

## INVESTMENT CONSULTANCY MARKET INVESTIGATION

### RESPONSE TO WORKING PAPERS

The CMA has now published its eight scheduled working papers (**WPs**). We have responded to each working paper individually. This submission sets out our overarching comments on the CMA's emerging findings.

#### 1 Executive summary

- 1.1 The CMA's work to date demonstrates that competition in the investment consultancy (**IC**) and fiduciary management (**FM**) markets is working well. To the extent the CMA has identified potential concerns, the evidence presented falls well short of that required to support a finding of an adverse effect on competition (**AEC**). These are not static markets. Rather, there are improvements underway that are effecting positive change (for example, MiFID II and the introduction of enhanced standards for fee disclosures). Taken together, we believe these factors give confidence that these markets are working well now and will continue to do so in future.
- 1.2 In particular, the evidence produced by the CMA demonstrates that:
- (a) **these markets are not concentrated:** there are more than 37 IC providers and more than 18 FM providers active. In addition, the largest three IC providers have less than 50% of the IC market based on revenues and no single provider has a share of more than 17% of the FM market.<sup>1</sup> The CMA has also found that the FM market is characterised by the increasing presence of large, well-resourced asset management firms. Providers strive to maintain high levels of customer service, price keenly and innovate to win and retain customers in the face of such a diverse and competitive field.<sup>2</sup>
  - (b) **barriers to entry and expansion are not significant:** the only potentially material barrier to entry identified by the CMA is research capability, and a number of parties have suggested ways that this can be overcome in practice.<sup>3</sup> The number of recent new entrants identified by the CMA demonstrates that barriers to entry are not prohibitive.
  - (c) **clients are sophisticated, experienced, and generally satisfied with their service providers:** the survey found that 95% of FM and IC purchasers were very or fairly satisfied with their provider.<sup>4</sup> In addition, these clients are experienced and sophisticated purchasers who have made an active decision to take on the responsibility of a trusteeship.<sup>5</sup> This is not a retail market where consumers may appear satisfied without fully understanding the services they are provided.
  - (d) **there is no evidence that firms make excessive profits:**<sup>6</sup> the CMA has not conducted a full profitability analysis, but the analysis it has conducted of IC and FM provider margins does not indicate that these are out of line with comparable sectors.
- 1.3 As well as these core emerging findings, other evidence identified by the CMA to date has been consistent with competitive, effective markets: from many aspects of the CMA's customer

---

<sup>1</sup> Competitive Landscape working paper, paragraphs 5, 7, 74 – 75, 111 – 112 and 117 – 120.

<sup>2</sup> Indeed, innovation is a significant characteristic of these markets. An example of Mercer's approach to investment innovation is [§<].

<sup>3</sup> Barriers to Entry and Expansion working paper, paragraphs 24 to 28.

<sup>4</sup> CMA survey, page 14. 95% of respondents are either "very" or "fairly" satisfied with their FM service and 95% of respondents are "very" or "fairly satisfied" with their IC service. In each case, the majority of clients are "very satisfied" with the services they are receiving from their provider.

<sup>5</sup> Trustee Engagement working paper, paragraphs 40, 41 and 46.

<sup>6</sup> Financial Performance and Profitability working paper, paragraph 6.

survey to the documentary evidence in the CMA's Gains from Engagement WP (which shows providers, such as Mercer, actively monitoring and responding to competitive threats to their customers).

1.4 To the extent the CMA has identified potential concerns, they rely on contested or inconclusive evidence that does not all point in one direction:

