The supply of fiduciary management services by investment consultancy firms

AON RESPONSE TO CMA WORKING PAPER

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QAS Institute and Faculty of Actuaries Quality Assurance Scheme

AON Empower Results®

THE SUPPLY OF FIDUCIARY MANAGEMENT SERVICES BY INVESTMENT CONSULTANCY FIRMS

RESPONSE FROM AON

INTRODUCTION AND SUMMARY

Aon welcomes the opportunity to respond to the CMA's Working Paper on the supply of fiduciary management services by investment consultancy firms dated 29 March 2018 ("**WP**") which has been released in the context of the CMA's wider work on assessing Theory of Harm 2. We also note the publication of the Trustee Survey by the CMA on the same date.

In this response we comment on three key areas, each of which we expand below:

- The benefits of offering IC-FM to clients on a combined basis are considerable and do not appear to have been fully addressed by the CMA. It is these benefits, rather than any 'steer' by an existing IC provider, that have influenced trustees in how they purchase FM services.
- The CMA's analysis undertaken in relation to potential conflicts of interest in the provision of both IC and FM services by a single firm is incomplete. Moreover, the evidence presented by CMA in the WP does not support the finding of an AEC.
- Certain of the CMA's proposed remedies would be materially disproportionate to any AEC, even if one were found. In particular, there is no basis for a structural separation of the provision of IC and FM services. This measure would not be effective in eliminating all potential IC-FM conflicts but would significantly damage the provision of IC-FM services, leading to a reduction in choice for trustees in terms of both service providers and products.

The benefits of offering both IC and FM to clients within a single firm are considerable

The development of FM services demonstrates the ability of our sector to innovate our service offering to respond to our clients' needs. By evolving to provide FM alongside IC, firms offer clients an alternative way of benefiting from their intellectual capital. Schemes have enhanced choice in how they are advised on, and implement, investment strategies. This has improved client outcomes.

In this way, FM and IC should not be seen as distinct offerings. They are substitutes: trustees can choose to purchase varying combinations of services according to their needs. FM can particularly benefit smaller and mid-sized pension schemes who can be constrained in time and resources in effectively implementing sophisticated investment strategies. This has expanded customer choice in the market, encouraged new entry and put pressure on incumbents to innovate.

Trustees recognise these benefits and will often favour selecting the IC they work with as a FM. They are a natural choice for a trustee who is comfortable with their existing IC's service and strategy.

Aon's processes to manage the introduction of FM to any client have been thoroughly tested and are in accordance with FCA and MiFID requirements. We believe that the implementation of clear, robust and consistent policies and processes across the sector are capable of managing any potential conflict. We would welcome proportionate and consistent regulation across our industry to ensure all firms operate to consistently high standards.

The CMA's analysis of potential IC-FM conflicts is incomplete; no support for finding an AEC

Given the benefits outlined above, we are not surprised that the Trustee Survey evidence demonstrates a high degree of satisfaction from trustees with the services they receive from combined IC-FM firms.

Yet the CMA does not appear to have collated sufficient evidence to understand trustees' purchasing decisions that have led to this satisfaction. While the WP on Trustee Engagement and the Trustee Survey have assessed the reasons why trustees purchase both IC and FM services, they do not provide clear evidence of the factors which influence trustees' motives for deciding to either switch, or retain their existing IC provider for FM. In particular no persuasive evidence is presented in the current WP:

- that potential conflicts are a material concern for trustees, that these are not being well managed, or that they give rise to adverse effects on competition;
- of customers being 'steered' towards the FM services of their incumbent IC. The CMA appears to infer that a trustee has been 'steered' simply by virtue of the fact that they have not switched provider when purchasing FM or have not used a third party evaluator ("TPE");
- of the relevant pros and cons of trustees appointing a new firm for FM, as opposed to purchasing FM services from their existing IC provider; and
- supporting Theory of Harm 2, i.e., that conflicts of interest reduce the quality and/or value for money of services provided to trustees.

On the supply-side, the CMA has also failed to undertake sufficiently rigorous analysis, in particular by:

- failing to sufficiently consider and capture the conflicts of interest that may exist in other models such as the IC-only model or when an apparent 'FM-only' firm also provides asset management services. In our view it is not possible to structure a financial services firm in a way that avoids all potential conflicts of interest;
- adducing no persuasive evidence that firms are acting in breach of their conflicts of interest policies; and
- focussing excessively on the three largest IC-FM providers which does not allow the CMA to assess adequately whether competition law issues exist across the entire market.

The CMA has concluded only that there is "*some* evidence of practices and behaviours on the supply and demand side that *could be consistent* with *some* customers being steered towards the FM services of their incumbent IC, without having applied much competitive

pressure on the incumbent firm." (emphasis added). This falls short of indicating that current practices give rise to an AEC that would require remedies.

Comments on remedies

All firms need to operate to the same high standards and on a level playing field. This means that if remedies are to be imposed, these need to be proportionate and imposed fairly across the combined IC and FM market place. They should be designed to address any potential conflicts of non-integrated ICs, TPEs and professional trustees in addition to integrated IC-FM providers.

With respect to the specific risk of perceived or potential conflicts of interest among IC-FM firms, existing conflict management policies can be highly effective if adopted by all market participants. FMs must comply with FCA and MiFID conflicts rules, which apply to any referral from an IC to FM irrespective of whether the IC is FCA authorised or carrying on regulated activity. Consistent transparency measures across the sector, together with improved guidance for trustees, can mitigate risks of conflicts and can encourage trustees to make informed purchasing decisions. This could be supported by an extension of the FCA's regulatory perimeter.

We see no basis for the structural separation of the provision of IC services from FM services. As set out above, the CMA has not adduced sufficient evidence to support a finding of an AEC with respect to conflicts of interest. Even if it were to do so, a separation remedy would be significantly disproportionate:

- It would not be effective in its aim of eliminating IC-FM conflicts because IC-only firms are also subject to a potential conflict of interest against recommending FM.
- Other less onerous measures are available, including effective conflicts of interest policies that are properly enforced.
- It would produce considerable disadvantages that are disproportionate to any potential benefits. Apart from the immense damage that this remedy would cause to IC-FM businesses in terms of business disruption and the material loss of efficiencies, clients would experience a reduction in available products and a reduction in the number of IC and FM firms available to them. New conflicts of interest would also be likely to emerge.

