

26 June 2018

Mr P Swan
Competition and Markets Authority
Victoria House
37 Southampton Row
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Dear Peter

Submission from Aon ahead of the CMA's provisional findings

At this point, halfway through the CMA's Market Investigation, we would like to take the opportunity to summarise our views of the CMA's evidence and our views on the findings that have emerged so far.

We were the only firm to make an initial submission to the CMA when the Market Investigation commenced in September 2017, where we stated that:

- Offering increased choice to clients has driven the evolution of our services
- We face a wide range of effective competitors
- Barriers to entry within our markets are low
- Trustees are very capable of assessing the service we offer
- We recognise and manage the potential conflicts we face
- Transparency and consistency of information on service quality and fees could be enhanced

These views have been echoed consistently within the CMA's working papers. Indeed, based on the findings to date, the CMA has not made a clear case to conclude that there is an adverse effect on competition (AEC) in the market under any of the CMA's three theories of harm.

In this submission, we set out some concerns regarding the CMA's analysis and approach, our views on the CMA's investigation and potential remedies. Four points deserve emphasis:

- **First**, there are areas where the CMA needs to obtain a better understanding of the complex market in which we operate, before it can reach meaningful conclusions. For example, we and others have highlighted major concerns about the validity of the CMA's findings on asset manager recommendations. Similarly, the CMA's analysis of gains from trustee engagement does not enable it to conclude that a clear minority of less engaged customers (trustees) do not benefit from the engagement of the vast majority of schemes. It is imperative that the CMA bases its provisional findings on robust and clearly-established evidence.
- **Second**, the early discussion of highly speculative and intrusive remedies has, in this case, stifled competition. Some clients have been reluctant to purchase FM services and some TPEs are urging caution over the use of investigated FM firms, due to the possibility of a divestment remedy. We urge the CMA to discard those remedies that are now clearly

disproportionate to, and unjustified by, the CMA's findings. This will enable choice for customers to be maintained.

- **Third**, to justify a remedy as draconian as structural separation or the prohibition of cross selling, the CMA would need to demonstrate unequivocally that this would eliminate potential conflicts in the most proportionate way. However, such a remedy would fail to do so by:
 - Requiring customers to navigate new conflicts of interest - for example, those arising in IC-only firms who would not be motivated to recommend FM.
 - Reducing product choice (e.g, removing the option of purchasing partial delegation packages).
 - Reducing the number of available IC and FM providers.
 - Creating barriers to entry into FM, despite non-integrated IC providers being otherwise well-placed to enter the FM segment, due to the ability to share IC and FM resources.
 - Raising the costs of operating as either an IC or an FM provider.

Less intrusive but more effective remedies are available to better-manage potential conflicts of interest, particularly by providing better information to empower trustees. Overall, a structural remedy would be unnecessary, materially disproportionate, and we would oppose it in the strongest terms.

- **Fourth**, any remedies imposed should not be devised in a silo. The working paper on asset manager recommendations illustrates that the wrong conclusions can be reached absent industry knowledge. We believe there is a place for a regulator assisted by an expert industry body to facilitate the transparent and consistent presentation of quality and fees. It could also hold market participants to account for managing potential conflicts. The regulator and industry body will need in-depth market understanding and engagement with market participants to reach solutions that will help customers.

1. OUR VIEWS ON THE EVIDENCE COLLATED BY THE CMA

Theory of Harm 1 – Demand side and information issues: whether difficulties in customers' ability to effectively assess, compare and switch investment consultants result in weak incentives for investment consultants to compete for customers.

- 1.1 The CMA's investigation has found that customer satisfaction is high, that trustees have a broad range of providers and that there is no general shortfall across the sector in providing information, albeit that it can vary in the level of detail and presentation. We refer the CMA to our response to the working paper on trustee engagement, which sets out our view that trustees are considerably more competent and experienced, and place

IC and FM service providers under significantly more competitive pressure, than the CMA appears to conclude is the case.

1.2 We are concerned that the CMA's analysis is incomplete and/or flawed:

1.2.1 The heart of this market investigation concerns trustee decision making and behaviour. However, there is a material absence of any analysis of the factors that influence trustee decisions.

