INVESTMENT CONSULTANCY SERVICES AND FIDUCIARY MANAGEMENT SERVICES MARKET INVESTIGATION

AON RESPONSE TO CMA WORKING PAPER: FINANCIAL PERFORMANCE AND PROFITABILITY

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QAS Institute and Faculty of Actuaries ®
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CMA WORKING PAPER ON FINANCIAL PERFORMANCE AND PROFITABILITY

RESPONSE FROM AON

Aon welcomes the opportunity to respond to the CMA's Working Paper on financial performance and profitability dated 26 April 2018 and sets out its brief response below.

1. Aon operates in a competitive environment regarding both the provision of IC and FM services. This is borne out by the CMA's findings in the working papers on competitive environment and barriers to entry that concentration is not high, customers have a "*sufficient number of suppliers*" and there are numerous examples of new entry by IC and FM providers. Against that background, there is no reason to expect excess profits to be earned.

2. We agree with the CMA that it would not be proportionate to seek to identify the return on capital employed (the "**ROCE**") for the provision of either IC or FM services (or both). As we have already explained in our response to the financial questionnaire, such a metric would not be reliable due to the difficulties that the CMA recognises in relation to measuring the asset base appropriately (i.e. creating a balance sheet for IC and FM services and, in each case, measuring intangible assets).

3. We note that the CMA has compared aggregate net profit margins for the six providers in its sample (all of which provide both IC and FM services) with those earned by asset managers ("**AMs**") and found AM margins to be higher than those earned in aggregate by IC and FM providers. This is in line with our view that our profits are not excessive.

4. We caution, however, that it is very difficult to identify a suitable benchmark against which to compare IC and FM profit margins. In particular, we do not consider a comparison with the average of operating margins of firms in the FTSE All Share index to be meaningful. The latter averages margins across a wide range of industries (e.g. chemicals, media, transportation, pharmaceuticals) that are subject to different degrees of risk. Further, it is unlikely that margins have been computed in a consistent way across all of the firms in the index. As such, there is no reason to expect this to be a meaningful benchmark for profitability of IC and FM provision. We reiterate that the low levels of concentration and many examples of new entry and growth found by the CMA are more reliable indicators of the intensity of competition in IC and FM markets than would be a benchmarking exercise of net profit margins or any other profitability metric.

5. The CMA has asked whether it should seek to measure customer detriment on the basis of financial measures of profitability. We do not think this is necessary. First, our IC and FM services provide substantial value to our customers, and trustees as a whole indicate very high levels of satisfaction with the IC and FM services they receive. This is not a context that suggests "customer detriment". While some

measures can improve competition further, customers are not poorly served at present. Second, the CMA could not reliably assess the existence or otherwise of customer detriment based on measures of profitability. This is because, as the CMA appears to recognise, there is not a reliable way to assess whether profits or margins are "excessive" relative to a competitive benchmark in this particular case.

6. We understand that the CMA is considering whether profitability data shed light on the incentives to "steer" IC clients to take FM services. We act in the best interests of our clients and strongly refute any suggestion that we would encourage them to take FM services when that would be against their best interests. In any event, we do not consider that the margin data assessed by the CMA can provide a robust indication of incentives to steer clients into FM, given that data limitations mean that IC and FM net profit margins can be compared for just one year.