- (a) **The evidence on gains from engagement is inconsistent and conflicting:** The CMA has found provisionally that disengaged clients moving from IC to FM with the same provider may pay higher prices than engaged clients. The CMA has not granted access to the data underlying its analysis of gains from engagement and so our ability to comment on it is limited. Based on what we have seen, we have identified errors and inconsistencies which indicate that this evidence is not sufficiently robust. The evidence is also susceptible to challenge and the conclusions drawn are not persuasive. In particular, the CMA's narrow approach to defining "engagement" in this WP understates the real level of engagement.<sup>7</sup>
- (b) **Value added through manager product recommendations:** The CMA's analysis shows that ICs deliver substantial value to clients through their skill in identifying asset manager products that, on average, outperform their relevant benchmarks.<sup>8</sup> To the extent there is no evidence of outperformance on a net of asset manager fees basis, it appears this is because much of the outperformance achieved by ICs is being absorbed by asset manager fees in the adjacent asset management market (rather than an inability on the part of ICs to identify outperforming products). Further, a net of fees approach to this analysis is problematic, both in principle (because individual client fees will vary and so a net of fees approach based on an average may not be meaningful) and in practice (where, for example, the average fee used by the CMA in its analysis is too high).
- (c) **Conflicts of interest in firms providing IC and FM are well managed:** The CMA's analysis of conflicts of interest has focussed to date on clients moving from IC to FM; and the CMA suggests there are some behaviours 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.<sup>9</sup> The evidence shows, conversely, that firms providing both IC and FM recognise and actively manage potential conflicts when clients switch from IC to FM and in practice the use of tendering and other, less formal, forms of market testing at the point of switch is very frequent and continues to increase. This is consistent with our experience as a provider of a range of services to our clients depending on how they choose to work with us. Our FM clients have benefited from substantial outperformance in terms of their funding levels, which strongly suggests there has not been any inappropriate encouragement to switch to FM.<sup>10</sup> Further, this demonstrates the advantages of our integrated model. The CMA should take this into consideration, and scrutinise the extent of any incentive for firms selling exclusively IC or FM not to recommend alternative approaches which may be of benefit to clients.

1.5 Overall, the evidence presented by the CMA is far from sufficient to support an AEC finding. These points are set out in more detail in **sections 2 and 3** below. Moreover, the CMA should take into account the current and forthcoming changes in these markets, including the growing incidence of tenders and the use of third party evaluators (**TPEs**), the new industry-led FM performance standard, as well as a range of regulatory initiatives set to raise standards. Further detail of these changes is set out in **sections 4 and 5** below. We believe that these measures, in combination, will further improve the competitive dynamics of these markets to the

---

<sup>7</sup> See Mercer's response to the Gains from Engagement WP, paragraphs 4.1 – 4.28 and the Annex.

<sup>8</sup> See the Asset Manager Product Recommendations WP and Mercer's response of 19 April 2018.

<sup>9</sup> Supply of Fiduciary Management Services by Investment Consultancy Firms WP, paragraphs 13 and 123.

<sup>10</sup> See paragraph 3.14 below and Mercer's response to the Gains from Engagement WP, paragraph 4.11.

benefit of clients, giving further comfort to the CMA that no AEC exists and that this will continue to be the case in the future.

## 2 These markets are functioning well

- 2.1 We are pleased the CMA's investigation has provided an opportunity for firms such as Mercer to explain more clearly the role of investment consultants. In particular, the CMA's investigation has clarified the nature of FM and the many providers operating in this area, including a number of large asset managers.
- 2.2 We are proud of the work we do with our clients, bringing our intellectual capital to bear through approaches that align with their particular needs: access to our tools and research, provision of investment advice and fiduciary management services. Each client is different and requires a bespoke approach to achieve its investment objectives. It is for this reason we offer a broad spectrum of services that allows our clients to choose how they work with us (as best befits the needs of the individual scheme).
- 2.3 The findings summarised in paragraph 1.2 above demonstrate that the IC and FM markets are working well. Indeed, there is also plenty of other evidence identified by the CMA to date that is consistent with the IC and FM markets being competitive and delivering effective outcomes. The CMA's survey has been particularly useful in providing insight into the views of trustees, with findings including:
- (a) the vast majority of trustees are satisfied with the service they are receiving from their provider;<sup>11</sup>
  - (b) trustees can, and regularly do, challenge their existing service provider;<sup>12</sup>
  - (c) trustees consider that conflicts of interests are generally well-managed by their service provider;<sup>13</sup>
  - (d) trustees are generally satisfied with the information that they are given by their providers and are confident of their ability to evaluate them;<sup>14</sup> and
  - (e) the majority of schemes appointing an FM provider for the first time test the market.<sup>15</sup>
- 2.4 While we understand the CMA has to focus its attention on the theories of harm outlined in its Issues Statement, the CMA should not overlook the positive evidence it has identified as part of this investigation.