1.2.2 The CMA has focused only on four narrow indicators of engagement – switching, tendering, undertaking a formal review of fees and/or quality and undertaking an external review of fees and quality. These are not representative of the broad nature of engagement with customers.

1.2.3 The CMA's gains from engagement analysis is based only on IC and FM fee rates and spend. It ignores other measures of value such as schemes' outcomes.

1.3 Thus, whilst there may be areas where improvements can be made in the sector (and where there seems to be consensus to do so) by encouraging greater consistency in performance disclosure, improving transparency or raising standards, the CMA has not presented sufficient evidence to find that trustee behaviour results in weak incentives to compete for customers.

Theory of Harm 2 – Conflicts of interest: whether conflicts of interest on the part of investment consultants reduce the quality and/or value for money of services provided to customers.

1.4 We stated at the outset of this investigation that we recognise potential conflicts of interest can arise in our sector, just as they can arise for firms in the asset management sector and in any professional services organisation where revenues can be increased by extending more services to existing clients. This does not indicate a competition problem, nor is the existence of a potential conflict sufficient to support the finding of an AEC.

1.5 Our evidence, the CMA's working papers, and third party responses demonstrate, that potential conflicts are widely recognised in the sector and measures have been implemented to address them. Consequently, 70% of trustees consider that conflicts are not a problem or are generally well managed.

1.6 There is also no clear or consistent evidence that IC customers are being sold FM services when not in their interests, or that they receive poor quality services or poor value for money. FM has provided choice to pension schemes and satisfaction levels are high. Yet we are concerned that the CMA may place undue weight on tentative or erroneous findings:

- 1.6.1 *Potential conflicts of interest affect a 'large' part of the market.* This is inaccurate as the Trustee Survey indicated on 74% of occasions FM services are not purchased at all.
 - 1.6.2 *Clients being 'steered' into FM.* The CMA cannot infer 'steering' simply because trustees have not switched provider or have not used a third party evaluator.
 - 1.6.3 *Switching is more costly and takes longer in FM than IC.* This fails to distinguish between the costs arising from the switching process itself, and the costs incurred from changing strategy, which is incurred up-front for FM but not for IC.
 - 1.6.4 *Trustees achieve a better price in FM by switching provider when moving from IC to FM.* The CMA simply refers to 'corroborating evidence' but the CMA's evidence in fact suggests internally acquired schemes pay less than externally acquired schemes.
- 1.7 The CMA's analysis is also materially deficient in some other key areas:
- 1.7.1 The CMA has failed to consider 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 (despite the CMA indicating that it would consider these conflicts).
 - 1.7.2 The CMA has not analysed the factors influencing trustees' decision on whether or not to use an FM provider that is not the incumbent IC provider.
- 1.8 In drawing conclusions, we urge the CMA to take account of the significant benefits brought to clients by integrated service offerings, notably the substantial efficiencies and the lowering of barriers to entry and growth into FM.
- Theory of Harm 3 – Barriers to entry and expansion: whether barriers to entry and expansion reduce competitive pressure on ICs, leading to worse outcomes for customers.***
- 1.9 The CMA has found that the IC and FM segments are competitive and neither is highly concentrated. It has also found that there has been sustained and significant market entry over the last 10 years, with the IC and FM segments still growing. The CMA has been unable to conclude that firms in either IC or FM make excessive profits. As such, pension schemes have a range of providers from which to purchase services. Larger firms are and will continue to be vulnerable to the competitive threat from smaller firms entering and expanding in the market.
- 1.10 In spite of these findings, and whilst the CMA concludes that no firm has market power in IC or FM, the CMA appears to suggest that integrated IC-FM firms have a strong

incumbency advantage such that this presents a barrier to other IC/FM providers expanding in the market. We see no evidence supporting this conclusion or to suggest a competition problem:

- 1.10.1 The FM segment is expanding with entry/ growth by non-integrated providers.
 - 1.10.2 Success rates are not directly linked to the number of tender processes participated in or the scale of any existing client base.
 - 1.10.3 Tenders are widespread and market testing is more extensive for trustees who purchase multiple services from the same providers.
- 1.11 Further, we see no basis to conclude that the three largest IC firms “*could continue to collectively gain market share*” in FM. Even the CMA notes that this is a ‘possibility’ that is ‘hard to predict’. Moreover, the only evidence cited to support it are internal documents from Aon, Mercer and WTW that express a desire to grow further, while the CMA has not analysed the growth plans of other competitors.
- 1.12 These findings mean that there is no basis on which the CMA can find an AEC. There are no fundamental concentration or incumbency issues to warrant onerous structural remedies that would damage incentives to enter or expand in the market.