1. THE JOINT PROVISION OF IC AND FM SERVICES BY THE SAME FIRM PROVIDES CLIENT BENEFITS

The provision of FM services alongside IC services provides clients with choice

1.1 Although the CMA's WP does not explicitly conclude as much, it carries a clear inference that the provision of IC and FM within a single firm inevitably may cause problems for competition, and may lead to worse outcomes for trustees. This is a fundamentally false premise which fails to take account of the nature of the services provided and trustees' needs. On the contrary, there are very significant benefits to clients from the two services being provided by a single firm.

1.2 Rather than being separate services, FM and IC are substitutes. Trustees can choose to purchase varying combinations of services according to their needs. This has expanded customer choice in how to receive advice and how to implement investment strategies; it has encouraged new entry; and it has put pressure on incumbents to innovate.

1.3 Crucially this allows trustees to obtain investment strategy support in a way that matches their needs and structure. Clients may take advantage of the same pool of expertise and intellectual capital, whichever service they select. The difference is simply that in the case of FM services implementation is offered in addition to advice.

1.4 In that sense, we agree with JLT (para 51 of the WP) that there is no 'cliff edge' between IC and FM and that the move to FM is usually part of an evolving strategy. Although the CMA does not appear to acknowledge this, it is often the case that a client's investment strategy formulated when receiving IC-only advice is continued when the client moves to FM. Implementation capability does, however, add the opportunity to secure rapid incremental improvements in returns. Clients can take advantage of any changes made to their investment strategy immediately, rather than awaiting approvals from quarterly trustee meetings. As such, the provision of FM is an alternative to receiving IC advice.

1.5 Framed through the lens of potential conflicts, this substitutability means that the provision of FM services involves precisely the same potential conflict as an existing IC provider proposing a project of work to replace an asset manager, or to conduct an investment strategy review, yet no WP has been produced to focus on the potential harm of these other types of cross-sales.

There are substantial other benefits to customers from combined IC-FM firms

1.6 We agree with all of the points summarised at paras 51 to 53 of the WP and have previously explained[1] that the benefits of joint provision of IC and FM services are, among others, that:

[1] Paras 5.10-5.11 of Aon's response to the Statement of Issues.

1.6.1 clients have the ability to choose between no delegation, partial delegation or full delegation, depending on their level of expertise, requirements and preferences;

1.6.2 where a client requests it, the consultant can maintain a complete picture of the client's attitudes and investment objectives across their entire portfolio, regardless of whether or not particular decisions have been delegated;

1.6.3 when combining IC and FM services, we are able to negotiate lower fees for asset managers when working on a FM basis, but this bargaining power also allows us to negotiate better rates in parallel for clients who purchase IC services;

1.6.4 efficiencies as a result of providing both IC and FM services include the sharing of common costs and best practice, as well as enabling access to higher-quality research.

1.7 The WP makes no attempt to address these benefits. Nor does it articulate any significant competition risks of the joint provision of these services. As such, it is inappropriate at this stage for the CMA to continue to seek feedback on far-reaching structural remedies that would separate the provision of IC and FM services.

Trustees recognise these benefits and are not 'steered' into FM

1.8 Trustees recognise these benefits of the joint provision of IC-FM services. Rather than being 'steered' they will often simply favour selecting the IC they work with as their FM. As existing clients, trustees will already be well-appraised of their IC firm's strategy, operational due diligence capability and manager selection expertise. Since these are core criteria in choosing an FM, just as they will have been when the scheme chose their IC provider, it is natural for many trustees to conclude that their existing IC provider would be their best fit to provide FM.

1.9 As we set out in Section 2 below, trustee decisions with respect to both the decision to purchase FM services; and the FM provider chosen to provide those services are taken on a well-informed basis. As we explained in more detail in our response to the Issues Statement, and as per evidence considered by the CMA at paras 40-46 of its WP on trustee engagement, trustees are generally capable and well informed and have many other advisors available to them.[2] They take decisions to adopt FM carefully after detailed consideration. This is reflected in the growth in the use of tender procedures, and the use of TPEs.

1.10 The CMA acknowledges that the FM segment has grown ten times in ten years (para 32) which has led to considerable benefits for customers. For example, all Aon FM customers have outperformed their liability benchmarks since they started to purchase the service. This sector would not have grown as quickly, meeting customer needs more effectively, without trustees being able to award FM contracts to their existing IC firm, where they wished to do so.

[2] See also Aon's presentation made during the CMA site visit on 11 October 2017, slide 5.

The CMA has previously accepted the benefits of a single firm providing multiple services

1.11 The CMA acknowledges at para 67 of the Statement of Issues that it is 'natural' for any firm to wish to 'upsell' additional services. The CMA has explored this issue before as part of its statutory audit market investigation. There, the CMA recognised the conflicts inherent in the provision by an auditor of non-audit services, highlighting their potential to impair auditors' independence. However, it determined not to restrict the provision of these non-audit services for reasons that can equally be applied to IC-FM firms.

1.12 First, the CMA found that there was no evidence to suggest that audit was a 'loss leader' whose viability was dependent on facilitating non-audit business. Similarly, there has been no suggestion that the viability of IC-FM firms is reliant on the provision of FM services, and evidence to date indicates the margins for each service are comparable. Applying the CMA's own analysis, the independence of the IC's advice on whether or not FM services may be suitable for a client should not be impaired.

1.13 Second, the CMA found that the provision of non-audit services was a way for non-incumbent auditors to demonstrate their service quality, sector expertise and capabilities, so enhancing competition. Similarly, providing IC services allows all IC-FM firms to demonstrate similar traits to potential FM clients before those clients purchase FM services. This is crucial, given the degree and nature of discretion that schemes delegate to FM services providers. Prohibition of firms providing both services could undermine the FM market as a whole, by eliminating the opportunity for smaller firms in particular to demonstrate necessary skills and build the trust of potential FM clients.

