

CMA INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT MARKET INVESTIGATION

MERCER'S RESPONSE TO COMPETITIVE LANDSCAPE AND BARRIERS TO ENTRY AND EXPANSION WORKING PAPERS

This is the combined response of Mercer Limited (**Mercer**) to the Competitive Landscape working paper dated 26 April 2018 (**CLWP**) and the Barriers to Entry and Expansion working paper dated 26 April 2018 (**BWP**) (together, the **WPs**).

1 Executive Summary

- 1.1 The WPs reflect our experience that the investment consultancy (**IC**) and fiduciary management (**FM**) markets are competitive and constantly evolving by way of new entry and expansion. In particular, we are confident that the CMA has correctly concluded that neither the FM nor the IC market is highly concentrated, and that barriers to entry are low.
- 1.2 Over the last decade, we have seen significant new entry and expansion from a range of firms with varied business models, and from a multitude of backgrounds. This is true for both the IC and FM markets, as well as in relation to both defined benefit (**DB**) and defined contribution (**DC**) schemes. In short, these are markets which are characterised by choice and where trustees have a variety of options as to how, and with whom, to work.
- 1.3 The CMA's previous working papers have illustrated that trustees are well-positioned to take advantage of this choice: trustees are sophisticated purchasers and exhibit high levels of engagement.¹ When coupled with the market characteristics set out above, this means that we face constant pressure to retain and win clients. As a result, we must constantly seek to innovate, price keenly and ensure the highest levels of customer service and quality.
- 1.4 Despite the numerous positive findings in the WPs, we are concerned that the CMA is seeking to place undue weight on a number of more tentative emerging findings in circumstances where the evidence to support these conclusions is weak. In particular, we do not accept the CMA's emerging findings that concentration in FM, particularly among the largest three IC-FM firms, may increase in the future, and even if it does, that this would be indicative of a competition problem. This assertion is speculative and runs counter to the evidence that we and other third-parties have submitted. Specifically, there is an increasing use of tenders and third party evaluators in this market, as well as the likely increase in the levels of switching in the market as it becomes more established.
- 1.5 Notably, the CMA has recognised recent examples of entry in the FM market; however, the nature and potential of these entrants has not been fully recognised. We consider that this not only leads the CMA to conclude that the trend in FM is likely to be toward further concentration, but is also a contributing factor in the CMA finding that barriers to expansion are higher in FM than IC (a comparison that, in any event, we do not consider useful). In reaching this emerging finding, the CMA places undue weight on its switching analysis and over-emphasises any potential advantage enjoyed by incumbents in the market.
- 1.6 In such circumstances, we do not believe the evidence and emerging findings support an AEC finding in either the IC or FM markets.

¹ See our responses to e.g. the CMA's working papers on Trustee Engagement, and Information on Fees and Quality.

2 Concentration in the IC and FM markets

- 2.1 The WPs support our view that the IC and FM markets are competitive: we compete vigorously to retain existing clients and to win new ones, and we must innovate constantly to compete.² The evidence cited by the CMA is consistent with our own experience in the IC and FM markets; these are markets with a large number of significant players and numerous examples of successful entry and expansion.
- 2.2 In particular, we note the following emerging findings from the WPs:³
- (a) The IC market is not highly concentrated.**
- 2.3 Using the Herfindahl-Hirschman Index (**HHI**), the CMA finds that concentration in the IC market is only 1,023. This is only just over the threshold for a market to be considered concentrated, and very significantly below the level that indicates a market is highly concentrated.⁴ Furthermore, the CMA's assessment evidences concentration is decreasing over time.⁵ The CMA states that this decline is slight, but this significantly understates the position: the HHI has in fact dropped dramatically from its level in 2007 of around 2000 – a fall of nearly 1000 points in 10 years. We expect this downward trend to continue, meaning that in the near future this market is likely to move below the lower HHI threshold and cannot be considered to be concentrated.
- 2.4 In terms of the nature of the competitors in the market:
- (a) The CMA finds that there are 37 firms providing IC services to pension schemes.⁶ Of these, the three largest firms in the market make up less than 50% of the market in revenue terms, with no one firm having a market share of over 20%.
- (b) The CMA finds that the seven smaller but “significant” firms that it identifies are well-established and, in several segments, enjoy a stronger position than the three largest players.⁷ [3<].
- (c) When segmenting the market by scheme size, the three largest firms account for only 30% of the market for the supply of IC services to small schemes and 45% of the market for the supply of IC services to ‘medium’ sized schemes. In both cases, the fourth and fifth largest players in the market are of notable size, indicating that there is no lack of choice even for smaller pension schemes.⁸
- (d) When segmenting the market by scheme type, the CMA finds that neither the DB nor DC markets are highly concentrated. In relation to the DC market, the CMA finds that the combined shares of Aon, Mercer and WTW are lower than in the DB market and the IC market as a whole, and that two of these three firms have market shares smaller than other mid-sized players in the market.