---

<sup>11</sup> 95% of respondents are either "very" or "fairly" satisfied with their FM service and 95% of respondents are "very" or "fairly satisfied" with their IC service. CMA survey, page 14.

<sup>12</sup> 70% of respondents to the CMA's survey stated that they had challenged their IC provider to improve their terms within the last three years. Trustee Engagement WP, paragraph 67.

<sup>13</sup> The majority of respondents (70%) to the CMA survey feel that potential conflict of an IC provider "steering clients into their own FM services" is either not a problem in the market, or one that is generally well managed. Moreover, the survey indicates that, contrary to the CMA's emerging finding set out in the working paper on the Supply of Fiduciary Management Services by Investment Consulting Firms, there is no industry policy of inappropriately cross-selling services. For example, only a minority of respondents indicated that their existing IC provider had ever raised FM. See CMA survey, pages 18 and 19.

<sup>14</sup> See Mercer's response to the CMA's Information on Fees and Quality WP, paragraph 1.1.

<sup>15</sup> CMA survey, page 69.

### **3 To the extent the CMA has identified potential concerns, these are limited and do not support a finding of any AEC**

- 3.1 The CMA's test for an AEC requires the CMA to compare the market to a "well-functioning market" – i.e. one that displays the beneficial aspects of competition but not an idealised perfectly competitive market.<sup>16</sup> We believe that the IC and FM markets more than meet this test; there is ample evidence to support these markets working well and the CMA has not identified systemic failings of competition or compelling evidence of detriment to clients.
- 3.2 The main concerns identified by the CMA to date appear to relate to variable levels of trustee engagement. These concerns revolve primarily around the behaviour of clients, and we highlight that it is not uncommon for levels of client engagement to vary in a market. The evidence to date (including the CMA's analysis in its Gains from Engagement WP) does not support a finding of any AEC in this respect. This is set out in more detail below.

#### ***Gains from engagement***

- 3.3 The CMA has conducted both qualitative and quantitative analysis in its Gains from Engagement WP. The CMA itself notes that its qualitative analysis was limited and focused on a small set of documents from a small number of providers. Even so, that limited evidence suggests vigorous competition where providers need to work hard to retain clients. Further, the improvements achieved by engaged customers are enjoyed more widely. In our experience, improvements in fees and quality are frequently shared across our client base.<sup>17</sup> For example, as the FM market has expanded, fees have reduced in general terms [§<].
- 3.4 Our ability to respond to the CMA's quantitative analysis of gains from engagement has been limited, because the CMA has not disclosed the data underlying its analysis. However, based solely on the information in the WP, we have concerns about the CMA's approach.
- 3.5 First, the CMA applies a narrower approach to defining "engagement" in this WP than in earlier papers. This narrower approach risks understating the actual level of engagement in the market.
- 3.6 Second, there are a number of errors and inconsistent results in the CMA's WP, and we believe the empirical results are not representative or robust to changing model specifications. Small changes to the assumptions underpinning the analysis have a material impact on the outcome. Overall, given the concerns we have with both the qualitative and quantitative analysis undertaken in this WP, neither should be relied upon by the CMA in its Provisional Decision.

#### ***Asset manager product recommendations***

- 3.7 The CMA analysed the asset manager product recommendations given by eight investment consultants that subscribe to the eVestment dataset. The CMA's analysis did not include Mercer [§<]. However, we have reviewed and commented on the analysis based on our experience of the market.
- 3.8 The most important point to emerge from the CMA's initial findings is that IC firms deliver substantial value to clients through their skill in identifying asset manager products that, on average, outperform their relevant benchmarks.
- 3.9 The CMA's eVestment analysis finds, for example, that for the majority of the ten year period studied, the IC firms were successful in identifying Buy-rated products that, on average,

---

<sup>16</sup> See CC3 (Revised), paragraph 320.

