust space).