² Recent innovations include the Mercer Pensions Risk Exchange, our monitoring and pricing platform that bring together pension funds seeking to transfer risk to insurers in the bulk annuities market. See <https://www.uk.mercer.com/what-we-do/wealth-and-investments/mercera-pension-risk-exchange.html>.

³ We note the CMA's emerging findings regarding the relevant markets for the purposes of this investigation. We do not consider that the definition of the relevant market(s) is critical to the issues at hand and have therefore not commented on the CMA's assessment at this time.

⁴ CC3 (Revised) Guidelines for market investigations; Their role, procedures, assessments and remedies”, Annex A.

⁵ CLWP, paragraphs 77 and 106 - 108.

⁶ CLWP, paragraph 75. The figure cited in this paragraph does not directly accord with the number of IC firms included in Figure 1 of the CLWP.

⁷ CLWP, paragraph 75.

⁸ Figure 4, CLWP (Shares of supply in the segments for ‘large’, ‘medium’ and ‘small’ clients within the market for IC services to pension schemes).

- 2.5 As a result, we believe the picture presented by the CLWP is of a market with a wide variety of IC providers offering meaningful choice to clients in all segments.
- 2.6 Finally, we note the CMA's recognition that in-house advisors play an important role in shaping competition among IC providers for services to large pension schemes. This is consistent with our own experience in the IC market. However, this does not mean that small and medium-sized schemes are not in a position to exert a competitive constraint on IC providers. The CMA's work to date illustrates that trustees have the skills, capabilities and experience to make well-informed decisions. Moreover, levels of engagement are broadly consistent irrespective of scheme size.⁹
- (b) The FM market is not highly concentrated.**
- 2.7 The CMA calculates the HHI of the FM market to be 1,324.¹⁰ This is significantly below the level that indicates a market is highly concentrated.¹¹¹²
- 2.8 The CMA finds that there are 18 firms providing FM services to pension schemes and that pensions schemes "*appear at present [to] have access to a sufficient number of suppliers*".¹³ Of these 18 firms, not one provider has a market share based on revenue of more than 17%. In addition to the three firms that offer both IC and FM services - and whose share of supply is less than 45% of the market - the CMA identifies two other suppliers of "*comparable size to the three largest IC-FM providers*".
- 2.9 In addition, there are a number of providers outside of the largest five firms that "*represent significant players in their own right*".¹⁴ A number of these additional players form part of large, well-resourced organisations, often with an asset management heritage. These firms are well-positioned to exert significant competitive pressure on the five largest players in the market and we feel the impact of this pressure on a daily basis.¹⁵
- 2.10 The CMA suggests that concentration, particularly among the largest three firms that provide IC and FM services, may increase in future in the FM market. The CMA has presented no compelling evidence to suggest that this will be the case.¹⁶ Even if it were correct, it is far from clear that this would be a problem given the low levels of concentration in this market.
- 2.11 [§]. This is a highly competitive market with significant new entry from well-resourced providers, where tenders and third-party evaluators (**TPEs**) are common. In particular:
- (a) The use of tenders is on the rise: the CMA's survey found that 70% of schemes that purchased FM for the first time, and could remember the purchase, said that they ran a tender process.¹⁷

⁹ We refer to the CMA's findings shown in its working paper on Trustee Engagement (Table 3). The difference between a 'small' scheme and a 'large' scheme's incidence of switching, tendering, and conducting external reviews of fees and/or quality was in no case higher than 3%, and the difference in incidence of conducting formal reviews of fees and/or quality was not higher than 10%.

¹⁰ BWP, paragraph 120.

