Investment Consultants Market Investigation

Appendix A1: Competitive Landscape

- 1. In this Appendix we set out supplementary analysis in relation to our provisional analysis and conclusions in Chapter 4 of the report.
- 2. In particular, we present our analysis of the size of the investment consultancy market through time, and our analysis of the size and concentration within individual candidate segments of the investment consultancy and fiduciary management markets. We also set out our views on the implications of joint purchasing with actuarial and administration services for market structure. We discuss each aspect in turn.

Evolution of the size of the investment consultancy market

3. As set out in paragraph 4.71, we have calculated the size of the investment consultancy market, based on the revenues submitted to us by Parties and in nominal revenue terms, over the last ten years. This analysis is shown in Figure 1 below.





Source: CMA Analysis, Parties' Data

- 4. Figure 1 shows that the investment consultancy market has been growing through time. Over the ten years for which we collected data, it has approximately doubled in size.¹
- 5. We understand that DC has been an area of particular growth as members are increasingly enrolled in schemes other than DB schemes. We therefore examined how total revenue for DB and Hybrid schemes on the one hand, and DC schemes on the other hand, have increased relative to their sizes in 2007. The vertical axis shows the percentage of that segment's size compared to its size in 2007.

Figure 2: Size of the 'DB/Hybrid' and 'DC' segments of the market for investment consultancy services to pension schemes through time



Source: CMA Analysis, Parties' Data

- 6. Figure 2 shows that the DB segment doubled in size over the ten-year period. Given the market is mostly comprised of DB pensions, it is unsurprising that this figure is around the same as the figure for the whole market.
- 7. Figure 2 also shows that there has been much more significant growth in DC schemes over this period, and a significant uptick in the last few years

¹ We have not collected data from any firm which is not currently active, which may understate historical shares if any firms had exited. However, we are not aware of significant market exit over this period. In the timeseries data, we are also unable to apply an estimate of the percentage of the market not covered by our data gathering exercise. We have this data only for our static analysis. As a result, the total market size here is likely to be a lower bound.

(possibly consistent with the roll out of autoenrollment), although the DC segment remains comparatively small in absolute terms at present.²

8. We undertook similar analysis for the fiduciary management market; given the greater importance of dynamics in the fiduciary management market to this investigation, this analysis is presented in paragraph 4.99 rather than here in the appendix.

Segmentation of the investment consultancy market

- 9. As set out under market definition in Chapter 4, we have not found it necessary to define separate markets by customer type, nor have we found it necessary to conclude on precise segmentation within the investment consultancy market.
- 10. Nevertheless, we recognise that competitive conditions may vary somewhat along particular scheme characteristics and that our competitive assessment should take this fact into account. We have therefore conducted analysis of concentration within particular segments along scheme size and type. The boundaries of these segments are considered indicative-only.

By scheme size

- 11. In line with approaches we have seen in the industry, for the purposes of this exercise we have used the following indicative thresholds to assess variation in concentration by scheme size.
 - (a) Small: schemes with assets of less than £100 million;
 - (b) Medium: schemes with assets of between £100 million and £1 billion, and
 - (c) Large: schemes with assets greater than £1 billion.
- 12. We show the sizes of each of these segments below in revenue terms. The blue portions of each bar represent the revenues firms have confirmed to us in our data gathering exercise. The black portion represents our estimate of the size of that part of the segment we did not cover in this exercise, as explained in the section on analysis of market structure.

² Both the segment for hybrid schemes, as well as the total revenues provided to other institutional investors have grown significantly over this period. However, due to concerns about the categorisation of our data in the former and the coverage of the market in the latter, we do not display this growth on the below chart or place weight on this finding.

Figure 3: Total revenues in the segments for 'large', 'medium' and 'small' clients within the market for investment consultancy services to pension schemes



Source: CMA Analysis, Parties' Data.

- 13. Figure 3 shows that each segment is of comparable size. That is, investment consultants in aggregate gain roughly as much revenue from 'large' schemes as they do from 'medium' schemes, and almost as much from 'small' schemes.
- 14. We have also calculated the size of each segment in terms of assets under advice and number of clients. These statistics are presented below.

Table 1: AUA and Number of Clients in investment consultancy pensions market, segmented by scheme size

		£bn
Scheme Size	AUA*	Number of Clients
Small	74	2,802
Medium	263	1,022
Large	2,025	470
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Source: CMA Analysis, Parties' Data. * Note: Figures rounded to the nearest whole number

15. When split by assets under advice, 'large' clients are found to account for almost the whole market. When split by number of clients, 'small' clients are found to account for most of the market. This is because there are a very small number of very large clients, and a very large number of very small clients: even though there are about six times fewer 'large' clients, in total they account for 27 times the AUA of small clients (although less than 1.5

times the revenue).³ Using revenue as a market shares metric avoids us assigning too much weight to schemes of any given size when calculating shares.

16. We have calculated shares of supply across each of these client types (using revenue). The following chart shows shares of supply for the largest five providers in each segment, all other providers are aggregated together.⁴

Figure 4: Shares of supply in the segments for 'large', 'medium' and 'small' clients within the market for investment consultancy services to pension schemes

[※]

Source: CMA Analysis, Parties' Data. Parties listed alphabetically within groups.

- 17. Figure 4 shows that the combined shares of supply for the largest three providers of investment consultancy services (Aon, Mercer and WTW) increase with scheme size. Specifically, their combined shares are below 30% for 'small' schemes, 45% for 'medium' schemes and 56% for 'large' schemes.⁵ In each segment these three investment consultants are the largest three players. The fourth and fifth largest firms remain of notable size.
- 18. The five-firm concentration ratio (ie the combined share of supply of the largest five firms, shown as that percentage of each bar which is not coloured grey or black in the chart above) is around 20 percentage points higher for large schemes than for small schemes.⁶
- 19. Although the segment for supply to smaller pension schemes is particularly unconcentrated, the figures above demonstrate that concentration is higher for the largest pension schemes.
- 20. However, the characteristics and purchasing behaviours of these large schemes may mitigate the impact of the greater concentration faced by these customers. For example, attendees of our pension in-house investment staff roundtable considered that larger schemes are less dependent on investment consultants because they are able to do more

³ This may be because large clients undertake a lot of small project work, use multiple investment consultants (and therefore may be double counted) or because the market is simply very skewed by measures of AUM and Number of Clients.

⁴ If a particular firm is one of the largest five firms in the large client segment but is, say, seventh largest in the medium client segment, that firm will appear with a coloured portion of the large client stack but will be part of the grey 'Other (known)' portion of the medium client stack. We have pseudonymised the firm identities: due to the method used, firms which are not in the chart will appear in the key.

⁵ These are lower bounds, the corresponding upper bounds are 32%, 49% and 60%.

⁶ The chart is ordered by the share of each firm in the market as a whole.

work in-house, particularly that of a more routine nature, and pick and choose different advisors for specific bits of advice.⁷

By scheme type

- 21. We have also broken the market down into segments based on scheme type. The revenue received from advice to DB pensions represents the majority of the market. DC pensions together appear to constitute a very low fraction (about 10%) of the total market.⁸ This remains true when we consider the number of DC clients and the value of DC assets relative to those for DB and Hybrid schemes.
- 22. Looking within these segments, we have calculated shares of supply to indicate whether clients of particular types are likely to face greater concentration than the average for the market overall. We present the shares of the top five providers in each segment in Figure 5 below.

Figure 5: Shares of supply in the segments for 'DB/Hybrid' and 'DC' clients within the market for investment consultancy services to pension schemes

[※]

Source: CMA Analysis, Parties' Data. Parties listed alphabetically within groups.

- 23. The chart shows that the largest five firms in each segment make up about 60% of each segment. Concentration in the DB pension segment looks very similar to concentration in the market as a whole: this is unsurprising because over 80% of the market is DB pensions.
- 24. Concentration in the DC segment appears to be lower: whilst the five-firm concentration ratio for DC schemes is comparable, the combined shares of Aon, Mercer and WTW is notably lower and two are smaller than other mid-size players in this segment.

Differentiation at service level

25. Investment consultancy services usually include combination of discrete elements, such as strategic asset allocation advice, liability hedging or manager recommendations.

⁷ Summary of discussion with pension scheme in house investment staff: 16 May 2018, paragraph 5

⁸ We note that we have relied on investment consultants' own classification of schemes between types. If investment consultants advise mainly on the DB portion of Hybrid schemes, it may lead investment consultants to have categorised them mainly as DB schemes. We have therefore aggregated together DB and Hybrid schemes. This is consistent with practice sometimes taken in this industry. Note that if some of these schemes are actually DC schemes, this would lead us to understate the size of the DC market.

- 26. For schemes which require particular services such as liability hedging, their options for their main investment consultant might be constrained to those providers which offer that service. In practice however, almost all investment consultants from which we obtained service level data offered advice on the full range of services.
- 27. We considered whether the evidence showed only a small subset of these providers could provide high quality, highly complex, or highly cost-efficient advice, such that differentiation between providers would systematically constrain trustees' choices. Responses stated that although firms vary in their resourcing and abilities to conduct either very complex analysis or very cost-effective analysis, there remain a significant number of options for clients seeking advice of each type.⁹ Further, there are many ways in which schemes' demands differ, such that the suppliers of investment consultancy services cannot be divided in any meaningful way.
- 28. Even if a client were forced to choose a particular firm due to their strength in one individual service offering, we consider that they would not necessarily have to use that same firm for all services. Some customers will contract for 'ad-hoc' project work from another investment consultant focussing on one of these services.¹⁰ Bfinance told us that another form which multiple consultant usage can take is for schemes to use a roster of several advisers.¹¹
- 29. In practice however, we note that most clients of all investment consultants purchase a full range of services from that main investment consultant. The CMA survey shows that at least 70% of schemes purchase strategic asset allocation, asset manager selection, reporting and operational services and advice on setting scheme objectives from their main investment consultancy provider. At least 60% also purchase monitoring and de-risking services, design of liability hedging and dynamic asset allocation from their main investment consultant.^{12,13}

⁹ Responses to the Market Information Request

¹⁰ Although some investment consultants told us that ad-hoc work for non-retained clients makes up less than 15% of their business, some firms told us that a relatively high proportion of their work for retained clients might be treated as project work. For example, [\ll].

¹¹ Bfinance's response to the Competitive Landscape Working Paper, page 2

¹² CMA survey.

¹³ Whilst schemes may use multiple consultants for these services, this does not undermine the point that most schemes appear able to purchase a full range of services from their main provider, implying that there is not sufficient differentiation in the nature of the service level offerings of investment consultants to require segmentation of the market by services.

Segmentation of the fiduciary management market

30. As we did in our assessment of the market for investment consultancy services to pension schemes, we have conducted some analysis at segment level.

By scheme size

31. We have segmented the market by scheme size. We present the total size of each segment in the bar chart below, again dividing the market into 'large, 'medium' and 'small' schemes.

Figure 6: Total revenues in the segments for 'large', 'medium' and 'small' clients within the market for fiduciary management services to pension schemes



Source: CMA Analysis, Parties' Data

- 32. Figure 6 shows that the segment for 'medium' size schemes is larger than the segment for 'large' and 'small' schemes.
- 33. As a sensitivity, we have also calculated the size of each segment as measured by AUM and number of clients. We set this information out in Table 2 below.

Table 2: AUM and number of clients in fiduciary management pensions market,segmented by scheme size

		£bn
Scheme Size	AUM	Number of Clients
Small	40.6	738

Medium	45.8	213			
Large	75.4	29			
Source: CMA Analysis, Parties' Data					

- 34. Table 2 shows that only 29 'large' clients use fiduciary management, as compared with over 700 'small' clients. Yet these 29 clients account for a greater value of AUM and revenue than investment consultants obtain from the 'small' clients. So, as for investment consultancy, a very small number of clients account for a very large share of assets in the market. As such, we consider that revenue is the best metric to use for market shares.
- 35. We have calculated shares of supply across each of these client size bands. This analysis is presented using a stacked bar chart in Figure 7 below. We show the shares of the largest five firms in each segment, representing the remainder in the grey portion of the bars, and the estimate of the market size not covered in the black portion of the bars.

Figure 7: Shares of supply of the top five providers in the segments for 'large', 'medium' and 'small' clients within the market for fiduciary management services to pension schemes

[※]

Source: CMA Analysis, Parties' Data. Parties listed alphabetically within groups.

- 36. The chart shows that the largest five suppliers across the market as a whole vary across segments, although [≫] and [≫] are amongst the largest five providers in each segment. [≫] is not amongst the largest five providers for 'large' clients.
- 37. The largest five firms in each segment make up (at most)¹⁴ around 70% of revenues in each segment. The segment for large schemes appears the most concentrated, with the three biggest firms accounting for over half the market. As set out above however, we consider that larger schemes have characteristics which mitigate against higher concentration. The segment for small and medium size schemes appears to be less concentrated.

By scheme type

38. Fiduciary management revenues were reported to us as being overwhelmingly comprised of DB schemes. Whilst DC schemes do purchase fiduciary management services, the form which this takes can vary. We have not found it necessary to provide specific figures at scheme type level for fiduciary management.

¹⁴ These shares are likely to represent lower bounds because we believe the estimate of the percentage of the market not covered in our data exercise may overstate the true size of this segment.

Differentiation at service level

- In contrast to advisory work, we understand that clients do not purchase fiduciary management services in a project- or ad-hoc based setting.
 Consequently, the division of services is less meaningful than in advisory work, where one may in theory be purchased in isolation from the others.¹⁵
- 40. Further, although some fiduciary managers are specialists in particular aspects of fiduciary management, for example dynamic liability hedging, we understand that almost all fiduciary managers can offer a full range of services. Therefore, we consider that the concentration faced by customers in need of aspects of fiduciary management such as hedging or partial/bespoke mandates would not be materially higher than in the market for fiduciary management services to pension schemes as a whole. As a result, we have not conducted analysis at this level.

Joint purchasing with actuarial and administration services

- 41. Stakeholders told us that investment consulting services are distinct from services such as actuarial advice and administration services. For example:
 - *(a)* WTW told us that 'the formal separation of actuarial and investment appointments was recommended in the Myners Report of 2001 and has been considered best practice since then'.¹⁶
 - (b) Capita told us that 'there is a clear boundary between actuarial and investment [advice] services, as our investment advisors are authorised by the FCA and the actuaries are not'.¹⁷
- 42. Nevertheless, several firms told us that there were complementarities between the services described above and other services which their clients may purchase. For example:
 - (a) WTW told us that although there were a relatively small number of areas where actuarial services and investment consultant services converged, in some cases actuarial and investment services are complementary inputs.¹⁸

¹⁵ DB customers generally purchase each service within fiduciary management. We understand DC customers likewise generally purchase several services, although they are less likely to buy dynamic liability hedging or dynamic asset allocation.

¹⁶ WTW's response to the market information request, question 5c.

¹⁷ Capita's response to the market information request, question 5c.

¹⁸ WTW's response to the market information request, question 5c.

- (b) Aon told us that 'Most well-run pension schemes take Integrated Risk Management (IRM) seriously. IRM is the consideration of the sponsor covenant, the actuarial valuation and the investment strategy holistically. Large portions of the IRM can be and is done either by an actuary or by an investment adviser.¹⁹
- 43. The areas where actuarial techniques and investment consulting may converge, include asset liability modelling and construction of Liability Driven Investment portfolios, as well as advice on integrated risk management frameworks considering funding arrangements, investment strategy and the sponsor's covenant.
- 44. Several firms told us that it is immaterial whether they provide the actuarial services or the actuary is employed by a different firm; in each case they will work with the actuaries to provide joined-up services.
 - (a) JLT told us that a number of their larger clients use other actuarial firms. JLT told us that they consider a joined-up approach integral, and so they would look to set up monthly calls between themselves and the actuary, just as they do with clients for whom JLT provides the actuarial services.²⁰
 - (b) Xafinity told us that 'we have seen external actuaries advise on appropriate return targets and levels of risk.'²¹
 - (c) In the context of actuarial and administration advice, Mercer told us that 'The client may appoint a number of advisors to assist them in managing their pension fund. Mercer is often expected to work with professionals from other companies and firms'.²²
- 45. However, for most firms, a majority of schemes do purchase these services from the same provider. We provide the figures for these below where firms gave us this information.²³

Figure 8: Percentage of DB investment consultant clients purchasing actuarial services from the same firm, split by firm.