2. THE CMA'S ANALYSIS OF POTENTIAL IC/FM CONFLICTS IS INCOMPLETE AND DOES NOT SUPPORT A FINDING OF AN AEC

The CMA's demand-side analysis is insufficient to justify finding an AEC

<u>High trustee satisfaction scores are relevant</u>

2.1 Given the benefits of the provision of both IC and FM services within one firm, it is unsurprising that the Trustee Survey indicated strong client satisfaction, with 95% of trustees surveyed being very or fairly satisfied with their IC or FM provider.[3] Indeed, trustees purchasing IC and FM services from the same provider are more likely than other trustees to be *very satisfied* with their main FM provider.

<u>Trustees are generally satisfied with their IC-FM services and how conflicts are managed</u>

2.2 It is also clear that trustees are less concerned about potential conflicts than the CMA has indicated. The evidence that the CMA has gathered as part of the Trustee Survey and in the WP does not show any consistent picture that conflicts are <u>not</u>

[3] Trustee Survey, page 14.

being addressed. The Trustee Survey indicates (WP at para 60(b)) that only 30% of trustees think ICs 'steering' clients into their own FM services is a problem that more should be done to address.[4] This alone does not indicate an AEC and we comment further on this particular aspect of the Trustee Survey at para 2.8 below. It is notable that 30% consider the potential problem to be well managed (i.e. those trustees see no need for a further remedy)[5] and the remaining 40% consider it is not a problem or do not have any view on this.[6] We also note that only 16% trustees surveyed said that their-then IC advisor had prompted them to consider FM.[7]

2.3 Among trustees that have actually purchased FM services, only 22% have identified ICs 'steering' clients into their own FM services as a problem that more needs to be done to address.[8] While those who have purchased only IC services indicate a greater concern (32%),[9] potential conflicts of interest do not appear to have been important in influencing their decision not to take FM services – only 4% of those who had made the decision not to buy FM services identified potential conflicts of interest as the reason for their decision.[10] These figures do not demonstrate that this is a persistent problem.

Potential IC-FM conflicts arise in a smaller segment of the market than the CMA indicates

2.4 While the CMA concludes that a large number of schemes are 'reliant' on a single provider for IC-FM, this is not supported by the CMA's evidence. The Trustee Survey found that "*less than half of the trustee boards said that they use an FM provider that was their provider at the time that they chose them*".[11] Moreover, it should not be surprising that many trustees will choose the same supplier for IC and FM, precisely because they are satisfied with the strategy adopted by that consultant. However, this does not imply that many schemes are *reliant* on that provider, not least because:

2.4.1 There are no significant barriers to switching IC or FM suppliers.

2.4.2 The FM space is competitive, with a large number of alternative providers available.

2.4.3 The Trustee Survey found that 70% of schemes purchasing FM services for the first time did so following a tender process, typically involving at least three firms, with 84% of these firms finding the proposals 'very easy' or 'fairly easy' to assess.[12] This significantly diminishes potential conflict of interest concerns.

[4] Trustee Survey, page 72.
[5] Trustee Survey, page 72.
[6] Trustee Survey, page 72.
[7] Trustee Survey, page 17.
[8] Trustee Survey, page 75.
[9] Trustee Survey, page 75.
[10] Trustee Survey, page 14.
[11] Trustee Survey, 5.13.
[12] Trustee Survey, page 18.

2.5 In any event, it is not accurate for the CMA to conclude that any competition issues arising from the provision of FM services by IC firms potentially impact a 'large' part of the market. FM services remain a small proportion of the market: it is far more frequently the case (74%) that FM services are not purchased at all.[13] If IC service providers had the ability to 'steer' improperly customers towards their in-house FM offering, one would expect the proportion of trustees purchasing FM services to be significantly larger than it is.

No analysis provided in the WP on trustee purchasing decisions

2.6 We flagged in our letter responding to the draft Trustee Survey that certain proposed questions were misleading in terms of what could be done better - as if switching *should* have taken place.[14] The respondent is implicitly prompted to view the separation of IC and FM facilities to be beneficial because it would 'force' a customer to switch provider when transitioning from IC to FM. Putting to one side the fact that the CMA has established no such benefit of forced switching (indeed, in our view it would harm many customers), this has a framing effect by presenting integrated provision in an adverse light.

2.7 The resulting focus of the WP is whether customers are 'steered' towards consultants' in-house FM services, when an alternative solution or deal could have been in their best interests. However, the CMA appears to infer that a trustee has been 'steered' simply by virtue of the fact that they have not switched provider when purchasing FM; or have not used a third party advisor to assist them in choosing an FM provider. This is misleading as it implies that trustees have not made an informed decision, or have been misled about their choice.

2.8 As we set out previously in our response to the CMA's Statement of Issues[15] and as noted above, trustees are well-informed, capable and aware of other service providers, especially given the high (and increasing) prevalence of schemes with independent trustees who may work with different firms under their other trustee appointments. Trustees challenge us when moving from Aon's IC product to Aon's FM product, and frequently take input from other sources in parallel, such as their sponsor, actuaries or lawyers. In addition, as the CMA itself notes (para 70 of the WP) in 2017 60% of trustees who made a new FM appointment were advised by an independent third party and that figure is growing rapidly year-on-year.[16]

2.9 By focussing too much on the act of switching, the Trustee Survey places insufficient focus on the trustee's process of review. While we note that the CMA's WP on trustee engagement details the reasons why trustees choose to purchase IC and FM respectively, we have not seen evidence of the CMA engaging in the reasons why a trustee might decide to retain their existing IC advisor for FM services, or indeed why they may have switched.

[13] Trustee Survey, page 44.
[14] See Aon's email to the CMA of 20 October 2017.
[15] Aon response to Statement of Issues paras 4.4 - 4.10.
[16] Trustee Survey, page 18.