¹¹ By way of comparison, the CMA referred to a HHI of over 2,300 in the supply of gas to microbusinesses as suggesting concentration was "*fairly high*" (Paragraph 9.31 of the CMA's provisional findings report in its energy market investigation, published 7 July 2015).

¹² In any event, as per the Revised Guidelines, the CMA should "*have regard to these threshold levels [...] only as one factor in its wider assessment of competition*" (paragraph 7).

¹³ BWP, paragraph 10(a).

¹⁴ CLWP, paragraph 118.

¹⁵ For example, we feel constant pressure from our clients and competitors to offer value for money. For this reason, we ensure that our offering is keenly priced – as demonstrated by the fact that Ernst & Young found that the total FM fees were among the lowest in the market (see Ernst & Young's *2017 Fiduciary Management Fee Survey*).

¹⁶ WP, paragraph 147. Indeed, the CMA itself places a caveat on its findings in footnote 61.

¹⁷ CMA survey, page 69.

- (b) There is an upward trend in the number of pension trustees using TPEs.¹⁸ TPEs drive competition amongst FM providers when trustees first enter the FM market, but also thereafter (for example, as part of trustees' reviews of existing providers).¹⁹ Of the DB FM mandates won by Mercer in the period Q1 2016 to Q2 2017, [§<] of those pension schemes engaged third-party advice.²⁰ We would expect this trend to increase in light of recent initiatives from the Pensions Regulator (tPR).²¹
- (c) FM is still an emerging service, as the CMA itself has previously acknowledged.²² We expect that the levels of switching and tendering in the market are only likely to increase as the market becomes more established.
- (d) As set out in our response to the CMA's working paper on Trustee Engagement, trustees have the ability to exert competitive pressure on FM providers and are more likely than not to do so. If we do not meet our clients' expectations, clients can and will switch away from us to an alternative provider.
- (e) As the CMA notes, the use of in-house advisors acts as a further competitive constraint.²³
- 2.12 In this context, we consider the CMA places undue reliance on the internal documents of the five largest providers of FM services. These are strategy documents and by their very nature are focused on aspirational business growth. Further, as the CMA itself notes, the content of these presentations may be driven by assumptions on market growth rates, as much as winning business from other providers.²⁴
- 2.13 On the basis of the evidence put forward by the CMA, we therefore consider it would be inappropriate to use its emerging finding that concentration may increase in the FM market to justify an AEC finding in FM, especially when the CMA itself says "*it is difficult to predict whether this trend will continue in even the near future*".²⁵ In particular, the CMA should resist any temptation to use its tentative findings in this area to support its contention that IC and FM firms inappropriately cross-sell services. The evidence presented in the working papers published by the CMA to date simply does not indicate a market in which clients are encouraged towards FM services (see paragraph 2.17 below for further discussion of this).
- 2.14 Finally, as regards DC, the CMA states that: "*The DC market, whilst very small, appears to be almost exclusively served by Mercer and Brewin Dolphin, with some coverage by River and Mercantile*".²⁶ We believe this is inaccurate, and that when taking into account master trusts, the CMA would find a larger number of providers active in the market.
- 2.15 Master trust is the primary vehicle for the provision of FM services to DC schemes in the UK. Mercer's master trust wrapper was introduced in 2014 as part of its wider DC FM offering.²⁷ We consider our key competitors to be [§<].
- 2.16 We believe the CMA should revisit its DC assessment to take into account the alternatives offered by the large number of master trust providers in the market.

¹⁸ For example, 60% of schemes appointing an FM in 2017 received independent written advice on FM selection and appointment, compared with 23% in 2015 and 33% in 2016. See KPMG's 2017 'UK Fiduciary Management Survey'. [§<].

¹⁹ [§<].

²⁰ We refer the CMA to [§<].

²¹ For example, the introduction of the 'Trustee Toolkit' by tPR.

²² See e.g. paragraph 4 of the CMA's working paper on Trustee Engagement.

²³ CLWP, paragraph 37.

²⁴ CLWP, footnote 66.

²⁵ CLWP, paragraph 146.

²⁶ CLWP, paragraph 130.

²⁷ Mercer's FM DC offering is known as Mercer Workplace Savings (MWS). [§<].