<sup>17</sup> We set our concerns regarding the quantitative and qualitative analyses presented in the Gains from Engagement WP in our response dated 29 May 2018. In particular, see paragraphs 4.1 – 4.28 and the Annex.

outperformed their relevant benchmarks and the performance of thousands of other 'Unrated' products available.

- 3.10 The CMA found that although ICs deliver substantial value to clients, a significant proportion of this value is absorbed by asset manager fees. However, this analysis overstates the level of likely asset manager fees and fails to include a comparator fee for passive managers. Further, a net of fees approach is unhelpful in terms of assessing the value that investment consultants generate for clients by recommending managers because fees vary materially by client as well as by manager.
- 3.11 In addition to the above, we have some specific concerns about the CMA's analysis, including:
- (a) no satisfactory explanation is provided for the focus in the analysis on Q1 2006 to Q4 2015 (a period with a known exceptional disturbance, being the financial crisis); and
  - (b) the comparison of the performance of Buy-rated products against Unrated products is neither reliable nor practical.
- 3.12 Finally, it is important to keep in mind that asset manager selection is only one component of the overall service delivered by ICs. It is widely acknowledged that this is not the key driver of scheme performance: scheme performance is predominantly driven by asset allocation. Running a pension scheme is a complex task; providers add value by helping clients navigate this complexity. Assisting clients in determining an appropriate asset allocation strategy is one of the most important areas in which we seek to do this. We recognise that asset manager selection is an area amenable to quantitative analysis; however, the CMA should not place undue weight on manager selection just because it is an area that is relatively quantifiable.

### **Conflicts of interest**

- 3.13 To date, the CMA's analysis has focussed on a specific potential conflict of interest: whether there could be potential incentives for a provider of both IC and FM services to encourage its IC clients to move to FM.<sup>18</sup>
- 3.14 We recognise the potential for conflicts of interest to arise in this scenario and, in common with other providers of both IC and FM, we have policies and processes in place to manage conflicts of interest that may arise (as the CMA noted in its WP<sup>19</sup>). However, we consider that the CMA's focus on this single point is disproportionate, and risks missing the bigger picture:
- (a) Over the more than eight years we have offered FM, [X] of our IC clients have become FM clients [Y]. This is not an outcome that is consistent with any concerted strategy on our part to attempt to switch IC clients inappropriately to FM. An industry-wide policy to inappropriately cross-sell services is not consistent with the results of the CMA's own survey of trustees: for example, less than a third (27%) of respondents purchasing FM services said that they had been prompted to do so by their existing provider and only 19% of schemes more generally said that their IC provider had ever suggested FM.<sup>20</sup>
  - (b) The evidence the CMA has found in relation to tendering shows such an approach would be commercially risky and counterproductive: in a market where 70% of new opportunities go to tender<sup>21</sup> (and likely more in 2018, as this is an increasing trend), a strategy to encourage clients to consider a switch into FM would likely put the appointment of their FM provider out to tender, with the risk of losing the client.

---

<sup>18</sup> The CMA has indicated that other issues relating to potential conflicts will be addressed in the Provisional Decision.

<sup>19</sup> See the Supply of Fiduciary Management Services by Investment Consultancy Firms WP, paragraph 8.

<sup>20</sup> CMA survey, page 17 (note, results cited remove "don't knows").

<sup>21</sup> CMA survey, page 69.



- (c) Any attempt to recommend an inappropriate service would be likely to damage the client relationship and the provider's reputation more widely in the market. Such an approach would risk material long-term harm to a firm's business. We focus on putting the interests of our client first; this is not only in keeping with our values as an organisation, but also ensures our reputation for quality in the market.
- (d) Finally, our full FM clients have benefited significantly from our FM offering: [§<].<sup>22</sup> These outcomes are inconsistent with clients being encouraged to take a service that is not appropriate for them.