2.10 These reasons why trustees switch or do not switch are complex and nuanced. It is not appropriate to assume simply that a switch would be in a scheme's best interests on every occasion. In many instances, trustees will have already undertaken due diligence on their IC firm's strategy, operational due diligence capability and manager selection expertise. Since these are core criteria in choosing an FM just as they will have been when the scheme chose their IC provider, so long as they are content with their existing IC's strategy, it is natural for many trustees to conclude that their existing IC provider would be their best fit to provide FM.

2.11 In these instances, schemes will move from IC to FM simply to secure investment implementation. An in-depth strategic review is not required because the provision of FM is a straightforward substitute for their existing IC service. To the extent these trustees retain their existing IC advisor to provide FM services, these are not examples of clients being 'steered' away from making an in-depth assessment of alternative investment strategies at the time of the move to FM, as the CMA seems to infer.

2.12 The key issue is that whether for reasons connected purely to implementation, or connected to implementation and investment strategy combined, trustees have the opportunity to consider all options and all other providers, of which they are well aware. It is clear that they are increasingly doing so by virtue of the increasing use of tenders and the increasing use of third party evaluators when purchasing FM services.

2.13 The CMA is only able to conclude that there is "*some* evidence of practices and behaviours on the supply and demand side that *could be consistent* with *some* customers being steered towards the FM services of their incumbent IC, without having applied much competitive pressure on the incumbent firm." (emphasis added). This falls short of indicating that current practices are leading to an AEC that would require remedies.

The CMA's supply-side analysis is insufficient to justify finding an AEC

<u>CMA has not assessed potential IC-only or FM-AM conflicts</u>

2.14 To be able to assess fully whether there is an AEC caused by the provision of FM services by IC firms, it is necessary to understand the counterfactual i.e. the extent to which customers could suffer equal or greater harm if IC or FM services were provided by firms on a standalone basis. The CMA has not undertaken this analysis.

2.15 While the CMA has acknowledged the possibility of these conflicts (such as non-integrated ICs not promoting FM services due to the fear of losing advisory revenues) it did not address them in the Trustee Survey. This was despite at least Aon warning the CMA in its response to the draft Trustee Survey that the proposed subject matter was too narrow.[17] In our view, the Trustee Survey was unbalanced.

[17] In Aon's email to the CMA of 20 October 2017, which enclosed our mark-up of the draft Trustee Survey, Aon notes its concern that the questions posed to the trustee "*do not capture fully the factors and stakeholders*

The survey prompts respondents to think of integrated provision of IC and FM services as a potential problem. But it fails to remind respondents that non-integrated provision may be equally or more 'problematic'. For example, apart from the 'IC-only' potential conflict of which the CMA is already aware, there is a real possibility that absent the economies of scale of providing IC and FM together, a greater number of firms may start to offer both asset management and FM services. This generates the risk of the FM part of that business potentially investing in its own asset management products against the best interests of clients. As such, respondents' answers are subject to a framing bias: respondents are steered to think of the conflict as only being one way, when in fact separation itself creates a conflict.

No consistent evidence of internal incentives of IC-FM firms to breach conflicts policies

2.16 The CMA quotes Aon in paras 76 and 77 as evidence that margins are higher for FM; [✂], per our written submissions and our meeting with the CMA of 22 February 2018) margins [✂]. At para 77 the CMA's reference to a firm who considered FM to be less profitable does not support the CMA's conclusions.

2.17 Paras 83-85 indicate that staff are not rewarded for selling FM services as an alternative to IC services at any IC-FM firm.

2.18 Customer pressure and the competitive environment is also a significant factor to ensure that IC-FM firms do not take advantage of potential conflicts of interest. If a firm consistently sold FM services against their client's interests, they would be commercially punished and their reputation as an advisor would suffer as customers and competitors would expose such behaviours.

No evidence of IC-FM firms failing to adhere to conflicts of interest policies

2.19 The CMA's evidence as to whether conflicts policies are adhered to is minimal. The only evidence in the WP which seeks to test this is at para 94, and this only relates to the narrow issue of independent review processes.

2.20 It is important to recognise the regulatory backdrop in respect of the adoption and operation of measures to mitigate conflicts of interest, including conflicts policies. In particular, firms are expected to maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts.[18] This includes establishing, implementing and maintaining an effective conflicts of interest policy.[19] A failure in this regard by an IC-FM firm could therefore constitute a regulatory breach in respect of which the FCA could take enforcement action.

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involved in the purchasing decision, in particular: + the interaction of the trustees with other providers who may be linked to existing providers; + the involvement of the sponsoring employers and its advisors; + whether the trustee is aware of the range of services provided by existing advisors; + whether the purchasing decision is made on the proposed advice and strategies offered by the relevant advisor."

[18] FCA Handbook, SYSC 10.1.7R.

[19] FCA Handbook, SYSC 10.1.10R.

2.21 Aon has provided the CMA with significant evidence of the comprehensive conflicts systems that it has put in place and the CMA accurately notes at para 49(a) of the WP that we told it "*while we may recommend to a client that they consider FM Services, we will not recommend to a client that they choose our own service, although we will introduce it."*

2.22 We cannot comment on what other firms have submitted, or their level of compliance, but the CMA merely acknowledges that firms have *some* policies that help to manage conflicts – without saying what more extensive policies would be preferable.

2.23 The CMA cites no evidence for its assertion at para 96(a) that policy documents are "*high-level and principles-based meaning that staff may have different views as to what type of conduct complies with policies when it comes to selling or advising on FM".* It is not appropriate for the CMA to draw an inference that this results in poor compliance and/or this leads to customers being steered to in-house FM solutions. At least on the part of Aon, we instigate regular conflicts of interest training and routinely conduct retrospective audits to check that compliance procedures have been followed when customers move from IC to FM.