[%]

Source: CMA Analysis, parties' estimates

¹⁹ Aon's response to the market information request, question 5c

²⁰ JLT's response to the market information request, question 3.

²¹ Xafinity's response to the market information request, question 5c.

²² Mercer hearing summary, paragraph 22.

²³ Information sourced from each firms' responses to the market information request.

- 46. Figure 8 shows that the percentage of clients purchasing DB investment consultancy services who also purchase actuarial services varies significantly by firm, but in all cases is a substantial fraction. Of the firms who provided data, one of the largest IC-FM firms ([∞]) had the lowest percentage of clients also purchasing actuarial services at [∞]%, whilst [∞] had the highest at around [∞]%.
- 47. Consistent with these figures, the CMA survey showed that 59% of DB schemes purchase actuarial services from the provider of their main investment consultancy services. The figure was similar for Hybrid schemes, but lower for DC schemes (16%).
- 48. As regards scheme administration, the CMA survey showed that about half of schemes of all types purchased this service from their main investment consultancy provider.
- 49. Many parties told us that although firms might purchase investment consultancy (or fiduciary management) services in addition to administration or actuarial services from the same provider, the incidence of joint tenders is (i) demand side led and (ii) more infrequent. That is, the investment consulting part of the services purchased might be open to competition from a full range of providers.
- 50. Nevertheless, there appears to be a notable group of pension schemes which prefer to purchase these jointly.
 - *(a)* KPMG told us that 'A number of smaller pension schemes prefer a bundled investment and actuarial service and we are more often appointed to deliver full service trustee services to these clients'.²⁴
 - *(b)* WTW told us that 'some small clients actively choose to have their actuarial provider also provide investment services in a bid to simplify governance arrangements'.²⁵
- 51. Aon told us that 13% of tenders, for investment consultancy and/or fiduciary management services they were involved during 2016 in were combined with a tender for actuarial services.²⁶ WTW told us similarly that fewer than 20% of tenders were combined in this way. Hymans also told us that such joint tenders are not common, particularly for larger clients.²⁷

²⁴ KPMG's response to the market information request, question 5.

²⁵ WTW's response to the market information request, question 5.

²⁶ Aon's response to the market information request, question 5

²⁷ WTW's response to the market information request, question 5; Hymans' response to the market information request, question 5.

- 52. For clients of other firms however, this scenario seems more common. LCP and Barnett Waddingham provided figures showing around a third of their (successful) tenders involved joint provision of services. ²⁸ Capita and JLT told us the 'vast majority' of their new tenders are of this type,²⁹ Xafinity told us this scenario is 'very typical'³⁰ and Spence & Partners told us it is typical.³¹
- 53. In such cases, clients' choice sets will include only those firms which are able to offer all the relevant services, and the market may appear more concentrated.³² We have therefore conducted analysis to assess the degree of concentration amongst firms which we understand also offer actuarial services.

Customers jointly purchasing actuarial services

54. We have calculated shares of supply for that group of firms which also offer actuarial services. We acknowledge that these shares include customers who may not purchase actuarial services. We show these in Figure 9 below.

Figure 9: Shares of supply for investment consultancy services to pension schemes, including only firms which offer actuarial services.

[※]

Source: CMA Analysis, Parties' Data

55. Figure 9 shows that concentration amongst these particular firms is not significantly higher than for the market as a whole. The largest three investment consultancy providers have the largest share amongst these firms, however there remain a large number of other significant players.

Other joint-purchasing customers

56. We do not have consistent data on which firms also offer scheme administration services. Nevertheless, we understand that it is common to provide this service if the firm also provides investment consultancy services,

²⁸ LCP's response to the market information request, question 5; Barnett Waddingham's response to the market information request, question 5.

²⁹ Capita's response to the market information request, question 5; JLT's response to the market information request, question 5.

³⁰ Xafinity's response to the market information request, question 5

³¹ Spence and Johnson's response to the market information request, question 8

³² Even where clients do not conduct market searches or tenders for investment advisory and either actuarial or administration services jointly, if clients (a) value the joint provision of services and (b) have already appointed the provider for one of the above services, competition may be weaker.

and that there would therefore be a large number of such providers available.

57. We therefore do not consider that customers who wish to purchase investment consultancy services from the same provider as their administration provider would face significantly higher levels of concentration than customers of similar types set out in the segment breakdowns above.

Provisional view on joint purchasing customers

58. Our provisional view is therefore that concentration is not materially higher for customers which purchase actuarial or administration services jointly with investment consultancy services.

Appendix A2: Manager recommendations analysis

Introduction

- 1. In this appendix we set out the methodology and present the results of the quantitative analysis we have conducted in order to test whether investment consultants collectively are able to improve pension schemes' investment returns by recommending asset management **(AM)** products that outperform their benchmarks, on average.
- 2. This analysis fits into (i) our assessment of outcomes in terms of whether investment consultants are providing value for money in relation to the quality of their services; (ii) our assessment of the information available to pension scheme trustees on the performance of recommendations and (iii) proposed information remedies.
- 3. This appendix is organised as follows:
 - (a) we describe the data used in our quantitative analysis and detail the process of building our working dataset;
 - (b) we outline our quantitative analysis and explain our choice of methodology;
 - (c) we summarise our results and discuss the main extensions and sensitivities we have conducted; and
 - (d) we present our provisional conclusions.

Data sources and the process of building our final data set

- 4. Our aggregate quantitative analysis (across investment consultants) is based on a data set combining:
 - (a) Information on the returns of AM products and of their benchmarks, spanning the period between 2006 and 2015. This data was originally sourced from eVestment by the FCA and used for the FCA's Asset Management Market Study, 2016.
 - (b) Historical information on investment consultants' ratings of AM products. Ratings data was directly sourced from a sample of eight investment

consultancy firms, namely Aon, Capita, Hymans, Redington, Russell Investments, WTW, KPMG and LCP.³³

- 5. Mercer has not been included in our aggregate analysis as it does not subscribe to eVestment. We have therefore conducted a standalone analysis for Mercer, using Mercer's proprietary Global Investment Manager Database (GIMD) of returns.
- 6. In the following paragraphs
 - (a) we describe our main data sources (eVestment, Mercer's Global Investment Manager Database, ICs' historical ratings data) and discuss how their limitations may have affected our analysis and our results;
 - (b) we set out and explain the steps we took in preparing the data set used for our final analysis and discuss how our handling of the data set may have affected the results of our analysis; and
 - (c) assess how representative our final data set is and discuss the implications for our provisional conclusions.

The eVestment database

- 7. EVestment is an established third-party data provider that is widely recognised in the asset management industry and used by the majority of the investment consultants in our sample.³⁴ It contains data on investment funds under traditional and alternative management.
- We have used the same eVestment data that was used by the FCA in its Asset Management Market Study in 2016. This data set includes information on:³⁵
 - (a) the returns of AM products;
 - (b) manager specified benchmarks for these products and their respective returns;

³³ Compared to the FCA analysis, we have increased the sample of firms from 6 to 8. We also attempted to include Cambridge in our analysis, but were unable to match any of their ratings into our eVestment dataset because the product identifiers submitted by Cambridge did not correspond to valid eVestment product codes (IDs).

³⁴ With the exception of Mercer.

³⁵ In addition to the variables listed above, the data set also contains information on the dates AM products were incepted, the dates they were added to eVestment as well as the dates they became inactive. eVestment data further indicates whether reported returns have been simulated and specifies the affected period and; maps AM products to the appropriate asset classes and vehicle types.

- (c) assets under management (AUM) for these products and;
- (d) AM fees.
- 9. In their submissions, several parties have referred to the limitations of the eVestment data set, making special reference to its product coverage, its timespan and quality issues with the reported data. We summarise and discuss these concerns below.

(i) The coverage of the eVestment database

- 10. Several parties submitted that the eVestment database only accounts for a small subset of the market and the AM products that are available to UK investors. In particular:
 - (a) Redington submitted that eVestment has a disproportionate focus on listed, liquid asset classes.³⁶
 - (b) Hymans submitted that an increasing amount of IC recommendations focus on alternative assets, which are under-represented in the eVestment universe.³⁷
 - (c) Russell Investments submitted that the limited coverage of alternative products in the data is likely to bias the results of our analysis given the relatively high active returns for this asset class.^{38,39}
- 11. We acknowledge that the eVestment database does not cover all AM products, and that it has better coverage with respect to 'traditional' AM products, as compared with 'alternative' AM products. Nevertheless, alternatives (including hedge funds) account for 39% of products and 48% of observations in our version of the eVestment dataset.⁴⁰ We have further considered whether the fact that certain asset classes are under-represented in the eVestment database may have affected our results. Taking into account the points raised by the parties, we have identified two ways in which the asset class composition of the eVestment database may have impacted our analysis:
 - (a) To the extent that 'alternative' AM products systematically perform better (compared to the more traditional AM products), our results risk

³⁶ Redington response to CMA working paper 'Asset Manager Product Recommendations', 10 April 2018.

³⁷ Hymans' response, March 2018.

³⁸ Comments of Russell Investments on CMA's working paper 'Asset Manager Product Recommendations'.

³⁹ Alternative asset management products include hedge funds, private equity, investments in real estate, infrastructure and commodities in a variety of vehicles.

⁴⁰ Hedge funds are the main alternative asset class covered in eVestment (44% of observations).

understating the overall ability of investment consultants to identify products that improve the investment returns of their customers.

- (b) In addition, if the focus of investment consultants' recommendations has shifted towards alternative assets, as suggested by Hymans in its response to our working paper, our results risk placing undue weight on a subset of products that are not representative of the universe of investment consultants' recommendations.
- 12. Notwithstanding these limitations, we also note that eVestment is a leading data repository providing one of the most complete pictures available of traditional and alternative institutional investor and asset management trends.⁴¹ Moreover, some parties use the eVestment database when presenting information on the performance of their recommended AM products.

(ii) The timespan of the eVestment dataset used

- 13. Several parties have submitted that a longer timespan would be preferable.
- 14. In response to our working paper, WTW submitted that it has access to eVestment data for a longer time period (2000-2016). WTW challenged our decisions (i) not to update the FCA's original data set with the more recent data for 2016 and (ii) not to take into account available data prior to 2006. ⁴²
- 15. We agree that a longer time dimension would in principle be preferable. However, our version of the eVestment dataset covers a period of 10 years, which is a sufficiently long-time horizon for a rigorous and robust quantitative analysis in the present case. Over this period, we are able to observe the returns history of around four thousand products.
- 16. Whilst we have not been able to source product returns data for more recent years from eVestment, we are not concerned that our data does not include the most recent available data (ie for 2016), as no parties told us that their approach to rating or market conditions had changed significantly since

⁴¹ As noted by the FCA in Annex 6 of the Interim report for the Asset Management Market Study, published in November 2016.

⁴² WTW submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations, paragraphs 2.9, 2.10, 2.11.

2015.⁴³ Furthermore, the data indicate that most parties haven't rated substantially more products in 2016 and 2017.⁴⁴

17. Extending our analysis to include returns data for the period prior to 2006 would increase the size of our data set but we consider older data to be less relevant in assessing recent performance and the current ability of investment consultants to identify assets that improve the investment returns of their customers.

(iii) The quality of the eVestment data

- 18. In its response to our working paper, Redington has outlined its concerns regarding only using eVestment data for our quantitative analysis. In particular, Redington highlighted some fixed income examples where: multiple vehicles with different risk-return profiles and varying fees are included under the same product ID in the eVestment database; several of the investment universes in the database are incorrectly specified; some products are missing from the investment universes or; there are significant issues with the fee data.⁴⁵
- 19. The points raised by Redington regarding the quality of the eVestment data cannot be easily verified. Though Redington has given examples for each of the concerns described above, we are not in a position fully to assess the occurrence and magnitude of such issues in the data and whether such mistakes display a systematic pattern that would threaten to bias our results materially.
- 20. That being said, we further note that:
 - (a) The eVestment database is an established data repository and is widely used in the industry and by the parties. Hence, we believe that any such inaccuracies are not systematic, are infrequent and limited in magnitude.
 - (b) Our baseline analysis is conducted at an aggregated level and therefore any accuracy concerns with respect to specific products are less likely to have affected our results.

⁴³ The following parties made some clarifications. (i) Hymans said that a higher proportion of their ratings were now in 'alternative' asset classes; (ii) Redington said that ESG factors are now included in their selection criteria (iii) Several parties said that their approach was essentially the same, but that the application of this approach is continually enhanced.

⁴⁴ We have received data on ratings also for 2016 and 2017.

⁴⁵ Redington submission of April 10, 2018 in response to CMA's working paper on asset manager product recommendations.

Mercer's Global Investment Manager Database (GIMD)

- 21. Several parties, namely Hymans, Russell Investments and Aon, have noted that the exclusion of Mercer from our aggregate analysis is likely to have affected our results.
- 22. We have not been able to incorporate Mercer into our aggregate analysis as it does not subscribe to eVestment and we could not match its ratings data to returns data from the eVestment database. We have therefore conducted a standalone analysis for Mercer, using Mercer's proprietary database.
- 23. GIMD, like eVestment, contains data on the performance of asset management products (or strategies). The principal difference between GIMD and eVestment is that GIMD performance data is organised into and presented via a number of universes and (selective) sub-universes, each containing a set of comparable products and was submitted with a benchmark, which was selected by Mercer. eVestment is also organised into universes, although products need to satisfy fewer criteria to appear in a given eVestment universe and each product has an accompanying benchmark, which is chosen by the asset manager in question.
- 24. We report the results of our analysis for Mercer in paragraphs 117-120 below. We note however that the findings of the Mercer analysis are not directly comparable to the findings of our aggregate analysis (a) as a result of the underlying differences between GIMD and eVestment and; (b) given that Mercer, submitted data for a longer time period (ie between 2000 and 2017) allowing us to undertake an extended analysis over 17 years.

The ratings data

- 25. Historical information on investment consultants' ratings of asset management products was directly sourced from the investment consultants in our sample. Investment consultants submitted ratings data for the period between Q1:2006-Q1:2018.
- We have categorised the parties' ratings as 'Buy', 'Hold', 'Sell' and 'Other'.
 'Other', encompasses the more granular rating categorisations that the parties were unable to map to 'Buy', 'Hold' or 'Sell'.⁴⁶
- 27. Table 3, summarises the ratings data provided by each investment consultant, broken down by rating category (ie "Buy", "Hold", "Sell" and

⁴⁶ In its response to our Confidentiality Ring, Aon told us that we have not accurately treated the rating data it submitted and as a result we have incorrectly categorised products in some quarters. We acknowledged Aon's suggested correction and have amended our code to incorporate these changes.

"Other"). The first four columns present the number of distinct products (with a valid eVestment ID) that have been assigned a given rating in any given quarter in the period between 2006: Q1 and 2015: Q4. The last column shows the number of distinct products that have been rated by the investment consultant over that period.⁴⁷ The numbers in parentheses show the number of observations (ie product-quarter pairs) by investment consultant and by rating category.