2. OUR VIEWS ON POSSIBLE REMEDIES

- 2.1 We consider that the CMA’s principal aim from the market investigation should be to secure better outcomes for customers and their employees. In our view, this means that to the extent the CMA does choose to impose remedies, these would be most effective if targeted at providing practical support to trustees to make informed and effective decisions when selecting an IC or FM provider. In doing so, trustees should be better able to exploit competitive opportunities that are already open to them. Any remedies that increase cost would be to the detriment of clients with DB plans and would directly reduce outcomes for members of DC plans.

Possible remedies which might benefit pension schemes

Measures to encourage trustee engagement

- 2.2 To drive trustee engagement, any remedy needs to facilitate trustees achieving value for money; having the necessary information to decide whether FM meets their needs; and choosing the best IC or FM provider for their circumstances.
- 2.3 The best FM provider will often quite legitimately be a scheme’s existing IC advisor and remedies should not be designed merely to facilitate or encourage switching.
- 2.4 Targeted measures to encourage greater trustee engagement via enhanced, but proportionate, trustee performance reporting could ultimately help to ensure that

trustees are responsible for operating their schemes in a manner that is sufficiently focussed on guarding their members' (*i.e.*, consumers') interests.

- 2.5 We support measures to assist trustees in undertaking tendering and market-testing exercises, such as the production of tender toolkits, although the CMA should not mandate them.

Measures to provide better information to trustees

- 2.6 We support the provision of better, more transparent and comparable information to trustees on IC and FM performance. Any remedy would also need to be developed closely in conjunction with the industry to take account of the necessary technical issues while being sufficiently flexible. This could be accredited by the CFA under their Global Investment Performance Standards.
- 2.7 We accept that a degree of standardisation of presentation could make it easier for trustees to compare product recommendations, but the CMA should avoid any measure that restricts choice or stifles innovation.
- 2.8 We also see benefits in a range of other measures to better inform trustees, including segregating advice and marketing materials and the work of the FCA's Institutional Disclosure Working Group (IDWG).

Extending the perimeter of FCA regulation

- 2.9 Bringing the supply of IC and FM services within the FCA's perimeter could be an effective way to require every IC and FM provider to implement a clear client communication framework. This would enhance transparency, manage conflicts of interest and encourage clients to consider the full range of options when selecting an FM provider.

Possible remedies which might disadvantage pension schemes

Divestment and other structural remedies

- 2.10 As explained above, the CMA has not presented sufficient evidence to show any AEC, let alone one for which such an extensive remedy would be appropriate. Structural or separation remedies would cause immense harm to market participants and would fail the CMA's proportionality test.

Proposal to prohibit the cross-selling of IC and FM services

- 2.11 Similarly, there is no evidence to justify this remedy. It would reduce choice for trustees, and therefore competition, by significantly reducing the ability of firms to offer integrated services. All professional services firms have the ability and incentive to cross-sell services, and conflicts of interest can be effectively managed.

Mandatory switching

- 2.12 This would comprise a particularly onerous remedy that would reduce choice and may result in negative outcomes for clients. Given that the CMA does not appear to have concerns with respect to the extent of industry concentration or existing switching rates, it is difficult to see what issue this remedy would address.

Mandatory tendering on a periodic basis

- 2.13 An ongoing requirement to tender on a periodic basis may similarly result in negative outcomes by forcing clients to go out to tender when the client has no issues with its current provider.

We await the CMA's provisional findings with interest and look forward to continuing our engagement with you.

Yours sincerely

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