2.24 The above analysis accords with the CMA's conclusion that it has only been able to identify "*some* evidence of practices and behaviours on the supply and demand side that *could be consistent* with *some* customers being steered towards the FM services of their incumbent IC" (emphasis added). We also agree with the CMA that (para 106) "*it is not straightforward to say how these practices might impact competition*". It is clear that the CMA's findings fall short of the standard required to demonstrate an AEC and therefore of the need for intrusive remedies.

The CMA's continued focus on the largest three IC-FM providers is unjustified

2.25 We are concerned by the continued focus of the CMA on sub-analysis of the three largest combined IC-FM providers. The FCA's market investigation reference contains no requirement to look at these three firms in isolation. The CMA's Statement of Issues contains no theory of harm that relates only to these three firms. Absent such a requirement, to maintain a tight focus on three firms does not allow the CMA to explore adequately the general market practices that it is required to under Theories of Harm 1-3 in response to the FCA's reference decision.

2.26 To perpetuate the myth of a 'Big 3', a concept that has already been given considerable unnecessary oxygen by the FCA and the financial press, is damaging to our business. The continued publication of supplementary data concerning Aon creates an unfair asymmetry of information that allows competitors to persuade clients (often incorrectly) that their own relative metrics (not cited by the CMA) are more advantageous to customers. The competitive disadvantage caused to Aon is disproportionate relative to any purported benefit realised by the inclusion of abstract discussions of 'leading three' data in published WPs.

2.27 In any event, the data that the CMA has adduced within the WP simply does not support a narrative of a powerful largest three players compared to others in the market:

2.27.1 While para 36 of the WP states that 'just over half' of FM mandates are held by the three largest IC-FM firms, there is no indication why this should be seen as problematic. There are many sectors that are considerably more concentrated than this, yet remain highly competitive. In those sectors, a 'top 3' holding only 53% would in fact be taken as evidence of reasonable fragmentation. Absent other information, meaningful conclusions cannot be drawn from the degree of concentration of the market.

2.27.2 The Trustee Survey provides further evidence of a fragmented market structure. It is also notable that across all DC schemes only 23% of FM customers name one of the largest 3 as their provider.[20] The figure is even lower for DB schemes. The survey also finds that the three largest providers account for less than 50% of services provided to the largest schemes and much smaller shares in relation to smaller schemes.[21] One might expect larger schemes to be more likely to have sophisticated procurement processes and effective buyer power, while smaller schemes to be more subject to behavioural biases. Indeed, as the CMA survey finds, larger schemes are far more likely to challenge their IC providers to improve their terms (74% vs 41%[22] for small schemes). For that reason, the CMA might be expected to focus instead on the part of the market where the three largest IC-FM firms are relatively weak.

2.28 It is unclear why the CMA's document review designed to assess "*The conduct of firms around the point at which their existing clients consider buying FM*" looked at only 100 documents supplied by the four main firms in order to conclude that:

2.28.1 The CMA did not find examples of firms mentioning rival FM services (para 103);

2.28.2 As trustees moved closer to the FM purchase decision, the CMA found that firms generally produced more detailed information on their own FM services (para 104).

2.29 Neither of these findings should be considered egregious, given that any professional services firm will tend to provide its clients with information on its own services, rather than those of its competitors. However, even if the activities were problematic, the CMA's conclusions are of limited utility, given the narrow sample set chosen and the further data limitations that the CMA sets out at para 100 of the WP. Aon has also previously explained to the CMA that [✂]. The CMA's observations are therefore unbalanced and provide no reliable support to form a

[20] Trustee Survey, page 41.
[21] Trustee Survey, page 39.
[22] Trustee Survey Results, Table 93. Tables 26 and 38 show a similar picture with respect to IC services; Trustee Survey, page 56.

view on the extent to which clients are 'steered' towards consultants' own FM services, even among the leading four industry players.

2.30 Overall, given that any remedies adopted should apply to the entire IC-FM industry, it is not objective or proportionate to continue to focus principally on the three largest firms. We urge the CMA to undertake further analysis across all firms in the sector in order to create a more robust and representative data set, before giving further consideration to remedies.

3. POTENTIAL REMEDIES

Preliminary comments

3.1 We recognise that the CMA is now required to set out its thinking on potential remedies early in the market investigation process. However in doing so, we urge the CMA not to pre-judge whether there are sufficient grounds to establish an AEC, and if there were an AEC, what remedies would be appropriate. To conflate these stages risks the CMA's substantive analysis (whether deliberately or not) being shaped to suit certain preferred remedies.

3.2 We reiterate the points set out in our response to the WP on information on fees and quality, where we submitted that any remedy:

3.2.1 must be a proportionate and effective response to an identified AEC;

3.2.2 must not duplicate or cut across ongoing initiatives;

3.2.3 must not be overly prescriptive in a way which might reduce competition and innovation in the market; and

3.2.4 should be subject to widespread industry engagement.

3.3 Specifically in the context of remedies to address potential conflicts of interest, we urge the CMA to consider the following:

3.3.1 The need to undertake considerable further analysis of supply-side factors, as set out in Section 3 above, before any AEC could be confirmed.

3.3.2 Any remedies should be applied equally and consistently across <u>all</u> providers/potential providers of both IC and FM so that no provider segment is placed at a competitive disadvantage and to increase the likelihood that any remedies are effective.

3.3.3 The trustee and pension scheme landscape is differentiated and there are many small pension schemes. Any remedies to address perceived conflicts of interest should not take away trustee choice, increase trustee costs, place an undue burden on smaller schemes, destroy client value or reduce incentives for providers to innovate.

3.3.4 The CMA should not seek to duplicate the broader regulatory work of the FCA or tPR:

(a) tPR is well placed to take forward measures to empower trustees – which would in many cases lead to more proportionate and

effective remedies than putting in place blunt structural supply-side measures.

(b) The FCA has already implemented a regime which requires firms to identify and manage conflicts. It also requires certain pre-sale disclosures (including in relation to costs),[23] which have recently been extended because of MiFID II.[24] Such disclosures seek to ensure that a prospective client can take an informed decision as to whether to take out the service. Any attempts to increase regulation in these areas would be duplicative and disproportionate in light of recent regulatory developments.