		Buy	Hold	Sell	Other	Not valid	Total # of products
[≫]		[%]	[%]	[※]	[%]	[※]	[%]
[≫]		[≫]	[≫]	[≫]	[%]	[※]	[≫]
[≫]		[≫]	[≫]	[≫]	[%]	[※]	[≫]
[≫]		[※]	[≫]	[※]	[※]	[※]	[≫]
[≫]		[%]	[≫]	[≫]	[%]	[※]	[×]
[※]		[%]	[※]	[※]	[※]	[※]	[※]
[※]		[%]	[※]	[※]	[※]	[※]	[※]
[≫]		[%]	[≫]	[≫]	[%]	[※]	[×]
[※]		[≫]	[≫]	[※]	[%]	[※]	[≫]
[※]		[≫]	[≫]	[※]	[※]	[※]	[≫]
[%]		[※]	[※]	[※]	[※]	[※]	[※]
[%]		[※]	[※]	[※]	[※]	[※]	[※]
[※]		[※]	[※]	[※]	[※]	[※]	[≫]
[※]		[※]	[※]	[※]	[※]	[※]	[※]
[※]		[※]	[※]	[※]	[※]	[※]	[≫]
[※]		[%]	[※]	[※]	[※]	[※]	[※]
[≫]		[※]	[≫]	[※]	[※]	[※]	[≫]
[≫]		[≫]	[≫]	[≫]	[%]	[※]	[≫]
Total		1,612	849	1,046	5,750	42,151	7,092
		(21,538)	(8,777)	(13,311)	107,202	(1,136,994)	(165,250)
Source: CMA's handling of Parties ratings data							

28. We note that there is a wide range in the number of rated products that each investment consultant contributes to the ratings data set used for our analysis.⁴⁸ Three (out of the eight in total) of the investment consultants in our sample, namely [%], [%] and [%], collectively account for 88% of the rated product-quarter pairs and for 97% of the 'buy-rated' product-quarter pairs in our sample. Hence, our analysis of the collective ability of investment

⁴⁷ As the same product can be assigned different ratings at different times the last column does not equal the sum of 'buy-rated' products, 'hold-rated' products, 'sell-rated' products and 'other-rated' products. In the same vein, as investment consultants in our sample may have rated the same products over the ten-year period covered, the last raw in the table does not equal the sum of all 'buy-rated', 'sell-rated', 'hold-rated' or 'other-rated' products.; ⁴⁸ Redington submitted that manager research was put in place during 2013. As the CMA's quantitative analysis only uses data up to 2015, it excludes the majority of Redington's ratings data. We acknowledge that and note that Redington participates in our analysis (ie final data set) with 4 rated products (or 0.4% of the 'buy-rated' products universe in our final data set).

consultants to recommend AM products that beat their benchmarks is likely to be weighted towards the practices of these investment consultants.

- 29. For our main analysis, which combines all investment consultants, we have created a single composite rating for each product-quarter pair. This composite rating corresponds to the most commonly occurring rating assigned to this product (across investment consultants) in each quarter. If, in a given quarter, there is no dominant rating, we have classified this product as 'Unrated'.⁴⁹ Our final data set contains information on around nine thousand 'buy-rated' product-quarter pairs.
- 30. We have assessed the performance of all products which had ratings attached over the studied period (ie Q1: 2006 Q4: 2015), not only those which received new ratings.

Data set building

- 31. In the following paragraphs we detail the steps we took in preparing the data set used for our aggregate analysis (ie across investment consultants), reflect on the reasoning driving these adjustments and discuss how the restrictions we impose are likely to affect the results of our analysis.⁵⁰
- 32. In building our working dataset we have performed some basic consistency checks. More specifically, we have dropped products without a valid eVestment ID, products with missing eVestment returns or fees data, products for which a benchmark was not identified and products for which the corresponding benchmark returns are not available on eVestment.
- 33. We have considered whether these restrictions may have distorted our sample and biased our results. However, we have not come across any evidence suggesting that products without a valid eVestment ID and/or products for which data on returns, fees and benchmark returns is missing are systematically associated with higher-than-average net returns and account for a substantial share of 'buy-rated' products.⁵¹

⁴⁹ In response to the confidentiality ring, [\gg] advisors tested the impact of some alternative approaches of aggregating ratings they considered in order to identify whether the results of our quantitative analysis are sensitive to alternative aggregations. [\gg] advisors did not find a change in the statistical significance of the headline results.

⁵⁰ When processing the GIMD for Mercer's standalone analysis we have applied the same adjustments as when processing the returns data from eVestment, where feasible. We discuss our standalone analysis for Mercer in more detail in paragraphs 105-106.

⁵¹ Regarding our decision to exclude from the analysis products for which benchmark returns were not available on eVestment, WTW submitted that the CMA could have used other sources for benchmark returns or compared these products to another suitable index. Relatedly, Aon submitted that the CMA has omitted a large number of fixed income strategies as the benchmarks are not listed in its version of the eVestment database even though these strategies have well known market benchmarks, which are included in Aon's version of the

- 34. In addition to these basic consistency checks, we have:
 - (i) reduced the product scope of our analysis by excluding passively managed products;
 - (ii) restricted our analysis to return data where the base currency is USD, or return data that were originally expressed in other currencies, but converted to USD by eVestment;
 - (iii) excluded simulated returns and;
 - (iv) removed products from the analysis entirely if their inception date was at least one quarter prior to the date they were added to the eVestment database to correct for backfill bias.

We discuss each of these steps in turn below.

(i) Excluding passively managed products

- 35. Most parties with the exception of Capita, agreed that passively-managed AM products should be omitted from the analysis as their returns are close to the benchmark.
- 36. In its submission following the confidentiality ring, Mercer has noted that our data building process fails to identify and remove all passive products from our data set. We have amended our data cleaning process to ensure that no exchange traded funds (ETFs) or passive products are present in the final data set.⁵²

(ii) Focusing on US Dollar-denominated returns

37. WTW submitted that by removing a subset of products not denominated in US Dollars, the CMA may have removed a number of products that may be of particular interest to UK clients.⁵³

eVestment database. Aon further submitted that there are also a number of well-known market benchmarks that are not currently listed in eVestment. We acknowledge that we are constrained by our dataset. Although we are not in a position to accurately recreate the universe of funds available to UK investors, we note that eVestment is a sufficiently comprehensive data set of AM products and enables a thorough and robust analysis.

⁵² Part D in the confidential annex prepared on behalf of Mercer dated April 19, 2018.

⁵³ Willis Tower Watson's response to CMA's working paper on Asset Manager Product Recommendations dated April 20, 2018, paragraphs 2.12 and 2.13.

- 38. Relatedly, Aon submitted that a significant proportion of Aon's rated funds are excluded from the CMA's net active return analysis due to the omission of asset managers' fees reported in GBP. ⁵⁴
- 39. We have also received non-USD return data⁵⁵ from the FCA. However, we did not use these data as we understand (following conversations with FCA and the parties), that it is not possible to convert return data if the product in question is hedged. As the data set does not identify which products are hedged and which are not, we did not convert non-USD return data for fear of introducing measurement error in our analysis.
- 40. Building on the FCA's assessment of third-party databases, we have identified two potential sources of bias in the eVestment data,⁵⁶ simulation bias and backfill bias.

(iii) Correcting for simulation bias

- eVestment, like other third-party databases, allows product providers to submit a simulated past performance history for newly incepted products. Only a small proportion of products in the eVestment universe is affected (ie 1.8% of the observations in our data set) and users of the database are in a position to identify these products.
- 42. As product providers have an incentive to make their new products appear more attractive, they are likely to employ statistical techniques in order to produce misleadingly strong simulated historical returns and attract prospective investors. Hence, an analysis based on simulated performance data would potentially risk overstating average returns. In the context of our investigation this would imply that:
 - (a) Our quantitative assessment would be exposed to the risk of overestimating the ability of investment consultants to improve the investment returns of their customers by recommending AM products that outperform their benchmarks. We have addressed this concern by excluding simulated returns from our analysis.
 - (b) The information provided by investment consultants to their customers would likely be overstating the returns of 'recommended' products. We

 ⁵⁴ Annex to Aon's response to CMA's working paper on Asset Manager Product Recommendations, part A2.
 ⁵⁵ Ie return data for which the base currency is not USD.

⁵⁶ See Annex 5 to the Final Report of the FCA's Asset Management Market Study and Table 1 in our working paper on 'Asset Manager Product Recommendations' of March 22, 2018.

discuss this concern with regard to the information investment consultants present to their customers in chapter 5.

(iv) Correcting for backfill bias

- 43. The eVestment database allows asset managers to 'backfill' product returns information for the period before reporting their products to eVestment. We have considered whether this practice could affect the results of our analysis.
- 44. Allowing managers to backfill returns information would risk distorting a database if:
 - (a) Managers choose to report products selectively to the eVestment database, only after they have proven to perform well (ie poor performers remain unlisted). This could lead to the database comprising products that perform on average better than the entire universe of products available to investors.
 - (b) After reporting the products that performed well to the eVestment universe, managers 'backfill' historical data in the database. Hence, returns for the period between a product's inception and the date the product was added to eVestment are potentially biased upwards.
- 45. The FCA's approach to dealing with backfill bias was to remove from the analysis observations on product returns for the period after a product's inception date but prior to the date the product was added to the eVestment database.
- 46. We have refined the correction used by the FCA and have entirely removed from the analysis the products for which the inception date and the date they were listed in the eVestment database were at least a quarter apart. The justification for this is that while the FCA's approach corrects for the fact that performance over this period may be biased upwards as a result of backfilling, it does not address the risk that the performance of potentially recommended products in the eVestment universe is biased upwards due to selective reporting.
- 47. Two parties however have criticised our preferred approach of dealing with backfill bias, on the grounds that it leads to extensive data loss which is unjustified given that backfill bias presents a limited risk. In particular,
 - (a) Redington submitted that our approach discards 25% of the products and 20% of the observations in the eVestment data set and leaves less than 50 eligible funds in several universes. Redington considers it unnecessary to discard all of these products as it believes the majority

of asset managers are not incubating strategies and then adding them to eVestment but rather add them once they are sold eVestment's services or when encouraged to do so by consultants and/or potential customers.⁵⁷

- (b) Aon told us that our approach has the unintended effect of dropping the vast majority of products that were incepted since 2007. Further, Aon submitted that, as eVestment did not become the preferred database until around 2012, failure to register funds with eVestment would most likely reflect that it was not the database of choice at the time rather than backfill bias.⁵⁸
- 48. We have carefully considered these points but we continue to be concerned that backfilling past returns risks biasing the analysis of performance data. As a result, we are concerned that:
 - (a) An analysis of the average performance of AM products using the eVestment data⁵⁹ (without accounting for backfill bias) would risk overstating the performance of 'buy-rated' products relative to their benchmarks and hence overstating the ability of investment consultants to recommend net outperforming AM products to their customers.
 - (b) Any information and/or quantitative evidence regarding the performance of 'recommended' products vis a vis their benchmarks that is presented to investment consultants' customers may be misleading if underlying returns data is not corrected for backfill bias.
- 49. In addition, our approach addresses the backfill bias more thoroughly, compared to the FCA's approach as it is explained in paragraphs 44-46.
- 50. However, we acknowledge that our methodology drops a large number of products from our working dataset,⁶⁰ which may have an impact on our ability precisely to estimate the relationship between ratings and performance.⁶¹ We have therefore considered whether there are more efficient ways (in terms of information loss) to address backfill bias and how these affect our headline results. We present and discuss the results of our sensitivities in paragraphs 131 to 136.

⁵⁷ Redington response to CMA's working paper on "Asset Manager Product Recommendations", dated April 10, 2018 and note prepared on behalf of Redington's advisers paragraph 2.4.

⁵⁸ Aon's response to CMA's working paper on "Asset Manager Product Recommendations", paragraphs 2.3.1 to 2.3.3.

⁵⁹ Or any other returns database that is subject to the backfill bias.

⁶⁰ The backfill bias correction 'costs' us c.25% of the universe of rated products and c.15% of 'buy-rated' products that have been successfully merged with the eVestment returns and fees data.

⁶¹ In other words, it is less likely to find statistically significant results.

Assessing the representativeness of our data set

- 51. Several parties have argued that our data building approach discards a lot of information and distorts our data set thus undermining the generality of our results and hence our ability to draw conclusions about the degree to which investment consultants add value to their customers through manager recommendation services. In particular, the parties have raised the following concerns:
 - (a) Our resulting data set only covers a small fraction of not only the universe of funds available to UK investors but also of the universe of each investment consultant's recommendations.
 - (b) The asset class composition of the resulting data set is not representative of the universe of products in eVestment, the universe of funds available to UK investors or the universe of investment consultants' recommendations.
- 52. We acknowledge that in the process of cleaning, combining and handling the data we had to drop a large amount of information on investment consultants' recommendations. Only c.45% of investment consultants' ratings data, are present in our final data set.⁶² Each investment consultant retains between 35% and 50% of its 'buy-rated' products in the final dataset. ⁶³ We note however that a robust quantitative analysis requires data on a representative sample of the population and not on the entire population.
- 53. To assess that, we have also analysed the asset class composition of our final data set in more detail. Equities account for almost 70% of 'buy-rated' products in our data set (compared to c.45% of the assets in pension schemes' portfolios in Q1: 2016);⁶⁴ Fixed Income assets for 23% (compared to c.20% of pension schemes' portfolios in Q1: 2016) and ⁶⁵ alternative assets (including Hedge Funds) for 4.8% (compared to c.10% of pension schemes' portfolios in Q1: 2016).⁶⁶
- 54. Our data building process therefore has, to some extent, impacted the asset class composition of our data set. Most notably, equities are materially over-represented in our data while alternative AM products (including Hedge

⁶² Not including Cambridge.

 ⁶³ With the exception of Capita and Redington which participate in the analysis with a very small number of products and Cambridge, for which we have not been able to match any of its rated products.
 ⁶⁴ 'Asset Management in the UK 2016-2017'; The Investment Association Annual Survey, September 2017. See chart 26, page 56. See also, 'The Purple Book, DB Pensions Universe Risk Profile, 2017', Pension Protection Fund. See Fig. 7.3, p 34.

⁶⁵ The Purple Book, DB Pensions Universe Risk Profile, 2017, Fig. 7.3, p 34.

⁶⁶ The Purple Book, DB Pensions Universe Risk Profile, 2017, Fig. 7.3, p 34.

Funds) are under-represented. We have further considered whether our data-building routine and the ensuing information loss raises concerns about the quality of inference and the generality of our results.

55. We acknowledge that if investment consultants are more capable of identifying products that improve investment returns beyond the benchmark for the asset classes that are under-represented in our analysis (in particular alternative products) and/or the aforementioned product categories are systematically more likely to outperform their benchmarks, our results risk understating the overall ability of investment consultants to recommend outperforming products to their clients. We revisit this point in paragraphs 143 to 147 below, where we repeat our analysis for each asset class individually.

Our quantitative analysis

56. In the following paragraphs we present and explain the methodology behind our quantitative analysis. In particular, we detail our baseline test, discuss our baseline econometric approach and our methodology with regard to our gross to net of AM fees returns conversion. We further discuss any methodology points that were raised by the parties in their responses to our working paper.

Our baseline test

- 57. In order to assess whether investment consultants' recommendations improve their clients' investment returns we have tested whether 'buy-rated' AM products outperform their respective benchmarks on average, ie whether the average active return for 'buy-rated' AM products is positive to a statistically significant extent.
- 58. We have chosen this to be our baseline test, as it is consistent with the standard way in which the performance of AM products is measured in the financial services industry.
- 59. Alongside our 'baseline test', we have also looked at the performance of 'recommended' AM products, relative to that of other actively-managed AM products that an investment consultancy customer may have invested in, if they decided not to take investment consultants' recommendations into account. We present the results of our secondary test in paragraphs 110 to 112.
- 60. We consider that our baseline test, as well as the secondary test we are using as a sensitivity, are more appropriate for assessing the ability of

investment consultants to recommend outperforming AM products to their clients compared to the alternative methodologies used by some parties. $[\%]^{67}$ one of the tests used by [%], analyses the aggregate cumulative return against benchmarks for product ratings which have existed for 1, 3, 5 and 10 years. We consider that this methodology is subject to survivorship bias.⁶⁸

Choice of econometric model

Time series model (baseline econometric specification)

- 61. We have conducted our baseline test on an aggregated data set, mapping average quarterly returns (across AM products) to (lagged) composite ratings.⁶⁹ We have performed an Ordinary Least Squares **(OLS)** regression of average quarterly active returns for 'buy-rated' products on a constant term. We have used Newey-West standard errors,⁷⁰ which are robust to both heteroskedasticity⁷¹ and auto-correlation of the error term (up to the second lag, by assumption).⁷²
- 62. The parties have challenged our decision to convert a panel data set featuring information on the quarterly performance of several 'buy-rated' products into a time series, on the grounds that:
 - (a) This approach reduces the richness of the data by removing potentially useful cross-sectional information.
 - (b) The panel data approach has greater statistical power because of the greater number of observations.
- 63. We note that our approach can deliver a robust analysis and is consistent with the recent literature investigating the ability of investment consultants to pick out-performing products, see Jenkinson et al., 2014.⁷³ In addition, it has

⁶⁷ Asset management product recommendations, 22 March 2018. See slides 46 and 47..