- (c) **The markets for the provision of services to customers who purchase (i) IC and actuarial services from the same provider, and (ii) IC and administration services from the same providers, are not concentrated.**²⁸

2.17 This finding, taken together with the CMA's previous evidence regarding the provision of multiple services by the same firm,²⁹ runs counter to any suggestion that a small number of firms may be in a position to inappropriately cross-sell services in the market, to the detriment of other market participants and customers.

3 Barriers to entry and expansion in the IC and FM markets

3.1 A number of the CMA's emerging findings concerning barriers to entry and expansion in the IC and FM markets are consistent with our own experience: these are markets with low barriers to entry and expansion, characterised by a wide range of competitor offerings. In particular, we note the following findings:

- (a) **There are no prohibitively high barriers to entry in IC or FM.** We strongly agree that any barriers to entry in these markets are not prohibitively high. The evidence presented by the CMA for example highlights that the cost of developing research capabilities does not pose material obstacles. Rather, it is apparent that firms have a number of methods available for overcoming such difficulties.³⁰ This reflects our experience of competing for new business, [§<].
- (b) **There is no link between a firm's existing client relationships and its overall success rate in winning business.** The CMA's data analysis shows no connection between the number of tenders a firm participates in and the scale of its existing client base. This is powerful evidence that firms from across the market compete vigorously for opportunities.
- (c) **As regards expansion, there is no evidence to suggest that the costs of acquiring customers are prohibitive.**³¹ New entrants can, and do, take advantage of opportunities to win clients.

3.2 While we welcome the numerous positive findings in the BWP, there are a number of areas in which we believe the CMA should exercise caution going forwards:

Comparison of IC and FM

3.3 We are pleased that the CMA considers there to be no prohibitively high barriers to entry in either IC or FM. Emerging findings that FM barriers are comparably greater as compared to IC should, however, be treated with caution. As a starting point, these are two different service models and there is no reason to think that they are a useful comparison for each other. Further:

- (a) The CMA notes that a lower proportion of schemes have switched FM provider within the last five years, when compared with IC.³² As we have stated previously, the CMA must keep front of mind the nascent and fast-growing nature of FM, and so it would be inappropriate to give undue weight to lower levels of switching in FM at this stage. The

²⁸ CLWP, paragraphs 165 and 167.

²⁹ For example, the CMA has found that trustee engagement appears higher for those trustees that purchase multiple services from the same provider. Paragraph 2.2(c) of Mercer's response to the CMA's working paper on Trustee Engagement dated 12 April 2018.

²⁹ CLWP, Figure 9 and paragraph 107

³⁰ The CMA for example cites detailed examples of entry by Redington, KPMG, Momentum, and Cardano. [§<].

³¹ BWP, paragraph 40.

³² BWP, paragraph 13, 62 and 77.

CMA should therefore treat its switching rate data with caution, and place greater emphasis on the growth in number of opportunities.³³ We refer the CMA to our detailed submission on switching.³⁴

- (b) The CMA's suggestion that firms with an established IC client base may have an advantage in winning new FM clients is at odds with the CMA's finding that there is no link between a firm's overall success rate in a tender, and its existing client relationship.³⁵ This is bolstered by the growth in opportunities and considerable number of new entries. We further address the findings relating to incumbency below.
- (c) The CMA considers that FM provision appears to require a larger fixed cost base for a research function. While we broadly concur with this finding, we do not believe that this presents a material obstacle to enter the FM market. This is exemplified by the number of methods described in the WP for developing research capabilities employed by firms as they build scale, as well as the entry by a number of firms already established within the asset management sector.
- (d) We are not aware of any firms having exited the market. A high survival rate is indicative of the surmountable nature of any barriers.³⁶

Role of brand and reputation

3.4 We agree that trust is essential in these markets, which may take time and effort to build – and this is an investment that Mercer has made to compete effectively. However, we reject the implication that trustees rely on reputation in the absence of information on quality and value for money; in our experience, trustees are sophisticated, engaged and well-informed, and this is supported by the CMA's evidence.

- (a) The results of the CMA's survey show that the vast majority of trustees – current and prospective – are satisfied with information they receive on performance and fees, and find this easy to understand.³⁷ This is further supported by trustees' high level of experience and qualification,³⁸ availability of a number of information sources, and the increasing use of professional trustees and TPEs. This is inconsistent with any hypothesis suggesting that trustees place undue reliance on reputation.
- (b) The CMA considers that the extent to which brand recognition acts as a barrier "*will be determined by the behaviour of trustees when conducting tender processes*".³⁹ However, the evidence of this factor having a material impact on trustee behaviour is far from compelling.
 - (i) The assumption that reputation determines a trustee's choice of providers to invite to tender is overly simplistic. Such choices are based on a multitude of factors including but not limited to customer satisfaction, service delivery records, marketing, and third-party advice.