3.4 In light of the analysis not yet undertaken by the CMA, it is premature to comment fully on each potential remedy that the CMA has suggested in the WP. However, where it is possible to do so, we set out preliminary comments below.

Views on whether the perimeter of existing regulation is sufficiently broad to cover the potential conflicts of interest faced by IC-FM firms

3.5 In considering potential remedies it is important for the CMA to understand fully the nature of any regulatory gap that exists with respect to the provision of IC services. This can arise where an IC does not provide advice in relation to specified investments, for example because it provides only asset allocation advice or manager recommendations. For such entities the numerous regulatory requirements governing the identification and management of conflicts will not apply.

3.6 However, in the context of the conflicts faced by IC-FM firms this regulatory gap does not detract from the regulatory coverage of potential IC-FM conflicts. This is because, regardless of whether the IC services fall within the regulatory perimeter, the FM side of the business will be carrying out regulated activities. As explained in further detail in ***Annex A***, which critiques the CMA's regulatory assessment at Annex A of the WP, the scope of FCA regulation is sufficiently broad that the promotion/recommendation of in-house FM services by an incumbent IC should be identified as a conflict of interest by the fiduciary manager. This means the numerous regulatory requirements concerning the management of such conflict will be applicable. Furthermore, such a conflict will also fall within the scope of the extensive MiFID II requirements, to which a fiduciary manager will also be subject.

3.7 Therefore, when considering the potential remedies in respect of the theory of harm discussed in this WP, the CMA must view potential IC-FM firms' conflict within the context of the existing regulatory regime, breach of which can lead to regulatory enforcement action, fines and/or public censure. Implementing remedies that place further obligations on IC-FM firms in respect of the management of conflicts would therefore be disproportionate.

Measures to encourage trustee engagement

[23] FCA Handbook COBS 2.2A2R.
[24] FCA Handbook COBS 6.1ZA.11R to COBS 6.1ZA.15G.

3.8 The CMA's key objectives in driving trustee engagement must be to allow trustees to achieve value for money; to have the necessary information to decide that FM meets their needs; and to be able to choose the best FM provider for their circumstances.

3.9 It is not necessarily the case that a switch to a new or different FM provider will always be in the trustees' best interests. In many circumstances, the best FM provider will quite legitimately be their existing IC advisor and remedies should not be wholly designed to facilitate switching.

3.10 We have stated previously that we support measures:

3.10.1 to provide clear, consistent and transparent information to trustees;

3.10.2 to provide guidance to trustees to support them in their purchasing decisions. This should be in relation to both:

(a) the trustees' decision to purchase FM; and

(b) their choice of FM provider.

3.11 We also support measures to assist trustees in undertaking tendering and market-testing exercises. However, the scope of any tendering measures needs to be formulated once the potential impact, costs and burdens of such measures on pension schemes of all sizes (and in particular small schemes) have been fully understood. This means that it is premature to comment in response to this WP on the potential trustee engagement remedies that the CMA puts forward at this time.

Measures to reduce the risk of conflicts through controlling or incentivising firm behaviours

3.12 The CMA needs to undertake significant further analysis before progressing supply-side remedies:

Comparison of relative client outcomes for IC-only firms

3.12.1 We note that at para 54 of the WP the CMA acknowledges that "*many IC-FM firms said that the investment consultants who do not offer FM may be subject to an equally serious (or more serious) conflict, in that they may fail to recommend FM to their advisory clients in order to avoid losing advisory work*". We also note that the CMA accepts that "*these firms also raised a range of other conflicts of interest.*"

3.12.2 Given this recognition, it is concerning that the CMA does not appear to intend to undertake full analysis of these conflicts as part of a focussed WP and only intends to look at them as part of its "*wider investigation*". We cannot see how it would be possible to undertake any proper analysis of the potential remedy to prohibit firms from offering both IC and FM services without understanding how conflicts impact on IC or FM-only firms in practice, or how these potential conflicts might be changed or amplified as a consequence of separation. It is not necessary for the CMA to make a

predictive assessment of remedy outcomes; the evidence already exists and the CMA needs to gather it.

Comparison of relative client outcomes between different FM providers

3.12.3 The CMA appears to be working towards a conclusion that IC firms selling their FM service to existing clients is not beneficial to those clients, but does not appear to have collected data to show:

(a) What a good outcome would be for a client when choosing a new FM provider compared to a decision to retain their existing IC service. Clients often have complex and varying requirements that include a consideration of balance of risk or choosing a provider that shares a particular investment philosophy.

(b) Whether clients who opted to purchase FM from a firm other than their incumbent IC provider had their needs met more effectively (which might not only be measured in terms of rate of return).

(c) Whether clients who tendered to choose an FM provider (which may have then been their incumbent in any event) had their needs met more effectively than firms that made a direct award.

3.12.4 Absent this analysis, it is not possible to judge whether a particular suggested remedy would in fact lead to improved client outcomes.

Whether combined IC-FM firms gain share at the expense of non-integrated firms

3.12.5 The CMA has considered whether the three largest firms are gaining/losing share but has not assessed the relative impact of the combined IC-FM model by considering whether all combined IC-FM firms are gaining total share compared to standalone firms.

3.12.6 That said, growth in share for IC-FM firms is not a sign of a competition problem; it can be explained by the IC-FM model offering better outcomes for clients.

3.13 Our preliminary comments on potential remedies to reduce conflicts via firm behaviours are:

Measures to reduce firms' incentives to promote their own FM (para 130(b) of the WP)

3.13.1 Even if the CMA had adduced sufficient evidence to support the finding of an AEC with respect to conflicts of interest (which it has not) we could not under any circumstances support measures prohibiting existing IC firms from providing FM services or master trust services. This remedy would fail the CMA's core tests for proportionality:

(a) **It would not be effective in its aim of eliminating IC-FM conflicts** – as explained above, there are inherent conflicts in IC-only firms potentially not promoting FM services.