3.15 The majority of trustees think that conflicts of interest are either not a concern at all or are being well managed.<sup>23</sup> The CMA should place weight on trustees' views, rather than that of market competitors who may have different incentives. In particular, IC-only firms arguably have a strong incentive not to raise FM with their clients, since to do so could mean losing the client to an FM provider.

3.16 For all these reasons, we believe the concern in this area is overstated and fails to take sufficient account of the measures already in place to address conflicts of interest by providers.

#### **Information on fees and quality**

3.17 The CMA's emerging finding is that customers in these markets are not accessing the "necessary information to judge the value for money of investment consultants and fiduciary managers".<sup>24</sup> This has not however been borne out by the evidence.

3.18 As mentioned at paragraph 2.3 above, the CMA survey showed the vast majority of both prospective and current clients reporting that they are satisfied with the information they receive from providers in respect of fees and performance. That notwithstanding, the CMA seeks to draw adverse conclusions on practice across the sector by relying on a small sample of documents provided to approximately 40 clients across 15 firms. It would not be appropriate for such example documents – which were not provided in the context of the wider communications between provider and client – to form the basis for any conclusion that there are widespread market failings.

## **4 Changes already taking place in the markets**

4.1 As the CMA is aware, there are a number of recent and ongoing initiatives that are taking place in these markets – and adjacent markets – that are aimed at further enhancing disclosures made to clients and continually raising standards amongst trustees. This is not a static industry. The CMA's own guidance states that when conducting its analysis of market characteristics and outcomes, the CMA should be mindful of "*any significant changes that are anticipated in the market in the foreseeable future*".<sup>25</sup> This is the relevant framework or counterfactual that the CMA should use when assessing any potential competition concerns (and the impact of possible remedies).

4.2 The most important changes are as follows:

---

<sup>22</sup> See also [§<].

<sup>23</sup> CMA survey, page 18.

<sup>24</sup> Information on Fees and Quality WP, page 8.

<sup>25</sup> The CMA's *Guidelines for Market Investigations: Their role, procedures, assessment and remedies* (CC3, revised) states that in assessing whether or not an AEC has arisen, one of the three issues that the CMA must examine is the main characteristics of the market and the outcomes of any competitive process. In conducting this examination, the guidance indicates that the CMA will look at the "*legal and regulatory framework that applies to the reference market*" and "*the history of the market...and any significant changes that are anticipated in the market in the foreseeable future*" (see e.g. paragraphs 94, and 102(c) and (e)).

- (a) **Use of tendering continues to increase:** The evidence shows that levels of tendering and use of TPEs are increasing in both the IC and FM markets. This is reflected in both the CMA's survey and third party evidence such as KPMG's FM market survey<sup>26</sup>. For example, the CMA's survey found that 70% of schemes that purchased FM for the first time, and could remember the purchase, said they ran a tender process.<sup>27</sup> Further, the evidence and data relied upon by the CMA refers to the last complete year – 2016. Our expectation, based on what we see in the market, is that the trend of tendering and using TPEs is increasing and that by the time the CMA's investigation concludes, levels will have risen even further.

Against this background, any imposition of a mandatory tendering regime, including at the point of switching from IC to FM, would be disproportionate. We are rapidly approaching the point where only a small minority of clients do not tender – and we expect, in the majority of cases, this is for a good reason (for example, where the client has tested the market in a less formal way).