⁶⁸ Survivorship bias (or survival bias) is a form of selection bias that arises when the analysis of the variable of interest (here performance relative to the benchmark) concentrates on individuals (here AM products) that made it past (ie survived) some selection process (here retaining their 'buy' rating) while not taking into account those that did not. As continuing to receive a 'buy' rating is contingent on performance over one, three, five and ten years the observed performance of products that have retained their ratings over the pre-specified periods will likely be inflated compared to the overall performance of the universe of 'buy-rated' products.

⁶⁹ We have lagged ratings data by one quarter to account for the delayed response of ICs' clients to changes in ratings.

⁷⁰ The term 'standard error' refers to the estimated standard deviation of the sampling distribution of the coefficient on the constant term in our regression. It is a measure of the statistical accuracy of an estimate, in other words the precision with which our estimate based on a given sample approximates the true population value.

⁷¹ A time series is heteroskedastic if the volatility of errors is constant over time.

⁷²In the presence of autocorrelation and/or heteroskedasticity our point estimates are unaffected, but the estimator of the standard errors, used for hypothesis testing, is no longer consistent.

⁷³ Jenkinson, Tim and Jones, Howard and Martinez, Jose Vicente, 2014. 'Picking Winners? Investment Consultants' Recommendations of Fund Managers.' Journal of Finance, 71 (5): pp. 2333-2370.

the advantage of being less exposed to measurement error arising from inaccuracies permeating the product-specific returns and fees data on eVestment. In addition, our results are less sensitive to the number of rated products that come in and out of our sample (given that we are dealing with an unbalanced panel) as averaging takes out some of the variation.

Panel model (alternative econometric approach)

- 64. However, we acknowledge that there is potentially useful information in the cross-sectional variation of the panel dataset, which is 'discarded' in our time series approach.
- 65. We have therefore tested the sensitivity of our results to an alternative econometric model and have re-run our analysis on the product-quarter panel data set, performing a pooled OLS regression of quarterly active returns for 'buy-rated' products on a constant term.
- 66. We have conducted our analysis using two different specifications, accommodating different assumptions on the modelling of errors. In particular,
 - (a) We use 'clustered' standard errors at the product-level, to account for the fact that there may be auto-correlation in the performance data.⁷⁴
 - (b) We use Driscoll-Kraay standard errors to account for auto-correlation (up to the second lag, by assumption) and arbitrary cross-sectional correlation in performance data.⁷⁵
- 67. Given that cross-sectional correlation (ie between AM products) of performance is often a feature of financial data, we are concerned that our product-level clustered standard errors specification is likely to yield misleadingly narrow confidence intervals. In other words, under this specification we are more likely to find statistically significant results because our estimation process understates standard errors.

⁷⁴ Under specification (i), the underlying assumption is that unobserved factors driving the performance of individual AM products may be correlated over time, while they are assumed to be uncorrelated for different AM products. Failure to control for within-cluster error correlation can lead to misleadingly small standard errors and consequently erroneously narrow confidence intervals. The risk is that we are then more likely to find falsely significant results.

⁷⁵We can think of the Driscoll Kraay estimator as a hybrid estimator combining a heteroskedasticity and autocorrelation consistent (HAC) estimator and a 'cluster robust' estimator. The former accommodates the temporal dependence (ie autocorrelation) whereas the latter accommodates the cross-sectional dependence. The error structure is therefore assumed to be heteroskedastic, autocorrelated (up to some lag, here lag=2) and possibly correlated between individuals (here, AM products).

- 68. Two parties however submitted that product-level clustered standard errors are more appropriate compared to Driscoll-Kraay standard errors. In particular,
 - (a) Aon submitted that the time dimension of our panel data set (T=39) is not sufficiently long as the Driscoll-Kraay estimation requires 'a large number of time periods'. ⁷⁶
 - (b) WTW submitted that in the context of the data set available to the CMA, there are drawbacks to using Driscoll-Kraay standard errors. In particular, WTW submitted that Driscoll-Kraay standard errors require a large panel data set with a high ratio of time periods to cross-sectional observations, and that this was not the case for the CMA's analysis.⁷⁷
- 69. We have carefully considered the points raised by these parties. We further refer the parties to the academic literature⁷⁸ and note the following.
- 70. The Driscoll-Kraay estimation does not place any restrictions on the limiting behaviour of the number of panels (N) and therefore, it is possible to apply even if the size of the cross-sectional dimension (ie number of panels) is much larger than the time dimension (T).⁷⁹ As such, the Driscoll-Kraay estimator overcomes the 'large cross-sectional dimension compared to time dimension problem' that other asymptotics-based covariance matrix estimators (eg Parks-Kmenta⁸⁰ and Panel Corrected Standard Errors⁸¹) face.⁸²
- 71. In addition, Driscoll-Kraay standard errors are robust to very general forms of cross-sectional and temporal dependence when the time dimension becomes 'large enough' for asymptotic inference to hold. That being said, we further note that despite the fact that the cross-sectional correlation consistent standard error estimator proposed by Driscoll and Kraay relies on large T asymptotics, its finite sample performance dominates the performance of

⁷⁶ Submission by Aon's authorised advisers in response to the CMA's working paper on asset manager product recommendations, April 23, 2018.

⁷⁷Willis Tower Watson submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations, paragraphs 2.19 and the confidentiality ring submission of Willis Tower Watson's authorised advisers of April 19, 2018.

⁷⁸ In particular Driscoll, J. C., and A. C. Kraay. 1998. Consistent Covariance Matrix Estimation with Spatially Dependent Panel Data. Review of Economics and Statistics 80: 549–560 and; Hoechle, Daniel, 2007. Robust standard errors for panel regressions with cross-sectional dependence. The Stata Journal 7, Number 3, pp. 281-312.

⁷⁹ Including the limiting case in which N tends to infinity at any rate relative to T.

⁸⁰ See Parks, R. 1967. Efficient Estimation of a System of Regression Equations When Disturbances Are Both Serially And Contemporaneously Correlated. Journal of the American Statistical Association 62: 500-509 and; Kmenta, J. 1986. Elements of Econometrics. 2nd edition, New York: Macmillan.

⁸¹ Beck, N. and N.J. Katz, 1995. What to do (and not to do) with time series cross-section data. American Political Science Review 89:634-647.

⁸² We refer the interested reader to the discussion in Hoechle (2007), explaining that these estimators typically become inappropriate when the cross-sectional dimension becomes large.

other commonly used alternatives, which do not account for cross-sectional dimension even when the time dimension is quite short.⁸³

- 72. We have therefore decided to place greater weight on the results of the Driscoll-Kraay standard errors specification.
- 73. We present the results of conducting the analysis using the panel model in paragraphs 113 to 123 below. We note that the choice of econometric model is inconsequential for our baseline results and conclusions.
- 74. WTW has instead proposed a non-parametric approach (randomisation inference)⁸⁴ as a more appropriate alternative to assess whether 'buy-rated' products outperform their benchmarks.⁸⁵ This approach has the additional advantage of not relying on assumptions regarding sample size and/or the accuracy of the model.⁸⁶
- 75. We acknowledge the appeal of the proposed approach but note that:
 - (a) Randomisation inference is not typically used outside experimental setups.
 - (b) Assignment of 'buy-ratings' is not random as investment consultants assign buy-ratings to AM products with a particular expected return and/or risk profile.
- 76. In addition, Young (2017), notes that randomisation inference systematically raises the p-values of otherwise obtained statistically significant results which depend upon outliers. Hence, if the results reported in Young (2017) hold in

⁸³ In the original work from Driscoll and Kraay (1998) the authors demonstrate this using Monte Carlo simulations considering a moderate time series dimension of size T=25 and a moderate cross section of N=20. Relatedly, Hoechle (2007), using Monte Carlo simulations on both a medium (1000 subjects) and a large-sized (2500 subjects) micro-econometric panel with 40 time periods demonstrates that in the presence of cross-sectional dependence Driscoll-Kraay standard errors dominate OLS, White, Rogers and Newey-West standard errors for pooled OLS estimation. Results hold for both balanced as well as unbalanced panels. Our estimation uses the Driscoll-Kraay estimator as it has been adjusted by Hoechle (2007) in the respective xtscc Stata command for use with unbalanced panels. Hence, whilst specifying the number of periods justifying appeal to asymptotic inference is not straightforward we note that a time dimension of 39 periods is 'reasonably long' for financial data.
⁸⁴ WTW cites Young, A. 2017. Channelling Fisher: Randomization Tests and the Statistical Insignificance of Seemingly Significant Experimental Results. Working Paper.

⁸⁵ WTW advisers have submitted an analysis using randomisation inference demonstrating that randomly generated 'buy-rating' samples outperformed the real WTW 'buy-ratings' in less than 10% of the cases, which is however below the conventional statistical significance threshold.

⁸⁶ As it is explained in Young (2017) and Hess (2017), – see Hess, S. 2017. Randomization Inference with Stata: A Guide and software. The Stata Journal, Volume 17(3) pp. 630-651 - unlike asymptotic inference, which assumes each observation to be a random draw from a distribution of outcomes, (Fisherian) randomisation inference takes the set of study subjects (here AM products) as fixed to what is observed in the data, but treatment assignment (here a 'buy' rating) itself is viewed as random. The researcher hence obtains the distribution of the test statistic under the null hypothesis of 'no effect' (here no outperformance relative to the benchmark product) through randomly re-assigning the treatment (re-randomization or re-sampling). The actual test statistic observed is then compared against the distribution of all conceivable test statistics (obtained through re-randomisation), in order to assess the proportion of possible treatment assignments that yield a test statistic greater than or equal to the observed test statistic.

general, our preferred methodology is more likely to yield statistically significant results compared to the proposed alternative.

Gross vs net of AM fees performance and gross to net of AM fees conversion

- 77. We have conducted our analysis both on a gross and net (of AM fees) basis. Several parties have challenged our decision to place more weight on results net of AM fees. In particular:
 - (a) Mercer submitted that performance gross of AM fees is a more relevant and reliable measure for individual pension scheme decision-making. Mercer told us that trustees incur AM fees regardless of whether they pick an active product themselves or engage instead an investment consultant to assist in the selection process, the difference being that investment consultants can negotiate lower fees for their customers.⁸⁷
 - (b) WTW submitted that our analysis should consider performance both net and gross of AM fees as the incompleteness of the fee data and the challenges associated with calculating a representative average fee level and discount rate cast doubt over our results.⁸⁸
- 78. On the other hand, KPMG is supportive of the analysis and conclusions in our working paper which focus on 'net of fees performance' as this is more reflective of the 'real world experience' for customers.⁸⁹
- 79. Relatedly, several parties submitted that to the extent that our analysis finds evidence of out-performance of 'buy-rated' products on a gross of AM fees basis, but not on a net of AM fees basis, this should not be interpreted as lack of investment consultants' ability to identify high performing products. In particular:
 - (a) WTW submitted that the CMA's focus should be on ensuring asset manager fees are low enough to have reasonable confidence that the skills of investment consultants in picking asset management products will translate into positive net of costs returns for clients.⁹⁰

 ⁸⁷ Mercer's response to Asset Manager Product Recommendations working paper, paragraphs 2.182.24.
 ⁸⁸ WTW submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations, paragraph 2.29.

 ⁸⁹ KPMG's response to 'Asset Managers Product Recommendations' working paper, April 12, 2018.
 ⁹⁰ WTW submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations, paragraphs 1.12-1.14.

- (b) Mercer submitted that it is relevant that concerns about the levels and opacity of AM fees have already been identified by the FCA and that remedies are already being implemented in this area.⁹¹
- (c) Aon submitted that this may suggest weak competition among asset managers. ⁹²
- 80. We have considered the parties' points but for the purposes of this exercise, we consider it appropriate to place more weight on the figures net of AM fees, as these are a better approximation of the return on investment an investment consultancy customer could expect to receive if it invested in a 'buy-rated' product.⁹³
- 81. In the following paragraphs we outline the principles driving our gross to net of AM fees conversion.
- 82. Our gross to net of AM fees conversion utilises AM fee data from eVestment, which we received from the FCA. For each product we have calculated a 'standard AM fee' by taking a simple average of the fees corresponding to different size mandates (USD 10 million, 25 million, 50 million, 75 million, 100 million, 200 million, 500 million) based on the fee scales entered onto the eVestment database for each vehicle type⁹⁴ (Separate/Segregated Account, Commingled/Co-ownership Fund, Mutual/Pooled Fund).
- 83. We note that the FCA took into account investment consultants' fees as well as AM fees when converting from gross to net.⁹⁵ Including investment consultants' fees would further reduce the performance of recommended products relative to their benchmark on a net basis.
- 84. Asset managers told us at the round table discussion that investment consultants are able to successfully negotiate discounts on their customers' behalf. Hence, the 'rack rate' AM fee for a product/asset class may not be representative of the effective fee level an investor would incur in practice. Our analysis of parties' data on the fees their customers pay to asset managers confirms that only a minority of customers pay the 'rack rate'. In our calculation of active returns 'net of AM fees' we have therefore incorporated discounts, which appear to be an important feature of pricing in this industry.

⁹¹ Mercer's response to Asset Manager Product Recommendations working paper, paragraphs 2.9 and 2.10.

⁹² Response from Aon to CMA's working paper on asset manager product recommendations, paragraph 1.1.4 (c).
⁹³ TPR guidance states that trustees should monitor performance on a net of fees basis. Eg for DB schemes: TPR guidance on 'monitoring DB investments', which accompanies Code of Practice 3 ('funding defined benefits').

⁹⁴ Vehicle types, are essentially 'wrappers' for investment product.

⁹⁵ Investment consultants' fees are non-negligible and can be as high as 30 bps per annum.

- 85. To obtain the level of discounts, we compared the data we received directly from the parties on pre- and post- negotiated fees and computed average discount rates across all customers (which we use in our headline results) and by investment consultant (which we use in our investment consultancy-specific results).⁹⁶
- 86. For the parties included in this analysis, we find that customers received a discount rate of approximately [≫]%, on average. This rate varied across the parties included, although we note that this variation may be driven by the characteristics of their customers rather than their respective negotiating positions.
- 87. Our approach is different from the approach favoured by the FCA, which used the fees for segregated mandates to indirectly account for discounts. The justification for that was that segregated mandates⁹⁷ typically have negotiated fees. We consider that the FCA's approach risks mis-stating the fee discounts achieved by customers if those using segregated mandates are not representative of the broader customer base for investment consultants.⁹⁸
- 88. In their responses, parties have made special reference to the following points regarding our 'gross to net of fees' conversion methodology.
 - (a) The CMA overstates the level of AM fees and understates the level of discounts that the investment consultants' customers receive.
 - (b) The CMA's gross to net of AM fees conversion fails to take into account passive fees.
 - (c) The CMA's gross to net of AM fees conversion does not adjust for withholding tax deductions of benchmarks where applicable.
 - (d) The CMA's gross to net of AM fees conversion does not take into account the additional costs associated with trading a foreign exchange hedge.
 - (e) The CMA does not take into account US Securities and Exchange Commission regulations and therefore risks understating gross returns.

⁹⁶ Our calculations exclude outliers, negative implicit discounts and discounts above 100%.

⁹⁷ In its response, Mercer told us that it considers the fee level of segregated mandates to be representative as it reflects the structure of the CMA's dataset. See Mercer's response to the asset manager product recommendations working paper, paragraphs 2.29-2.34.

⁹⁸ Hence the level of AM fees used in the FCA's headline analysis appears to be lower compared to our analysis.