(b) **Other less onerous measures could achieve the same aim and in fact be more effective** - as set out below, potential conflicts can be (and are) well managed through other means. Moreover, the effective enforcement of conflicts management policies, backed up where necessary by regulation, could be applied across the entire industry (not just IC-FM firms) so would be more effective that an enforced separation remedy.

(c) **It would produce considerable disadvantages disproportionate to the aim of the remedy –** as explained above, a separation remedy would cause considerable harm to clients of IC-FM firms:

(i) **Clients would be harmed by the removal of a significant degree of product choice –** for example, all-in-one partial delegation packages would no longer be available.

(ii) **Clients would experience a reduction in the number of IC and FM providers available to them** - if firms were obliged to separate their IC and FM services, it is likely that they would sell either their IC or FM client book (potentially to a competitor) rather than separate their businesses into two. Other firms might determine that they only way to fund the necessary intellectual capital to remain competitive would be to merge with a fellow IC or FM provider. Overall, both of these effects would be likely to reduce the net number of IC and FM providers.

(iii) **Clients would be disadvantaged by fresh conflicts of interest emerging** - customers would also be required to navigate new conflicts of interest inherent in the fact that IC-only firms would not be incentivised to recommend FM, or that FM-only firms might use in-house funds rather than independent highly-rated funds as we do today.

<u>Proposal to prohibit the cross-selling of IC and FM services (para 130(b)(ii) of the WP)</u>

3.13.2 We agree that this would reduce choice for trustees. It would also significantly reduce the ability of firms to offer integrated services. All professional services firms have the ability and incentive to cross-sell services and to the extent this could lead to conflicts of interest, these can be effectively managed. For IC-FM firms, effective and enforced conflicts policies, combined with transparency measures to ensure trustees are making informed buying decisions, are key to this. We already implement sufficiently strong internal separation and controls, as referenced by the CMA at Para 130(b)(iii) of the WP, and suspect that CMA concerns would

be significantly lessened if all market participants implemented equivalent safeguards and controls.

Proposal to segregate advice and marketing materials (para 130(a) of the WP)

3.13.3 [✂]. We agree that [✂] trustees would be better protected against potential conflicts of interest and therefore support this remedy.

Potential conflicts between the provision of IC and FM

3.13.4 These conflicts can be effectively managed using clear and comprehensive policies. As set out above, the CMA has not collated consistent evidence that conflict policies are being routinely disregarded or are ineffective and at Aon in particular we have spent significant time in recent years refining and improving our policies and compliance. We will continue to focus on these, due to the new regulatory requirements that the CMA has outlined at the WP's Annex A.

3.13.5 Bringing the supply of IC and FM services within the FCA's perimeter could be a proportionate and effective way to require every IC-FM provider to implement a similarly clear communication framework with clients. This would enhance transparency, manage conflicts of interest and encourage clients to consider the full range of options when selecting an FM provider. This would also be consistent with the package of UILs that we proposed to the FCA, the key points of which were as follows:

(a) **UIL 4:** proposed to give clients the ability to compare overall fees charged and other fees charged by third parties across all FMs, by introducing transparent fee structures for FM services (including during tenders) in a specified format.

(b) **UIL 5:** proposed that FMs would provide clients with an annual fee disclosure statement, covering all costs and directly comparing these with any costs projected during the competitive tender process.

(c) **UIL 6:** included a proposal that firms should make certain advance disclosures to any IC clients to whom it is proposing to provide FM services, and this would appear to accord with the potential CMA remedy suggested at para 130(c) of the WP. Potential disclosures could include:

(i) an explanation of differences between that client's previous IC services contract and their new FM services contract;

(ii) a statement that a party acting as an IC may introduce but not recommend its own FM services;

(iii) a statement that other entities also provide FM services;

(iv) a statement that it would be best practice for a client to conduct a competitive tender process before entering into an FM contract; and

(v) a requirement that where a party is the incumbent consultant, that they should not manage any competitive tender process in which they are a candidate (this appears to accord with the CMA's potential remedy set out at para 130(e) of the WP).

(d) **UIL 8:** proposed the introduction of an ICs' code of conduct. This stressed an IC's duty to act in the best interests of its clients and a requirement to have documented controls in place to identify, manage and control conflicts. This appears to accord with the CMA's potential remedy set out at para 130(d) of the WP.

ANNEX A

OVERVIEW OF THE SCOPE OF THE REGULATORY REGIME

This annex sets out our views on whether the perimeter of existing regulation is sufficiently broad to cover the potential conflicts of interest faced by IC-FM firms, as requested by the CMA at paragraph 43 of the WP. We consider the manner in which the various provisions apply to the activities of IC-FM firms and, in particular, whether they will apply to the promotion/recommendation by an IC of its own FM services.

Our conclusion is that, with the exception of PRIN 8, these FCA provisions are already sufficiently broad to capture the conflicts faced by IC-FM firms, irrespective of whether the activities carried out by the IC constitute regulated activities.

1. PRIN 8 – DUTY TO MANAGE CONFLICTS FAIRLY

1.1 We note that PRIN 8 applies only in relation to the carrying on of 'regulated activities' or of 'ancillary activities in relation to designated investment business'. An activity relating to designated investment business will be ancillary, inter alia, where it is an unregulated activity that is carried on in connection with a regulated activity or held out as being for the purpose of a regulated activity.

1.2 An investment consultant promoting/recommending its own FM service is not a regulated activity as it does not constitute advice relating to a specified investment. Equally, the manner in which clients are referred to FMs is not a regulated activity. Additionally, we would not consider this activity ancillary to the designated investment business that an IC conducts; it is too far removed from advising on investments (the core designated investment business which may be carried on by an IC). Similarly, the manner in which clients are referred to FMs is not ancillary to the FM's designated investment activities.

1.3 As such, the conflicts that the CMA has identified in respect of IC-FM firms would be outside the scope of this particular provision of the FCA Handbook.