- (b) **Performance standard benchmarks have been introduced:** The CMA is aware of the recent industry effort to introduce a method for comparing FM performance at the point of tender.<sup>28</sup> This initiative, to which all the major FM providers have signed up, requires providers to produce performance data in a designated form. Clients and TPEs can then use that data for the purpose of comparing providers as part of a tender. This initiative has only recently been introduced, and there is a process in place for its governance to be transferred to the CFA Institute. To the extent the CMA is considering any remedy around comparison of FM performance, this initiative is now addressing this issue.
- (c) **Fee information is being disclosed:** The introduction of MiFID II has already resulted in enhanced disclosure of fee information by FM service providers, on which we have provided detailed information to the CMA.<sup>29</sup> While these changes have only very recently come into force and it will, therefore, take some time before their full effects are felt; these changes will have a material impact on market practice.<sup>30</sup>
- (d) **Recent regulatory initiatives will raise standards further:**
- (i) Following the publication of its *Trustee Landscape* research paper, the Pensions Regulator (tPR) has introduced a number of new initiatives aimed at raising standards amongst trustees.<sup>31</sup>
  - (ii) We are mindful of the work of the FCA's Institutional Disclosure Working Group to enhance transparency in relation to fees and costs at the asset manager level. Greater disclosure by asset managers will assist IC and FM service providers, such as Mercer, in driving competition between asset managers for the benefit of clients.
  - (iii) The Department for Work and Pensions has recently been looking at ways to strengthen the DB pension system. Proposed changes include: measures to enhance the effectiveness of tPR's powers to protect scheme members; the introduction of clearer funding standards; and further consultation on scheme

---

<sup>26</sup> For example, 60% of schemes appointing an FM in 2017 received independent written advice on FM selection and appointment, compared with 23% in 2016. See KPMG's 2017 'UK Fiduciary Management Survey'.  
<sup>27</sup> CMA survey, page 69.

<sup>28</sup> We refer to the performance standard proposed by IC Select.

<sup>29</sup> See paragraphs 1.1(d) and 2.5 to 2.6 of our response to the CMA's Information on Fees and Quality WP.

<sup>30</sup> In this context, we note that the CMA's *Guidelines for market investigations: Their role, procedure, assessment and remedies* (CC3, Revised) specifically states that in assessing the effectiveness of different remedy options, the CMA "may need to take account of existing law or regulations either currently applicable **or expected to come into force in the near future**" [emphasis added]. The guidance states that such legislation may include both UK and EU legislation and directions (for example, MiFID II).

<sup>31</sup> For example, the introduction of the "Trustee Toolkit" (available at <https://trusteetoolkit.thepensionsregulator.gov.uk>).

consolidation, a development we consider has the potential to enhance trustee governance and increase access to certain services.<sup>32</sup>

- 4.3 Given the effect of the measures outlined above, both individually and in combination, any concerns identified by the CMA will be short-lived as the changes described above take effect.

## **5 Conclusion**

- 5.1 We have made the point in previous submissions that as a result of the new streamlined procedure there is a risk that the CMA identifies potentially useful changes that could be made in the market at an early stage in its investigation, and then falls into the, perhaps understandable, error of too easily identifying an AEC in order to justify those changes. We believe this is a real risk in this case: as set out above, grounds for an AEC do not exist, either on the evidence of the market as it stands and even more clearly taking into account the recent and imminent changes.
- 5.2 To the extent there are improvements that can be made, the evidence shows that these will be driven by the market itself – as has indeed happened recently with innovations such as the new initiative to provide comparability of performance between FM providers. This is the definition of a market working well and the CMA should be slow to interfere.
- 5.3 There is a risk that if the CMA intervenes in these markets it could create additional costs and restrict innovation. The negative results of this would be passed on to customers, without any benefit to competition. Indeed, trustee engagement could actually be reduced by the imposition of unnecessary and/or duplicative remedies: notwithstanding that the CMA is dealing with a sophisticated customer base, it is important that trustees are not over-burdened by time and resource-intensive measures.
- 5.4 The CMA should also give serious consideration to whether it is the appropriate body to develop and implement any remedies. In particular, as explained in paragraph 3.2 above, we note that the potential concerns identified by the CMA to date primarily relate to the demand side. Given this, in our view, tPR is best placed to address those concerns in light of its own ongoing work to raise trustee standards.

---

<sup>32</sup> See [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/691305/print-ready-protecting-defined-benefit-pension-schemes.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/691305/print-ready-protecting-defined-benefit-pension-schemes.pdf).