89. We discuss these points in greater detail in the following paragraphs.

(a) Calculation of average level of fees and discounts used in our analysis

- 90. Some parties, namely Mercer, WTW and Redington have argued that the asset management fees used in our analysis are higher than those paid by their customers. ⁹⁹ In particular, they have argued that our use of a simple averages across AUM levels and vehicle types in computing the product-specific standard AM fee overstates the resulting level of AM fees for the following reasons:
 - (a) AM fees vary markedly between vehicle types. By placing equal weight on each vehicle type¹⁰⁰ our methodology assumes that the customer base of each investment consultant is equally spread amongst the three vehicle types and hence does not yield fees that are representative of the fees paid by the parties' customers.
 - (b) By averaging across AUM levels, the CMA's standard fee calculation does not take into account the tiered fee structure that is used in reality.
 - (c) The presence of some distortive outliers appears to inflate the average fees calculated.
- 91. In the same vein, some parties (namely Aon, WTW and Redington) have argued that by calculating a simple average of implicit discounts across all products¹⁰¹ (including passive products, which are not relevant for the analysis) we mis-state the average AM fee discount rate that they secure for their customers.¹⁰²
- 92. We acknowledge that the data used to compute these discount rates may not be fully representative. We do not have discount data for smaller customers, and due to returns containing missing or poorly populated fields, we had to drop many records. Nevertheless, we consider that the former issue is likely to overstate the average discount achieved, and the latter is not likely to have

⁹⁹ Mercer's response to the asset manager product recommendations working paper, paragraphs 2.29-2.34 and paragraphs 12-19 of the Annex submitted on behalf of Mercer on April 19, 2018. Willis Tower Watson submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations, paragraph 2.27(a). Confidential submission from Redington's authorised advisers, April 19, 2018 paragraphs 3.1-3.3.
¹⁰⁰ Including vehicle types that are rarely used in the UK as noted by Willis Tower Watson in its submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations.
¹⁰¹ We note that the data set does not allow us to compute product-specific discount rates.

¹⁰² Response from Aon to CMA's working paper on asset manager product recommendations, paragraph 3.2 and A.3.3 in the accompanying Annex. Willis Tower Watson submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations, paragraph 2.27(b). Confidential submission from Redington's authorised advisers, April 19, 2018 paragraphs 3.4-3.8.
a systematic effect. Therefore, we do not think these issues are likely to affect the provisional conclusions we have drawn from the analysis.

93. In paragraphs 124 to 127 below we have tested the sensitivity of our results to using (a) AM fees that are 50% lower compared to the product-specific average fees calculated by averaging across AUM levels and vehicle types and; (b) an average discount rate of [≫]%¹⁰³ instead of our estimated average discount rate of [≫]%.

(b) Accounting for passive fees

- 94. Several parties (namely Mercer, WTW, Redington, PLSA) have told us that pension schemes are subject to management fees when investing in passive tracker products (ie benchmarks) and therefore our calculation of returns 'net of fees' should also account for the appropriate fee level for each passive benchmark.¹⁰⁴
- 95. Mercer submitted that most passive products tend to attract management fees between [≫] bps and [≫] bps, depending on the product category.¹⁰⁵ WTW told us that passive fees vary between 3 bps and 40 bps, depending on the AUM level and the asset category. WTW also submitted an additional piece of analysis using its own ratings and incorporating passive fees of 5 bps, 10 bps and 20 bps.¹⁰⁶
- 96. We consider our approach to be more appropriate, as the focus of our analysis is to test whether investment consultants are able to identify products that out-perform their benchmarks on average, rather than compare the average gains from active management with the average gains from passive management.
- 97. We have also considered assessing quantitatively whether investors are on average better off when they choose actively managed products over passively managed products. We have therefore tested the sensitivity of our

 ¹⁰³The sensitivity level for the discount rate is equal to 1.5 x [≫]% (ie the implied average level). Our analysis of the data suggests that 70% of observations in the data are associated with discounts up to [≫]%.
 ¹⁰⁴ Mercer's response to asset manager product recommendations working paper, paragraphs 2.30 and 2.31.
 Willis Tower Watson submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations, paragraphs 2.22-2.24, results reported in Tables 4-6 and confidentiality ring submission of Willis Tower Watson's authorised advisers of April 19, 2018. Redington's response to CMA's working paper on Asset Manager Product Recommendations dated April 10, 2018. PLSA response to CMA working paper on Asset Manager Product, dated April 5, 2018.

¹⁰⁵ Mercer's response to asset manager product recommendations working paper, paragraph 2.31. ¹⁰⁶ WTW finds that its own 'buy-rated' products outperform their benchmarks to a statistically significant extent for all assumed levels of passive fees when they use Newey-West SE or product-level clustered SE. See WTW submission of April 20, 2018 in response to CMA's working paper on asset manager product recommendations, paragraphs 2.22-2.24 and results reported in Tables 4-6 as well as the confidentiality ring submission of WTW's authorised advisers of April 19, 2018.

results to incorporating passive fees of 5 bps, 10 bps, 20 bps and 40 bps. We present the results of our sensitivities in paragraphs 128 to 131 below.

(c) Tax assumptions

- 98. Aon submitted that for some products the CMA uses benchmarks that are gross of withholding tax despite the product claiming its tax, which results in the understatement of both the gross and net active returns for these products.¹⁰⁷
- 99. As we state in our working paper,¹⁰⁸ multi-country strategies typically choose a benchmark which reports returns on a net basis, meaning withholding tax deductions that are applied to dividends prior to investment. In its analysis, the FCA found that only 11% of products are affected by this issue and that the overall bias was likely no higher than 5 bps, a relatively small amount. Following the FCA's approach we have not addressed this further.¹⁰⁹

(d) Foreign exchange hedge

- 100. Aon submitted that the foreign exchange hedged benchmarks recorded in eVestment do not take into account any additional costs of trading a foreign exchange hedge.¹¹⁰
- 101. We note Aon's concern but have decided not to address it further on the basis that:
 - (a) As is acknowledged by Aon, there is no readily available source for the actual market cost of foreign exchange hedges.
 - (b) No other party has raised this point. We therefore think that even if there are additional costs associated with trading a foreign exchange hedge, these costs are not sufficiently significant to warrant correction.
- 102. To the extent that such costs are material, our analysis likely underestimates the net active returns of recommended products and thus understates the ability of investment consultants to identify products that improve their customers' investment returns. We consider this in interpreting the results.

¹⁰⁷ Annex to Aon's response to CMA's working paper on asset manager product recommendations, part A.3.4. ¹⁰⁸ Slide 11.

¹⁰⁹ In the Annex to Aon's response to CMA's working paper on asset manager product recommendations, Aon's advisers have identified in our sample, products that use benchmarks that are gross of withholding tax where net of withholding tax benchmarks should have been considered instead as the products themselves claim tax. The analysis submitted by Aon uses benchmarks net of withholding tax for these products. As this is a limited concern and for the sake of consistency we have decided to not incorporate the proposed change.

¹¹⁰ Annex to Aon's response to CMA's working paper on asset manager product recommendations, part A.4.

(e) Gross returns and SEC regulations

- 103. Aon told us 'it believes that' when reporting net return information to eVestment, AMs typically convert from gross returns by subtracting the highest fee reported by eVestment, in line with SEC regulations. Hence, by adding the average fee to the net AM return in order to obtain the gross return, the CMA understates the gross return by an amount equal to the difference between each fund's average and maximum fees. ¹¹¹
- 104. We note Aon's concern but have decided not to address it further on the basis that:
 - (a) No other party has confirmed that Aon's understanding of how AM managers report net returns to eVestment is correct.
 - (b) Given that we already find evidence of outperformance for 'buy-rated' products (relative to their benchmarks) on a gross basis, this would not change the direction of our results.

Standalone analysis for Mercer

- 105. We have also conducted an analysis for Mercer using its GIMD database. We have conducted the same tests and used the same econometric specification and methodology as we did for our aggregate analysis and for the other ICs in our sample.
- 106. When processing the data from Mercer's GIMD we applied the same methodology we used to process data from eVestment, where feasible. One notable difference however, is that, in the Mercer analysis, the 'rack rate' fee for a given product was calculated on the basis of fees for the vehicle type that is most relevant for a UK investor, as submitted by Mercer, and for which data was available. In the eVestment analysis, the 'rack rate' fee for a given product was calculated by averaging across fees for different vehicle types.

Results

Results of our baseline test

107. Table 4 presents our baseline results on a gross and net of AM fees (adjusted for the average discount) basis.

¹¹¹ Response from Aon to CMA's working paper on asset manager product recommendations, paragraph 3.2 and A.3.2 in the accompanying Annex.

Table 4. Baseline results

	Average active returns per quarter (%)				
	Gross	Net			
Buy	0.231***	0.041			
Observations	(0.004) 39	(0.608) 39			
pvalues in parentheses					
*** p<0.01, ** p<0.05, * p<0.1					

108. We found that 'buy-rated' products outperform their respective benchmarks on a gross basis by 23.1 bps per quarter on average, to a statistically significant extent. Once we account for 'AM fees' however, we no longer find statistically significant outperformance for 'buy-rated' products relative to their benchmarks. In other words, because of the variability in the performance of 'buy-rated' products, we are not in a position to state that the observed net outperformance of recommended products as against their respective benchmarks (by 4.1 bps per quarter on average) is not entirely attributable to chance.

Additional results and sensitivities

- 109. We have further tested the sensitivity of our results by:
 - (a) using an alternative test (ie whether 'buy-rated' products outperform 'unrated' products);
 - (b) employing an alternative methodology (panel model);
 - (c) performing our analysis separately for each investment consultant;
 - (d) assuming a higher average AM discount rate;
 - (e) incorporating passive fees;
 - (f) alternative ways of correcting for the backfill bias;
 - (g) considering a different time period not exposed to the financial crisis of 2007-8; and
 - (h) performing our analysis separately for each asset class;

(a) Alternative comparator test: 'buy rated' vs 'unrated'

- 110. Alongside our 'baseline test', we have also looked at the performance of 'recommended' asset management products, relative to that of other activelymanaged asset management products that an investment consultancy customer may have invested in, if they decided not to take investment consultants' recommendations into account.
- 111. In particular, we tested whether the difference in active returns for 'buy-rated' and 'unrated' AM products is positive to a statistically significant extent, on average. The results of our secondary test are summarised in Table 5.¹¹²

	Average active returns per quarter (%)			
	Gross	Net		
Buy - Unrated	0.097	0.066		
	(0.215)	(0.465)		
Observations	39	39		
pvalues in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

Table 5. Results of our secondary test

112. We found that the net (of AM fees) active return of 'buy-rated' products was higher than that of 'unrated' AM products, but not to a statistically significant extent. More specifically, the active returns net of fees for 'buy-rated' products are higher than the net active returns for unrated products by approximately 7 bps per quarter on average. The absence of statistical significance implies that the observed outperformance of 'buy-rated' products may be entirely due to chance.

(b) Alternative Methodology - Panel Data

113. Table 6, presents the results of our alternative methodology (ie the results of repeating our analysis on a product-quarter level data set using a panel model).

¹¹² We have run an ordinary least squares regression of the difference in gross and net (of AM fees) active returns between 'buy-rated' and 'unrated' products on a constant term using heteroskedasticity and autocorrelation consistent standard errors.

Table 6. Panel data methodology

		Average active returns per quarter %			
		Gr	oss		Net
		Driscoll clustered Kraay SE (product)		Driscoll Kraay SE	<i>clustered</i> SE (product)
B	Buy	0.228*** (0.007)	0.228*** (0.000)	0.044 (0. 612)	0.044 (0. 241)

pval in parentheses

*** p<0.01, ** p<0.05, * p<0.1

- 114. We find that the gross product return of 'buy-rated' products is 23 bps higher than their respective benchmark returns per quarter, on average. The net of AM fees active return of 'buy-rated' products is also positive on average (by 4.4 bps per quarter), though not to a statistically significant extent.
- 115. We note that our point estimates are not affected by our choice of standard errors specification. In addition, we observe that the choice of standard errors specification does not make a difference for the significance of our results.
- 116. Overall, results are robust to the different econometric models used. Therefore, our findings are not contingent on our choice of baseline econometric model (ie time series or panel model) or our choice of standard errors specification (ie Driscoll Kraay or clustered at the product level).

(c) Investment Consultancy breakdown

- 117. In addition to our aggregate approach, which combines investment consultants, we have repeated our quantitative analysis for each of the eight investment consultants in our sample individually, using the same methodology except for the fact that we calculated discounted 'rack rates' using investment consultant-specific average discounts.
- 118. We have also conducted an analysis for Mercer using Mercer's GIMD.¹¹³ Mercer submitted data for a longer time period between 2000 and 2017, which allowed us to increase sample size and undertake an extended analysis over 17 years.
- 119. The results of our investment consultant-specific analysis (including Mercer) are summarised in Table 7 below.

¹¹³ Mercer does not subscribe to eVestment and therefore we were not able to include it in our aggregate quantitative analysis.

Table 7. Investment consultant breakdown (baseline test, time series model)

N	let (discounted	l 'rack rate	es') average	active return	s per quai	rter
[※]	[※]	[≫]	[%]	[※]	[%]	[≫]
[%]	[%]	[%]	[%]	[%]	[%]	[%]
[%]	[※]	[≫]	[※]	[※]	[≫]	[≫]_
[≫]						
[≫]						
Notes: [%	\$]					

[※].

- 120. We found that the net active return of 'buy-rated' products is positive on average for all investment consultants but one ([≫]). Net outperformance of 'buy-rated' products for different investment consultants ranges between 2.6 bps and 23.4 bps. Results on outperformance, net of AM fees are statistically significant for [≫] (though marginally, at the 10% level) and [≫] (at the 5% level of significance).
- 121. We note however that the results for Mercer are not comparable to the results for other investment consultants (a) as the analysis for Mercer is based on a different data set; (b) extends over a longer time period and; (c) features some differences in the methodology, notably regarding the gross to net of AM fees conversion of returns.
- 122. For completeness, we have also conducted the investment consultantspecific analysis using the alternative methodology (panel model). Results are reported in Table 8. Under our preferred specification (Driscoll-Kraay SE), results are broadly robust to this exercise.¹¹⁴

Net (discounted 'rack rates') average active returns per quarter						
	[※]	[%]	[≫]	[%]	[%]	[≫]
Driscoll- Kraay SE	[%]	[≫]	[≫]	[≫]	[≫]	[※]
	[≫]	[※]	[※]	[≫]	[※]	[※]
Clustered SE (product)	[※]	[%]	[※]	[※]	[≫]	[%]
	[※]	[≫]	[≫]	[≫]	[≫]	[※]
[※] [※]						
Notes: [🔀]]					

Table 8. Investment Consultant breakdown (baseline tests, panel model)

¹¹⁴ The point estimates for some ICs have been affected.

[※].

123. Net active returns of 'buy-rated' products continue to be positive on average for all but one ([≫]) investment consultant. Net outperformance of 'buy-rated' products for different investment consultants ranges between 3.6 bps and 18.6 bps. However, results on outperformance, net of AM fees, are statistically significant for [≫] (at the 5% level) and [≫] (though marginally, at the 10% level) under our preferred specification (Driscoll Kraay SE).

(d) Sensitivities with the level of AM fees and the average discount rate

- 124. As we have discussed in paragraphs 91-93, some parties have submitted that our average product-specific AM fees are materially higher compared to the fees incurred by their customers whilst our average discount rate of 13%, understates the level of discounts that their customers enjoy. We have therefore tested the sensitivity of our results to assuming (a) product-specific AM fees that are 50% lower compared to the average fees calculated by taking a simple average over AUM levels and across vehicle types and (b) an average discount rate of 19.5%.
- 125. We have conducted this sensitivity using both our baseline econometric model (time series with Newey-West standard errors) and our alternative methodology (ie panel model both with product-clustered and Driscoll-Kraay standard errors). Our results are reported in Table 9 and Table 10.

Table 9. Sensitivities with the level of average AM fees used in the gross to net conversion

Net average active returns per quarter,						
assuming 50	assuming 50% lower fees.					
	Time					
series Panel Model						
	Newey West SE	clustered SE (product)	Driscoll- Kraay SE			
Buy	0.106 (0.192)	0.109*** (0.004)	0.109 (0.214)			

pval in parentheses

*** p<0.01, ** p<0.05, * p<0.1

126. When assuming a lower level of AM fees, we find that 'buy-rated' products outperform their respective benchmarks on a net of AM fees basis (across specifications). However, results are statistically significant only for the Panel Model with product-level clustered errors.