2. SYSC 10 – IDENTIFICATION AND MANAGEMENT OF CONFLICTS

2.1 The summary of this provision that is provided by the CMA at paragraph 134(b) is not entirely accurate. The following better reflects the content of SYSC 10.1.3R and 10.1.4R, read in conjunction with SYSC 10.1.1R:

"*SYSC 10 makes provision for firms to take all appropriate steps to identify and to prevent or manage conflicts of interest that arise, or may arise, when ~~in the course of~~ providing a service to its clients in the course of carrying on~~that is a~~ regulated activities and which may damage the interests of a client.*"

2.2 This distinction is important to note as these provisions, and in fact the other relevant sections of SYSC 10, are not therefore limited to services that are regulated activities, but are in fact broader in scope.

2.3 This is further expanded by SYSC 10.1.4R, which sets out guidance on identifying the types of conflict that may arise in the course of providing a service. In

particular, it is noted that the firm should take into account whether it, or an associated entity, has an interest in the outcome of a service provided to the client which is distinct from the client's interest in that outcome. Such a conflict may result from the provision of a service during the course of carrying out a regulated activity "*or engaging in any other activity*."

2.4 As a result, where the nature of the activities carried out by the IC arm of an IC-FM firm constitute regulated activities (i.e. it carries out regulated investment advice) and that firm promotes or advises on its own FM provision (i.e. the circumstances flagged by the CMA in paragraph 21 (a) to (d)), then we consider that this promotion/advice would constitute an activity that is caught by SYSC 10.1.4R and the resulting conflict between the interests of the IC-FM firm and the needs of the client would need to be dealt with in accordance with SYSC 10.

2.5 If the IC service does not entail any regulated activities (for example, because only asset allocation advice is provided) then the provisions of SYSC 10 will clearly not be applicable to the IC. However, the FM services provided by the relevant IC-FM firm will be regulated and we consider the provisions of SYSC 10.1.4R to be sufficiently broad that they will capture the conflict inherent in this joint provision of IC-FM services.

2.6 Therefore, regardless of whether an IC-FM firm carries out regulated activities as part of its IC service, the conflict of interest provisions set out in SYSC 10 still operate to require the FM to identify and manage the relevant conflicts.

2.7 By way of summary, this means that the IC-FM firm would need to:

2.7.1 Take appropriate steps to prevent or manage the conflict (SYSC 10.1.3R);

2.7.2 Maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent the conflict from adversely affecting the interests of its clients (SYSC 10.1.7R);

2.7.3 Make certain disclosures to the client in accordance with SYSC 10.1.8R if the arrangements described at 2.7.2 above are not sufficient to reasonably ensure that the risks of damage to the client are not prevented; and

2.7.4 Implement a comprehensive conflicts of interest policy which aims to identify and manage the conflicts of interest arising in relation to its various business lines and its group's activities under a comprehensive conflicts of interest policy (SYSC 10.1.9G). The requirements and content of the conflicts policy is specified in SYSC 10.1.10R and 10.1.11R and there is a requirement to review this policy on at least an annual basis.

3. COBS 6 – CONFLICTS DISCLOSURES

3.1 As the CMA notes, COBS contains certain requirements regarding the information that must be provided to clients regarding its management of and policy relating to conflicts of interest. The relevant requirements in COBS differentiate between those that apply to non-MiFID firms (COBS 6.1.4R) and those that apply to MiFID firms (COBS 6.1ZA.5EU).

3.2 The information requirements contained in COBS 6.1.4R are unlikely to be relevant for present purposes as they apply only in respect of designated investment business:

3.2.1 Carried on for retail clients, being a person that is neither a professional client nor an eligible counterparty. The vast majority of entities that receive IC-FM services are institutional investors who are considered by the FCA to be per se professional clients (see COBS 3.5.2R); and/or

3.2.2 That is not MiFID business. The FM services carried out by an IC-FM firm will constitute MiFID business, as will the IC services provided (to the extent that any such services do constitute regulated activity).

3.3 Therefore it is the requirements of COBS 6.1ZA.5EU that will be of relevance to IC-FM firms. This particular provision requires firms to provide clients with a description of their conflicts of interest policy and further details of such policy upon request from the client. By virtue of SYSC 10 (as described above) we would expect such a policy to include details of the conflict of interest that exists between IC-FM firms and their clients and how this is managed. As such, extant FCA regulation already enables FM clients (and certain IC clients) or prospective clients to obtain details of the manner in which an IC-FM firm manages its conflicts of interest.

4. MIFID II

4.1 MiFID II contains numerous provisions that seek to identify, manage and prevent conflicts of interest, which will be applicable to certain IC firms and all FM firms. These have been summarised by the CMA and will not be considered in detail here. Many years of work has gone into developing the extensive MiFID II framework and so we consider the key question to be whether the inherent conflict arising from the joint provision of IC-FM services will be caught by the MiFID II requirements and not whether this framework is sufficient.

4.2 The MiFID II provisions concerning the identification of conflicts are set out in the MiFID Org Regulation[25] and largely follow those contained in SYSC 10.1.4R, which are discussed in section 2 above. Essentially, for the purpose of identifying the types of conflicts that arise in the course of providing investment services, a MiFID firm should take into account whether it, or an associated firm, finds itself in a situation whereby the MiFID firm or associated person has an interest in the outcome of a service provided to the client which is distinct from the client's interest. We consider that this covers circumstances in which an FM obtains clients by virtue of its own IC arm promoting or recommending its in-house FM services, regardless of whether the IC services are caught by MiFID.

5. PRIN 7 – CLEAR, FAIR AND NOT MISLEADING COMMUNICATIONS

5.1 An additional regulatory principle that the CMA should note is that, when carrying out a regulated activity, a firm is under an obligation *"pay due regard to the*

[25] Commission Delegated Regulation (EU) 2017/565.

information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading". Although this does not directly deal with conflicts, it does go towards the CMA's concern, set out in paragraph 21(e), that an incumbent firm may overemphasize or provide unclear information on the benefits of its FM services relative to its costs.