³³ BWP, paragraph 69.

³⁴ See Mercer's response to the working paper on Trustee Engagement.

³⁵ BWP, paragraph 13(c).

³⁶ See also paragraph 233 of "CC3 (Revised) Guidelines for market investigations; Their role, procedures, assessments and remedies", which includes survival rates as a factor to be considered in an assessment of the impact of entry barriers.

³⁷ See Mercer's response to the working paper on Information on Fees and Quality for our submissions on this topic.

³⁸ See Mercer's response to the working paper on Trustee Engagement, paragraph 2.2(a).

³⁹ BWP, paragraph 44.

- (ii) The evidence cited by the CMA is unpersuasive as to the height of any reputational barrier.⁴⁰ Other results of the CMA survey paint a much more positive picture, with 51% (rising to 58% excluding “don’t knows”) of trustees inviting at least four providers to tender in IC, and 27% (rising to 31% excluding “don’t knows”) in FM.⁴¹
- (iii) The CMA was not able to determine the reasons why trustees had not invited more providers to tender, due to the low number of respondents inviting fewer than three.⁴² The results in relation to switching in IC, however, show that only 8% of trustees chose not to switch due to the reputation of their provider. Reputation therefore appears to be of low relative importance in trustees’ decision-making.⁴³

Position of incumbents

- 3.5 The CMA has not been able to identify any persuasive evidence that incumbents are more likely to be invited to tender, or, importantly, more likely overall to succeed in winning business. The evidence to the contrary is largely anecdotal and tentative.⁴⁴
- 3.6 We strongly disagree with the statement that “[f]irms with existing relationships in adjacent or vertical markets may have a competitive advantage in entry”.⁴⁵ Both our experience and the survey results point to sophisticated trustees who are highly engaged in the process of selecting their provider:
- (a) As we have submitted previously, the fact that 55% of pension schemes in the CMA’s client sample bought FM services from their existing IC is not indicative of a problem. It is our experience that trustees make such purchasing decisions as a result of conscious decisions, often with independent support and/or market testing.⁴⁶
 - (b) Indeed, the survey results show that the rate of market testing is higher for trustees who purchase multiple services from the same providers. For example, those schemes that purchase FM services from their IC provider are more likely to conduct tenders, switch provider, and conduct external reviews of fees and quality.⁴⁷ This firmly rebuts the existence of any meaningful advantage on the part of incumbents or integrated firms, including that they may be in a “*strong position*” to cross-sell FM, or could benefit from a “*general ability to get initial access to a client to directly promote their services*”.⁴⁸ Rather, the results show that trustees are judicious when it comes to selection, and that opportunities are available to other players in the market.
- 3.7 We agree with the CMA’s point that “*as more firms choose to adopt FM services, the number of opportunities to win a contract and the associated revenues available may also be increasing.*” We would encourage greater emphasis to be placed on this factor in the CMA’s ongoing assessment of how easy it may be for new entrants to win clients in this market.

⁴⁰ That the “CMA survey found that the median number of FM providers invited to submit a tender or proposal was three” – BWP, paragraph 44.

⁴¹ See Tables 63 and 112 of the IFF Data Tables for All Schemes.

⁴² See Tables 64 and 113 of the IFF Data Tables for All Schemes.

⁴³ No such question was posed in relation to trustees’ reasons for not switching FM provider.

⁴⁴ See e.g. that the proportion of trustees who use the same provider for both IC and FM “*may* be due to an incumbency advantage” [emphasis added] (BWP, paragraph 59).

⁴⁵ BWP, paragraph 53.

⁴⁶ See Mercer’s response to the working paper on the Supply of Fiduciary Management Services by Investment Consultancy Firms.

⁴⁷ See the CMA’s working paper on Trustee Engagement (paragraph 58(d), and footnote 28); and Mercer’s response to the same, paragraph 2.2(c)(iii).

⁴⁸ BWP, paragraph 51(b).