Table 10. Sensitivities with the level of the average discount rate used in the gross to net conversion

Net average active returns per quarter, assuming an average discount rate of 19.5% Time					
	series	Pane	el Model		
	Newey West SE	clustered SE (product)	Driscoll- Kraay SE		
Buy	0.051 (0.530)	0.058 (0.121)	0.058 (0.503)		

pval in parentheses

*** p<0.01, ** p<0.05, * p<0.1

127. We found that 'buy-rated' products outperform their respective benchmarks on a net of AM fees basis but not to a statistically significant degree, across specifications.

(e) Accounting for passive fees

128. As we have discussed in paragraphs 94-96, several parties suggested that our analysis should account for AM fees associated with investing in the benchmark product. We have therefore tested the sensitivity of our results to incorporating passive fees of 5 bps, 10 bps. 20 bps and 40 bps. We present the results of our sensitivities (across methodologies), in Table 11 below.

<i>Net average active returns of buy-rated products per quarter, accounting for pas fees (%)</i>					buy-rated ing for passive	
Econometric Model		5 bps	10 bps	20 bps	40 bps	
Time series	(Newey-West	0.054	0.066	0.091	0.141*	
	SE)	(0.504)	(0.411)	(0.260)	(0.086)	
	clustered SE	0.057	0.069*	0.094**	0.143***	
Panel	(product)	(0.133)	(0.067)	(0.013)	(0.000)	
	Driscoll-Kraay	0.057	0.069	0.094	0.143	
	SE	(0.515)	(0.427)	(0.282)	(0.105)	
pval in parer	pval in parentheses					

Table 11. Accounting for passive fees

*** p<0.01, ** p<0.05, * p<0.1

129. We did find some evidence that 'buy-rated' products outperform on average their respective benchmarks on a net of AM fees basis when the benchmarks are associated with management fees of 10 bps or above, but only for the pooled OLS under the product-level clustered SE specification.

130. For passive fees as high as 40 bps we also find some evidence of marginally statistically significant outperformance for recommended products for our preferred specification. We understand that the majority of benchmarks are associated with fees ranged between 5 to 20 bps. As shown in Table 11, incorporating passive fees within this range in our analysis does not affect our main results.

(f) Alternative ways of correcting backfill bias

131. In paragraphs 43 to 49 we have explained why we are concerned about backfill bias in our data set. To further investigate our concerns, we have tested whether the difference in active returns of recommended AM products for which asset managers have backfilled observations¹¹⁵ and the active returns of recommended products for which no backfilling has occurred is positive to a statistically significant extent, on average. Our results are summarised in Table 12 below.

Table 12. AM products with backfilled returns perform better on average.

Average difference in net active returns of 'buy-rated' products with and without backfilled returns per quarter (%)

 Gross
 Net

 Newey West
 0.457***
 0.339*

 SE
 0.457***
 0.339*

 (0.
 (0.007)
 087)

 pval in parentheses
 *** p<0.01, ** p<0.05, *</td>
 p<0.1</td>

- 132. On a gross of AM fees basis, recommended products with backfilled returns, outperform recommended products with no backfilled returns by 45.7 bps per quarter, on average. Results are highly statistically significant. On a net of AM fees basis, active returns of recommended products for which AM have backfilled returns prior to their reporting date are on average 33.9 bps higher per quarter compared to the active returns of products for which no backfilling has occurred.¹¹⁶ These findings strengthen our concerns that managers' backfilling practice and in particular the selective reporting of outperforming products, would expose the analysis to the risk of overstating product returns.
- 133. An additional concern is that our preferred approach to correcting for backfill bias incurs a substantial loss of information. That being said, we also note

¹¹⁵ And which are currently removed from our data set as per our preferred backfill bias correction technique. ¹¹⁶Results are only marginally statistically significant (at the 10% level). As previously noted, the lack of statistical significance implies that the observed outperformance may be due to chance.

that despite discarding many observations, our approach does not further distort the ratings composition or the asset class mix of our data.

- 134. We have considered whether there are more efficient ways (in terms of information loss) in addressing backfill bias. We have therefore performed the following exercises:
 - (i) we have repeated our analysis using the FCA's baseline methodology;
 - (ii) we have tested the sensitivity of our preferred approach and entirely removed products for which their inception date and the date they were listed on eVestment were at least two, three or four quarters apart.¹¹⁷ The justification for this sensitivity is to relax the requirement for immediately reporting newly incepted products to eVestment (ie within the same quarter), acknowledging that a delay does not necessarily reveal managers' intentions selectively to report well performing products. However, the longer it takes an asset manager to report a new product to eVestment the more likely it is that they expect the product to prove outperformance before adding it to the eVestment universe.
- 135. The results of each of the sensitivities outlined in (i) (ii) are presented in columns (1) (4) in Table 13 below.

Net average active returns of 'buy-rated' products per

	quarter (%)				
		(1)	(2)	(3)	(4)
	Newey West				
Time series	SE	0.066	0.040	0.048	0.059
		(0.409)	(0.620)	(0.548)	(0.459)
	clustered SE	0.069*	0.043	0.050	0.061
Danal	(product)	(0.059)	(0.255)	(0.174)	(0.101)
Panei	Driscoll Kraay	0.069	0.043	0.050	0.061
	SE	(0.398)	(0.620)	(0.549)	(0.460)

Table 13. Alternative ways of dealing with the backfill bias

pval in parentheses *** p<0.01, ** p<0.05, * p<0.1

136. Our results are robust to all these sensitivities for our preferred specifications. However, we do find some evidence of outperformance (at the 10% level of statistical significance) for our panel model with product-level clustered SE when using the FCA's backfill bias correction.

¹¹⁷ For products added within n-1 quarters after their inception date (where n=2,3,4) only backfilled returns are dropped, as per FCA's methodology, whereas products that have been added at least n quarters after the inception date are entirely dropped from our sample.

(g) Different time period

- 137. We have also performed our analysis for the years 2012 to 2015 in order to see whether AM product recommendations perform better outside times of extreme 'system stress' (ie a number of years after the financial crisis of 2007-8).
- 138. Our results across specifications, are summarised in Table 14 below.

	Average active returns of 'buy-rated' products per quarter 2012-2015 (%)				
	producto por qu	Gross	Net		
Time	(Newey West				
Series	SE)	0.273***	0.051		
		(0.004)	(0.515)		
	clustered SE	0.276***	0.055		
	(product)	(0.000)	(0.210)		
	Driscoll Kraay				
Panel	SE	0.276***	0.055		
		(0.004)	(0.483)		
nval in na	ranthasas				

Table 14. Results for the period 2012-2015

pval in parentheses

*** p<0.01, ** p<0.05, * p<0.1

- 139. On a gross of AM fees basis, we found that over the period considered, recommended products outperform their benchmarks by approximately 27 to 28 bps (depending on the specification) on average per quarter, compared to 23 bps when the entire time period for which data is available is considered. When accounting for AM fees, the active return of 'buy-rated' products was positive on average (5.1 bps to 5.5 bps per quarter depending on the specification, compared to 4.1 for the period 2006 to 2015), but not to a statistically significant extent. The results of our sensitivity suggest that our analysis and findings do not understate investment consultants' ability to improve their customers' investment returns by recommending products that outperform the market as a result of the financial crisis.
- 140. In its response to our working paper, Mercer submitted a piece of analysis where the years 2007 and 2008 have been excluded from the data set to eliminate the distorting effects of the global financial crisis. Focusing on this period, Mercer finds some evidence (at the 10% level of significance) that recommended products outperform their respective benchmarks on a net of AM fees basis.¹¹⁸

¹¹⁸ See Mercer's response to CMA's Asset Manager Product Recommendations working paper (paragraphs 2.36 to 2.40).

- 141. According to Mercer, this suggests that for at least seven of the ten years studied by the CMA, the results demonstrate the skill of investment consultants in identifying outperforming AM products.
- 142. Our concern regarding Mercer's approach is that the boundaries of a financial crisis are not clearly identifiable as their effects tend to linger and so the period 2009-2012 can also be seen as a period characterised by high systemic risk for international and, in particular, European financial markets. Mercer's analysis highlights that the choice of time period over which to estimate the performance of AM products is likely to have a material effect upon the results.

(h) Asset class breakdown

- 143. We also conducted our quantitative analysis for individual asset classes, using asset class data in the eVestment database.
- 144. Our headline initial results are summarised in Table 15.

Table 15. Asset class breakdown

Net (discounted 'rack rates') average active returns Fixed Hedge Equities Alternatives Funds Income Buy -0.029 1.550 0.167 0.879 (0.093) (0.051) (0.850)(0.769) pval in parentheses *** p<0.01, ** p<0.05, * p<0.1

- 145. We found that 'buy-rated' products in all asset classes (other than equities) are on average higher compared to the returns of their respective benchmarks, but not to a statistically significant extent. We note though that we have seen evidence in marketing materials, tender documents and information provided to customers that investment consultants claim to 'outperform' in a range of asset classes, including equities.
- 146. Relatedly, the observed variation in net active returns that is observed across asset classes suggests that, in order to be in a position to assess whether recommended products outperform the market, investors should have access to information on net active returns for all asset classes.
- 147. In terms of informing our provisional conclusions, we observe that equities and fixed income assets, which jointly account for c.90% of assets in our data set, have the lowest returns relative to their benchmarks. As previously discussed (see paragraph 55 above) the asset class composition of our sample may have affected our results.

Risk

- 148. Several parties have told us that investment returns are not the only consideration relevant to trustees. Indeed, investors consider risk to be least as important, or more important, than returns.
 - (a) WTW referred us to the results of the CMA Survey which shows that risk management was ranked above achieving improved returns; ¹¹⁹
 - (b) Aon told us that some investors' objectives don't focus on outperforming market returns but instead on minimising absolute or relative risk and therefore that our approach is biased because it does not exclude the latter strategies from the analysis.
 - (c) Aon submitted that our analysis fails to capture non-directly observable aspects of the value generated by AM product recommendations such as their due diligence on asset managers.¹²⁰
- 149. Whilst we recognise that the process of manager recommendations is only part of the overall service that investment consultants provide to their customers and that risk is indeed an important consideration for trustees we further note that:
 - (a) manager recommendations is an area which potentially adds value to investors and can reasonably be measured;
 - (b) as is reflected in the information materials investment consultants share with their customers, achieving improved investment returns is indeed an important investment objective where claims are commonly made.
- 150. We have therefore decided to focus our quantitative analysis on studying the relationship between investment consultants' recommendations and returns relative to the market. As such, we have not pursued any further analysis on risk.

Provisional conclusions

151. In this appendix we set out the methodology and present the results of the quantitative analysis we have conducted in order to assess whether investment consultants add value for their customers by recommending AM

¹¹⁹ Willis Towers Watson response to CMA's working paper on asset manager product recommendations, dated April 20,2018, paragraphs 1.17,1.18.

¹²⁰ Aon response to CMA's working paper on asset manager product recommendations paragraphs 1.14, 5.2-5.6.

products that outperform their benchmarks and hence improve investors' returns.

- 152. We have conducted analysis on both a gross and net of AM fees basis. We placed more weight on the latter, as these are more representative of the actual gains accruing to investors.
- 153. The results of our aggregate quantitative analysis (ie across products and across investment consultants) indicate that over the period studied (2006-2015) and for the investment consultants in our sample (Aon, WTW, Russell Investment, Hymans, LCP, Redington, KPMG and Capita) 'buy-rated' products outperform their respective benchmarks on a gross of AM fees basis by approximately 23 bps per quarter, on average. These results are highly statistically significant.
- 154. Once we take into account AM fees, we find that recommended products continue to outperform the market though only by 4 bps per quarter on average. These results are no longer statistically significant. In other words, because of the variability in the net active returns of 'buy-rated' products in the data, the observed outperformance against their benchmarks may be attributable to chance.
- 155. As such, our quantitative analysis does not demonstrate, one way or the other, whether investment consultants, viewed collectively, add value through this service. We do however find some evidence that certain investment consultants in our sample add value for their customers by recommending outperforming AM products on a net of AM fees basis.
- 156. We have carefully considered the methodology points raised by the parties in response to our working paper. We have therefore conducted a number of additional exercises to address the points that we considered merited further work. Under our preferred methodology, our baseline results are robust to these sensitivities.
- 157. In interpreting our results in terms of our broader assessment of market outcomes, we note however that they are subject to a number of limitations. In particular:
 - (a) The asset class mix of our sample is biased towards equities and fixed asset classes, which have the lowest net active returns. The asset class composition of our working sample is not representative of the asset class composition of pension schemes' mandates, which may have led us to understate the overall ability of investment consultants to identify AM products that improve their customers' investment returns.

- (b) We note that that AM product recommendations is only one of the services investment consultants offer to their customers. Therefore, the results of our quantitative analysis cannot be interpreted as implying that investment consultants do not add overall value to their customers.
- 158. Furthermore, our quantitative analysis has identified several factors relating to how the performance of AM product recommendations is reported (gross vs net of AM fees performance, backfill bias, simulation bias, time period covered) that we consider make it difficult for trustees to assess investment consultants' ability to select products that outperform their benchmarks. These are considered in chapter 5, where we assess the information available to trustees on the performance of recommended products.

Appendix 3: Trustee Engagement

TPR codes of practice and guidance

 In this section we cover TPR's codes of practice and related guidance and initiatives, that assist trustees in fulfilling their regulatory requirements and managing their scheme effectively. We focus in particular on code of practice 7, as this relates specifically to 'trustee knowledge and understanding'.

Codes of practice

2. TPR has produced 14 codes of practice, which provide practical guidelines on how to comply with the legal requirements of pension regulation.¹²¹ In this sub-section we highlight particular aspects of the codes of practice which directly relate to trustee engagement.

Code of practice 7 – trustee knowledge and understanding

- 3. Code of practice 7 recognises that the level of knowledge and understanding required of a trustee will vary depending on the type of scheme, their role and their level of expertise. Trustees may take into account, for example, the size and maturity of the scheme and whether there is an investment sub-committee.
- 4. To ensure that every trustee acquires the required level of knowledge and understanding, TPR has developed the trustee toolkit. Code of practice 7 states that 'the regulator is of the view that this is required study for new trustees unless [trustees] can find an alternative learning programme which covers all the items in the scope guidance at a level relevant for them and within the timescale allowed'. It is 'strongly' recommended that trustees review their knowledge and understanding at least annually.
- 5. Regarding professional trustees, the code of practice states that they should be appropriately qualified to fulfil their role, and be fully conversant with scheme documents, from the date of appointment onwards. (Nonprofessional trustees have a period of six months to do so from the date of their appointment.) It is also stated that 'experience will clearly be required [for professional trustees] and it is likely that a formal qualification will be expected'.

¹²¹ TPR notes (eg COP 7, p.4) that 'codes of practice are not statements of the law and there is no penalty for failing to comply with them. Nevertheless, codes have legal effect; they must be taken into account by the regulator, a court or tribunal, if they are relevant to what is being decided'.

Other codes of practice

- 6. Code of practice 3 ('funding defined benefits') states that 'trustees should have sufficient and appropriate knowledge and understanding to enable them to provide sound and prudent oversight of the investment strategy. This may require having investment and/or risk management expertise within the trustee board in order to critically evaluate and oversee the investment strategy and associated risks, particularly where more complex investment strategies or risks are undertaken'.
- 7. Code of practice 13 ('the DC code') states that the trustee board should have sufficient breadth of knowledge and understanding to 'fully understand any advice they receive' and to be able to 'challenge advice they are given'. Trustees are also expected to 'regularly monitor the performance of their service providers'.

TPR guidance

- 8. TPR has produced a series of guidance documents to help trustees comply with their legal requirements (several guides directly accompany the codes of practice). Here we highlight particular extracts that directly relate to trustees' engagement with their advisors and/or their levels of knowledge and understanding.
- 9. The guidance on 'relations with advisers' recommends that trustees should 'regularly assess whether the adviser is good value for money'. Trustees should also ensure that they have a clear understanding of the fees being charged; this includes understanding how and when fees may be increased, and assessing the reliability of advisers' cost estimates.
- 10. The guidance on 'scheme management skills' (accompanying code of practice 13) states that DC scheme trustees should assess advisors' and service providers' performance 'against documented targets, measures and/or objectives on a regular basis'. It also notes that 'monitoring the performance of advisors and service providers is a core element of the legal requirement on many trustee boards to assess annually the value for members provided by their scheme'.
- 11. 'DB investment guidance' (accompanying code of practice 3) recommends that if trustees consider fiduciary management an option for their scheme, they 'should commit sufficient time and resources to the process of selecting and appointing a fiduciary manager. This includes taking appropriate advice and considering a suitably wide range of potential managers, as for any other investment management appointment'. It is also suggested that trustees may

wish to appoint an independent third party to advise on the selection of a fiduciary manager, and the ongoing monitoring and evaluation of their performance.

21st Century Trusteeship

- 12. TPR's 21st Century Trusteeship campaign is a targeted communications campaign to clarify TPR's expectations of the actions that trustees should take to meet their requirements and to manage their scheme effectively. Trustees are prompted to assess their governance across a core list of standards, and are signposted to new and existing resources to help them do so.
- 13. Within the documentation, trustees are advised to assess their knowledge, understanding and skills annually and to evaluate the decisions they have made over the past year. It is also suggested that scheme Chairs conduct individual performance appraisals and ensure that there is an annual evaluation of the board's overall effectiveness.

Levels of engagement – regression analysis

14. Table 16: Levels of engagement – investment consultancy servicesTable 16 presents the results of five separate regressions considering the factors that potentially influence whether a scheme (i) switched, (ii) switched or tendered, (iii) conducted an internal review of fees and/or quality, (iv) conducted an external review of fees and/or quality, or (v) undertook any of these actions. The data is based on the CMA survey.

	(1) Switched	(2) Switched and/or tendered	(3) Internal review	(4) External review	(5) Any of these actions
DB	-0.03	-0.08	-0.00	-0.03	-0.02
DC	-0.13**	-0.18**	-0.09	-0.10**	-0.08
Small	0.06	0.01	-0.08*	0.02	-0.04
Large	0.10**	0.05	0.04	0.02	0.08**
Inv. Sub-Committee	-0.08**	-0.07	0.08*	-0.01	0.06
3 largest	-0.19***	-0.14***	-0.05	-0.01	-0.11***
Between 3-5 services	0.01	0.02	0.07	0.06*	0.05
Between 6-7 services	0.04	0.06	0.16**	0.10**	0.10
Actuarial services	-0.02	-0.04	0.03	-0.01	0.04
Fiduciary management	0.11**	0.12**	0.02	0.10**	0.04
Scheme administration	-0.07*	-0.03	-0.06	-0.05	-0.06
Constant	0.34***	0.51***	0.55***	0.12**	0.69***
Observations	783	783	783	783	783
R-squared	0.07	0.04	0.05	0.03	0.05
***	4				

Table 16: Levels of engagement – investment consultancy services

p<0.01, ** p<0.05, * p<0.1

Standard errors are omitted for brevity. Omitted categories are hybrid, medium, no investment subcommittee, fewer than 3 services, no additional (non-IC) services.

Source: CMA analysis of CMA survey

The fiduciary management switching process and costs

- 15. In this section we detail the process and costs for switching between fiduciary management providers. As noted in the main text, switching fiduciary management provider typically involves a considerable upfront revision to the client's investment strategy; this generally requires assets to be moved from one set of funds to another. Due to this revision, and the potentially costly transfer of assets, the switching process usually involves both a planning phase and an implementation phase.
- 16. We cover these two phases in turn.

Planning phase

- 17. There are several aspects of the planning phase, many of which can occur concurrently. Key amongst these are strategic planning, legal reviews and transition planning.
- 18. The overall timings involved in this phase depend on the complexity of the scheme's investment strategy, the level of negotiation required between the trustees and the provider, and the frequency of trustee board meetings. Responses from parties indicate that this process can take anywhere from a week to several months.

Strategic planning

- 19. The trustees and the destination provider need to agree suitable investment objectives and any constraints that will be placed on the provider. Based on this, an investment strategy will be developed which will determine the structure of the proposed investment portfolio. This will be underpinned by detailed statistical analysis, including the modelling of asset and liability movements under different scenarios.
- 20. These overarching investment objectives, guidelines and strategy will be incorporated into the investment management agreement (IMA), which is the contract between the client and the provider.

Administration and legal reviews

21. There are a number of administrative tasks that need to completed, including tax documentation and anti-money laundering ('know your client') checks. Most importantly, the client and provider need to agree upon the IMA – ie the underlying contract. This will involve a period of negotiation and review by legal advisors.

- 22. We have limited visibility into approximate legal costs, and they will vary on a client-by-client basis. Aon has submitted however that they have negotiated special rates with a number of law firms that have experience with their documentation.¹²² They will provide legal reviews of the IMA at a [%].
- 23. Depending on the arrangements of the destination provider, some schemes will be required to appoint a custodian, and those with an incumbent custodian will be required to complete relevant documentation. Particularly if a new custodian is required, this could take several weeks.

Transition planning

- 24. The destination provider will need to collect details from the trustees on the current investment arrangements of the scheme, including detailed account information and portfolio holdings. Based on this information, the provider will devise a transition strategy to reallocate the client's assets into the new portfolio (agreed as part of the strategic planning).
- 25. The provider will assess, for example, whether current investments need to be redeemed for cash, or whether some of them can be novated or transferred directly ('in specie'). Some funds, such as private market funds or property, may have 'lock-in' periods, which prevent the client from withdrawing assets without heavy penalties.

Implementation phase

26. The implementation phase is the process of transferring the client's assets into the new portfolio. As noted by a number of providers, the timing and costs involved vary considerably on a case-by-case basis and depend, in particular, on the complexity and liquidity of the client's current portfolio.

The transition process and timings

- 27. The time taken to transition assets from one portfolio to another varies considerably on a case-by-case basis. Overall timings are particularly affected by:
 - (a) The client's current portfolio. If a client is invested in highly illiquid assets (such as private market funds or infrastructure), there may be significant exit charges and lock-in periods. It may be cost effective to transfer such

¹²² Aon response to CMA information requests.

assets gradually, or in some cases to keep the assets in the current investment until the fund is wound down.

- (b) The process for redemption and investment. In some cases, clients may be able to transfer assets directly ('in-specie') between providers. In other cases, existing assets must be sold for cash before being re-invested in new funds.¹²³ If assets can be transferred directly, this can occur within a matter of days. Disinvesting (for cash) and reinvesting in new funds can be on a timescale of weeks or months.
- *(c)* Frequency of trading. If funds are traded daily, then assets can be redeemed from a fund within a few working days. Some funds only allow quarterly redemptions however, whilst some require several months' notice.
- 28. It is therefore difficult to generalise about the length of time taken to transfer assets from one portfolio to another. Cardano for example submitted that the transition process could take between a number of days and a number of months; they stated that this depends on the liquidity of the initial portfolio and specific redemption terms.¹²⁴ River & Mercantile submitted that the bulk of assets could be transferred within two to six weeks, but less liquid assets could take longer.¹²⁵ Russell Investments submitted that it takes between five and 90 days to disinvest from the portfolio held by the previous fiduciary management provider and five to 30 days to invest in the Russell Investments arrangements.¹²⁶
- 29. Each of the major fiduciary management providers has an in-house team to oversee or assist with the process of transitioning assets from the current portfolio to the targeted portfolio. The cost of this service is typically incorporated into the overall fiduciary management fee, although in some cases clients may be charged extra for particularly complex transitions.
- 30. Alternatively, schemes can appoint an external 'transition manager'. This is most likely to be done when the portfolio is particularly complex, and there are potential risks and/or costs that can arise during the transition. As an indication of the cost of an external transition manager, Aon has negotiated rates of [≫] bps with [≫].¹²⁷ This implies a cost of £[≫] for a client transferring £100 million of assets.

¹²³ As an example, [&] fiduciary management solution for clients with assets below £[&] is to invest in 'fruition funds'; clients have a choice of investing in [&] pooled funds. [&].

¹²⁴ Cardano response to CMA information requests.

¹²⁵ River & Mercantile response to CMA information requests.

¹²⁶ Russell Investments response to CMA information requests.

¹²⁷ Aon response to CMA information requests.

Transaction costs

- 31. In the absence of entry and exit charges applied to investment funds (discussed below), the main costs involved in transferring assets are 'transaction costs' which are ultimately paid to the banks and brokers that trade the securities.
- 32. Transaction costs vary considerably by asset class. BlackRock has provided the following estimates of transaction costs for a number of major asset classes, including both the 'sell cost' and 'buy cost'.¹²⁸ A scheme switching from one portfolio to another would typically be required to pay both of these transaction costs. These costs are not specific to BlackRock products but are based on typical pooled fund spreads observed in the market and exclude any transition management fees.

Table 17: Typical transaction costs by asset class

Asset class	Sell cost (%)	Buy cost (%)	
Equities			
UK equities	0.05 – 0.10	0.55 – 0.60	
International developed equities	0.10 - 0.20	0.10 - 0.20	
Emerging market equities	0.30 - 0.40	0.30 - 0.40	
Bonds			
Government bonds	0.02 - 0.05	0.02 – 0.05	
Corporate bonds	0.20 - 0.60	0.20 - 0.60	
Source: BlackRock, The above cost	s are as a % of assets	traded. The costs are not	specific to BlackR

Source: BlackRock. The above costs are as a % of assets traded. The costs are not specific to BlackRock products but they are estimated and based on typical passive pooled fund spreads observed in the markets.

- 33. A scheme's total transaction costs will therefore depend on the mix of asset classes in its current and proposed portfolios. Further, these costs may be significantly lower in cases where assets can be transferred 'in specie'.
- 34. A number of providers have submitted estimates of the overall transaction costs that might be incurred by pension schemes switching from one provider to another:
 - (a) Mercer submitted that the transaction costs incurred when disinvesting from Mercer funds for a scheme with 50% in growth assets would typically not be more than [≫]% of assets.¹²⁹ They noted that a client might incur similar costs if reinvesting the assets with another fiduciary

¹²⁸ BlackRock response to CMA information requests.

¹²⁹ Mercer response to CMA information requests.

management provider. This implies that overall transaction costs (based on an upper bound of [\gg]% of assets) could be around £[\gg] for a pension scheme with assets of £100 million.

- (b) WTW submitted that based on their experience, average transaction costs were around 0.25% of assets for clients with assets below £1 billion. This falls to 0.1% for those with assets above £1 billion.¹³⁰ For a pension scheme with assets of £100 million, this would imply total transaction costs of around £250,000.
- (c) Goldman Sachs submitted that depending on the proportion of total assets that are 'rebalanced' and their structure, transition costs could be below 0.25% of total assets.¹³¹ This could rise to up to 0.5-1% of total assets. If costs were to reach 1%, this would amount to £1 million for a pension scheme with assets of £100 million.
- (d) Schroders submitted that typical transaction costs of investing for a new client would be equivalent up to 0.08% of assets.¹³² This would imply total transaction cost of around £80,000 for a pension scheme with assets of £100 million. If a Schroder's existing client redeems assets to another provider, the typical transaction cost would be equivalent to 0.07% of assets. This would imply total transaction costs of around £70,000 for a pension scheme with assets of £100 million.
- *(e)* River & Mercantile submitted 3 case studies in which a client switched into their fiduciary management service from another provider. Although they were only able to provide approximations, transaction costs were in the range of 0.1% to 0.3% of assets.¹³³
- 35. To put these figures in context, we note that the Ernst & Young FM Fees Survey 2017 estimates a median fiduciary management fee (excluding investment management costs) of around 0.2 to 0.3% of assets per year, and overall fees (including investment management costs) of around 0.5 to 0.7% per year (for clients below £250 million).
- 36. Depending heavily on the complexity of the initial portfolio, transaction costs in some cases could therefore represent approximately a year's worth of fiduciary management fees.

¹³⁰ WTW response to CMA information requests.

¹³¹ Goldman Sachs response to CMA information requests.

¹³² Schroders response to CMA information requests.

¹³³ River & Mercantile response to CMA information requests.

Entry and exit charges

- 37. Apart from transaction costs, it is our understanding that most funds do not incur explicit entry or exit charges. The main exceptions to this are highly illiquid asset classes such as private markets, infrastructure and property. Investments in these asset classes may also be subject to lock-in periods, potentially lasting many years. As noted above however, such investments would not typically affect the switching process as they could be retained until the fund winds down.
- 38. Some funds may apply 'anti-dilution levies'. The aim of these levies is to protect remaining investors from fluctuations in the value of their holdings due to the exit of an investor. Such levies are therefore more likely to apply to larger investments, which may complicate the exit of particular funds.
- 39. SEI Investments for example submitted that disinvestment from its manager of manager funds may be subject to a redemption fee if the redemption amount from any particular fund represent more than 5% of the total assets of the fund; this is designed to protect other shareholders from the transaction costs associated with large redemptions.¹³⁴

Variation across clients

- 40. The overall switching process and timelines appear to be broadly similar for DC and DB schemes. There is an additional complication in the case of DC however in that individual members' investments are likely to be impacted by the change, which will require communication with members and records to be updated. As noted by Aon, 'the extent and type of communication will impact the expected timescales'.¹³⁵ River & Mercantile also note that individual members continue to contribute to their DC 'pot' during the transition process, and therefore a 'blackout window' may need to be put in place.¹³⁶
- 41. Parties indicated that there is no substantial difference between switching fiduciary management providers and moving into fiduciary management for the first time. Similarly, there appears to be no fundamental difference between the switching processes for full and partial fiduciary management. In practice, switching may be quicker in the case of partial fiduciary management as clients will not typically need to undertake the detailed strategic planning phase.

¹³⁴ SEI Investments response to CMA information requests.

¹³⁵ Aon response to CMA information requests.

¹³⁶ River & Mercantile response to CMA information requests.

Appendix A4: Assessment of survey evidence

CMA survey of pension scheme trustees

- As part of our evidence-gathering, we contracted IFF Research Ltd (IFF) to conduct a survey amongst trustees of UK occupational pension schemes (CMA survey).
- 2. IFF's report of the findings from the CMA survey was published on our case page here, along with a technical appendix that includes the questionnaire used with respondents. The survey tabulations were published alongside the report.
- 3. This provisional decision report draws on the findings from the CMA survey where indicated. In some cases, the results presented reflect our further analysis of the survey findings rather than the results as reported by IFF; this is indicated where applicable¹³⁷ and described in more detail below.
- 4. This appendix presents our assessment of those aspects of the CMA survey that we consider relevant when interpreting the CMA survey findings. It should be read alongside the IFF reports that include details on the survey methodology and analysis.
- 5. We are disclosing the survey data as part of a controlled disclosure exercise following publication of the provisional decision report; this will be in an anonymised format.

General interpretation of survey findings

6. We conducted a sample survey from a population of interest of just over 7,100 pension schemes and achieved 966 interviews. Most of the survey results presented in IFF's report and throughout this provisional decision report are being used as estimates for this population of schemes and, as such, are weighted to match the distribution of pension schemes in the population (as described in IFF's technical appendix). Unless indicated otherwise, results in this provisional decision report are also population estimates and are, therefore, subject to sampling error; examples of typical expected error margins around the point estimates, taking into account the weighting effects, are provided in IFF's technical appendix, but are not included here explicitly.

¹³⁷ Where the results presented in this provisional decision report are based on our further analysis of the CMA survey dataset, we refer to this as **CMA analysis of CMA survey**

7. The CMA survey sought as many interviews as possible in the time available, and the achieved sample size is adequate for our purposes in most respects. Nonetheless, some of the sub-groups of interest are less prevalent or it was harder to recruit trustees to participate and the numbers of interviews achieved were, therefore, relatively small. We generally consider that for findings to be given full evidential weight in our inquiries, one requirement is that estimates should have a base size of at least 100 respondents. However, we still present here results derived from smaller base sizes where they are relevant to the discussion.

Respondent's ability to speak on behalf of the trustee board

- 8. As described in IFF's reports, we sought to interview the chair of trustees, or another trustee, who would be able to speak on behalf of the entire trustee board about the pension scheme in question. At the screening stage this was specifically clarified and it was confirmed that the potential respondent would be able to do so. The script was written accordingly and, throughout the survey, respondents were reminded from time-to-time to speak on behalf of the board. Most of the reported findings were weighted to the population of schemes in scope for the survey, such that an analytical unit is a pension scheme and the results are, therefore, being treated as population estimates at the scheme/trustee board level.
- 9. We recognise, however, that the respondent's ability to answer on behalf of the trustee board, or their tendency to reflect their own, individual position may have varied according to a number of factors, for example:
 - (a) the number and type of trustees on the board;
 - (b) the respondent's own position on the board and trustee type;
 - (c) the respondent's length of experience as a trustee for the scheme in question;
 - *(d)* the respondent's past and current experience as a trustee of other schemes, and
 - (e) the type of question asked: for example, in some cases less factual questions seeking opinions or attitudes may have tended to elicit responses that were more relevant to the individual interviewee rather than the trustee board as a whole.

Respondent's recall/knowledge

10. The ability of the respondent to recall, or provide answers concerning, certain facts about the scheme's use of investment consultancy and/or fiduciary management services may have been related to a number of factors, including:

Elapsed time

- length of time over which the trustee board had used investment consultancy/fiduciary management services;
- length of time since a relevant event, such as purchase from a specific supplier, date of a tender process, last time a provider was formally monitored;

Extent of knowledge

- whether the respondent was on the board of trustees at the time of the event in question, such as switching provider for investment consultancy or fiduciary management services, when a tender process was undertaken, or when a third-party evaluator was last used;
- the respondent's experience as a trustee with the sampled scheme and their role on the board;
- the type of trustee interviewed and the number of schemes for which they act as a trustee;
- the individual's own level of knowledge and capability.
- 11. All the survey questions included a 'don't know' response option. For some questions, the extent of 'don't know' responses may suggest a lack of recall or knowledge on the part of a material number of trustees.
- 12. Again, depending on the question being asked, and its response options, there may be different possible interpretations of 'don't know' responses and, consequently, different approaches to their treatment.
- 13. Except where stated otherwise, for reasons of consistency IFF have retained 'don't know' responses in the denominator of their calculations. In our analysis, we have made judgements on how to treat 'don't know' responses on a case-by-case basis. Therefore, in some instances the findings presented in this provisional decision report differ from those in IFF's report at least in part due to a different treatment of the don't know' responses.

Number of times an individual trustee was interviewed

- 14. IFF's technical appendix details how the sample was prioritised and how trustees were recruited to take part and screened. The intention was to interview an individual only once, notwithstanding that they may have been a trustee for multiple schemes in the sample.
- 15. Following the completion of fieldwork and analysis, it became apparent that there were a number of occurrences where the same individual had, in fact, been interviewed more than once, as follows:
 - (a) 24 people were interviewed twice (affecting 48 schemes);
 - (b) six people were interviewed three times (affecting 18 schemes);
 - *(c)* in total, 30 people were interviewed more than once (affecting 66 schemes).
- 16. IFF have provided an explanation of the ways in which this came about, as follows:
 - (a) In general, the sample was filtered to avoid any individual being listed more than once, however, in some cases, when submitting information to TPR regarding trustee names and details, individuals had used different phone numbers and/or email addresses, making it impossible to entirely eliminate duplicate individuals. Duplicate individuals were not eliminated by name alone, due to the possibility of false positives being detected using this method.
 - (b) And, more commonly, when recruitment for interviews took place, as had been agreed, IFF took referrals to trustees not listed on the sample, but who could reasonably be expected to be eligible to take part. When a referral took place, it was not possible to detect duplicate contacts in real time against the existing sample, nor against the identities of those that had already completed surveys.
- 17. In our view, this extent of duplication will not have had a material impact on the survey results or quality, as in each interview the respondent was asked to speak on behalf of the trustee board for the sampled scheme, all of which were unique in the final survey dataset. Nonetheless, we note that there are some attitudinal questions where the responses may have reflected the individual's own views (as discussed above) and where within-subject effects may, therefore, have had a small impact on the estimates obtained.

Potential for response bias

- 18. Response bias will have occurred if:
 - (a) The achieved sample was not representative of the population of interest in respect of certain characteristics (after the incorporation of design weights); and
 - (b) these characteristics are associated with respondents providing particular answers to survey questions; and
 - (c) it has not been possible to identify and correct for this bias (through additional weighting).
- 19. An example is where those individuals who are relatively more engaged in a market (than the average for the target population) have a greater propensity to respond to a survey about that market and to then provide responses that demonstrate high levels of engagement, such as searching and switching. Without corrective weighting, this would produce biased population estimates that suggest there is more engagement in the market than is actually the case. In practice, it is often difficult to identify and correct for any such biases, as insufficient is known about the group who have not responded to the survey.
- 20. For the CMA survey it is not possible to rule out some degree of response bias. It is conceivable that the pension scheme trustee boards covered by those trustees who were interviewed may not be representative of the target population (even after applying design weights) in respect of certain characteristics that could be expected to be associated with the distribution of responses for some questions.
- 21. It is important to note that, should such a bias exist, it could arise in a variety of ways, not just because those who are more engaged in the market may be more likely to take part. It could be that, for example, those with a particular view of investment consultancy or fiduciary management services as a whole, or of their own provider(s), might be particularly likely to respond and to provide answers that bias the population estimates in a particular direction.
- 22. The dataset provided by The Pensions Regulator (TPR) as the sampling frame for the CMA survey contained limited information to inform a comparison of the schemes responding to the survey with all schemes in scope. The TPR dataset didn't include variables likely to be associated with the trustee board's level of engagement or capability and, although it included a variable to record use of investment advisers, we had been advised by TPR that this was provided to them by schemes on a non-

compulsory basis and unlikely to be a reliable measure of use of investment consultancy services for our purposes. Differences in distribution across scheme type and sizebands were already corrected using design weights. We compared scheme-specific variables between the weighted achieved sample and the population, where available in both datasets; these didn't provide any compelling evidence that the weighted achieved sample was not representative of the population, in respect of these variables.¹³⁸

- 23. We also compared the survey response dataset with client data provided by the parties to inform our investigation, in part to examine measures of engagement. We note that this was not a like-for-like comparison, that only limited relevant variables were available in a useable form across the various client datasets and that the quality and completeness of the client data was mixed. Variables looked at related to:
 - (a) whether the scheme had an investment sub-committee;
 - (b) value of AUM;
 - (c) length of time the scheme had bought investment consultancy/fiduciary management services (from current provider[s]);
 - (d) switching, tendering and inviting proposals in the last five years;
 - *(e)* whether first fiduciary management provider was also an investment consultant at the time;
 - (f) tendering on first move to fiduciary management.
- 24. Notwithstanding the limitations highlighted at the paragraph above, we note that we did not find strong or consistent indications from the above comparisons that schemes participating in the survey appeared to be more engaged on average than the parties' clients. Whilst amongst surveyed schemes, tendering as part of the process for switching investment consultancy was higher and fewer schemes appointed the incumbent investment consultant as their first fiduciary manager (compared with parties' clients), fewer surveyed schemes had an investment sub-committee and other measures of switching and tendering were broadly similar.

¹³⁸ Variables compared were: scheme status ('Closed', 'Open', 'Paid Up', 'Winding Up'); whether Master Trust (only applicable to DC schemes); number of trustees.

Providers of investment consultancy and fiduciary management services

- 25. Trustees were asked during the interview if they used investment consultancy services and/or fiduciary management services and, if so, which provider(s) they used for each service bought and which were their main provider(s). Also, where applicable and for investment consultancy services only, which provider they had most recently switched from.
- 26. It was necessary for a survey conducted by telephone and that needed to elicit a high level of response to keep read-out text concise and avoid lengthy descriptions. It was also necessary to define investment consultancy services and fiduciary management services and we recognised that these terms would be less familiar to some trustees than others. The draft questionnaire was consulted on, tested through cognitive interviews and piloted, and a balance reached on how comprehensive we could make the definitions, and of fiduciary management services in particular.
- 27. The questionnaire was, of necessity, finalised at an early stage of our investigation and we provided lists of providers of investment consultancy services and of fiduciary management services known to the CMA at that time for interviewers to code responses against, together with the option of 'other specify'.
- 28. Our subsequent analysis of the responses to questions where trustees were asked to name investment consultancy and/or fiduciary management providers highlighted that some trustees had cited companies that were either known not to be providers of investment consultancy services or fiduciary management services (as appropriate), or that we did not know whether or not the named company was a provider of the services in question.¹³⁹ Where a respondent had named such a company, this could mean that:
 - (a) the company had been named correctly as a provider, but we had not found sufficient evidence during our market testing that it offered the services;¹⁴⁰ or

¹³⁹ We are also including within this category the possible outcome whereby a respondent had correctly named a provider, but the interviewer had not recorded it correctly, either against the pre-code list we provided or as a freetext entry following an 'Other (specify)' response.

¹⁴⁰ However, in some cases we were able to map what was recorded on the survey dataset to existing providers where, although the names did not match perfectly they were so close that it was considered highly likely that the discrepancy arose due to imperfect recall or recording of names; in these cases we treated the response as being a provider of the investment consultancy or fiduciary management services.

- (b) investment consultancy or fiduciary management services were in fact purchased by the scheme, but we had confirmed the company which was named did not offer the services; or
- (c) the scheme did not, in fact, purchase the services and the respondent had been confused by the meaning of investment consultancy or fiduciary management and given an incorrect response at the earlier question that asked what services were bought by the scheme (and had subsequently been asked all the questions that assumed they bought the services).

It was not feasible to distinguish between the scenarios at (a), (b) and (c) above.

Providers of investment consultancy services

- 29. As discussed above, some companies named by survey respondents as providers of investment consultancy services were not known to the CMA as providers of these services. However, the proportion of such responses was relatively low, and we recognised that because of the nature of advisory services it is particularly difficult to rule out, without additional research on a case-by-case basis, the possibility that a named company does in fact provide investment consultancy services.
- 30. In view of this, we decided to assume, for the purposes of analysis of survey data, that all companies named by respondents as providers of investment consultancy services did provide these services to the schemes which cited them.

Providers of fiduciary management services

- 31. It was more common for companies not known to the CMA to be named in response to questions about providers of fiduciary management services than in response to questions about providers of investment consultancy services. This is likely to reflect, in part, that fiduciary management services are less widely used and understood and, therefore, less familiar amongst trustee boards. There are a number of different ways that fiduciary management services may be described and it is also possible to have a 'partial mandate' arrangement that may have added to confusion amongst some trustees.
- 32. We refer to a company that we have confirmed does provide fiduciary management services to be a 'confirmed provider of fiduciary management services'. There are 17 such confirmed providers of fiduciary management

services, of which 15 were cited by survey respondents as providers of fiduciary management services. We recognise that this group is likely to exclude some valid providers of fiduciary management services named by trustees that are not known to the CMA, however, for certain analyses, we chose to take the approach that minimised the risk that results would be distorted by the inclusion of cases that didn't purchase fiduciary management services.

- 33. A total of 71 companies were named in the survey as being a main provider of fiduciary management services (though only a small minority of schemes said they used more than one provider for fiduciary management services). However, in terms of the proportion of the 279 schemes (26% of all schemes) that said they bought fiduciary management services, the 15 confirmed providers of fiduciary management services (cited by survey respondents) cover 50% of these schemes. If all schemes that named a non-confirmed provider of fiduciary management services as their main provider were considered not to buy fiduciary management services at all, then we would estimate that 145 schemes (or 13% of all schemes) buy fiduciary management services.
- 34. Some of our internal analysis included sensitivity testing to establish whether different treatment of cases where non-confirmed providers were cited produced materially different findings. The way responses were treated in analysis presented in this provisional decision report varied depending on the survey questions being used to inform the analysis and whether or not the results were sensitive to different approaches. Generally speaking, analysis based on questions that could be expected to be reliably answered only by those that bought fiduciary management services included only those cases where a confirmed provider of fiduciary management services had been named by the respondent.
- 35. This means that some results presented in this provisional decision report differ from apparently similar measures in IFF's report, at least in part for the above reason; there may also be differences within this provisional decision report, depending on the analysis undertaken and its purpose.

Respondents' views on ease of monitoring of existing providers and of assessing bids

36. Where we consider that it is the most appropriate approach to take, we only report the percentage claiming to find aspects of monitoring and assessment

¹⁴¹ The numbers and percentages of schemes buying fiduciary management services are scheme-weighted, consistent with the presentation throughout our provisional decision report.

to be 'very easy'. However, where both 'very easy' and 'fairly easy' responses are included, we report them separately; this reflects our view that, in this case, combining these categories to form an 'easy' category (which is an approach often taken in reporting survey findings) is less transparent and more likely to be open to misinterpretation.

- 37. Overall, high proportions of trustees stated that they found a range of aspects of monitoring and assessment to be 'very easy' or 'fairly easy'. While there are significant differences between some sub-groups for particular questions, these are often relative to high average proportions.
- 38. We consider that the claimed levels of ease of monitoring and assessment do not necessarily imply that information provided by investment consultants and fiduciary managers is consistently clear, regular and comparable, nor that trustee boards are necessarily demonstrating widespread capability in the market. Rather, we consider that the 'very easy' and 'fairly easy' responses are likely to reflect a mix of:
 - (a) clear and comparable information being assessed by engaged and capable trustees;
 - (b) clear and comparable information being assessed by trustees who are less engaged and/or capable; and
 - (c) less clear and/or comparable information being assessed by trustees who are less engaged and/or capable.
- 39. In support of the above view and to aid interpretation of these results, we note the following:
 - (a) Information provided to trustee boards by providers, or potential providers, is highly variable, for many reasons. For example, information provided may depend on characteristics of the scheme, trustee board and services bought/offered; different methodologies and technical assumptions used by providers may mean that the information presented is not as clear or comparable as trustees assume. Trustee boards surveyed will generally only have access to those documents relevant to their own scheme(s) and will not have been assessing information on a 'like-for-like' basis, and some 'very easy' or 'fairly easy' responses may reflect trustees not knowing 'what good looks like'.
 - (b) As discussed above, we cannot rule out the potential for a degree of response bias in our survey. This could have occurred, for example, if those schemes with more engaged or capable trustee boards were more likely to respond to the survey and so were over-represented in the
achieved sample (even after weighting). If this were the case, we would reasonably expect such a sample to find monitoring and assessment tasks easier than average in the target population as a whole.

- (c) We purposefully prioritised interviewing the trustee who was most able to speak knowledgeably on behalf of a pension scheme trustee board, more often than not the chair. These respondents may, typically, also be more experienced in tasks associated with monitoring and assessment and, therefore, find them easier. Even though respondents were asked to answer on behalf of the board as a whole, it is conceivable that in some cases the individual may not have done this for attitudinal questions of this type.
- (d) Furthermore, questions concerning the ease of understanding and comparing proposals were asked only of those who had engaged in the market by tendering and, in some cases, switching provider, so these responses reflect the views of relatively more engaged trustee boards.
- (e) The question about ease of monitoring aspects of the existing main provider's offering was, intentionally, asked before the question that sought to establish the types of monitoring that had actually been undertaken within the last three years. Some trustee boards had undertaken none of the specific types of monitoring activity we asked about. It is likely that some responses regarding claimed ease of monitoring may have been less informed than others, for example where they were not based on actual experience.
- (f) Other evidence we have collected to inform our investigation indicates that there is considerable variation in the level of detail and clarity in information provided and that in some communications with trustee boards information from providers on fees, performance and quality is not clear, regular and comparable. While not directly comparable, this is consistent with the view expressed above that the levels of ease of monitoring and assessment claimed by survey responses do not necessarily imply that information provided to trustee boards is consistently clear and comparable.
- 40. In relation to our assessment of survey quality, we note the following:
 - (a) We purposefully conducted a large-scale quantitative survey that would primarily provide robust estimates of factual information to inform our investigation.
 - (b) In doing so, we recognised that responses to some attitudinal questions would be harder to interpret, including where they were limited to rating-

scale response options. They reflect perceptions rather than facts and we interpret the findings accordingly. Also, responses to such questions may be more likely to reflect the attitudes of the individual respondent than the trustee board as a whole.

- *(c)* Following the CMA survey, we conducted some further trustee engagement, including with groups of trustees who had responded to the survey, to complement our survey findings by examining some aspects in more depth than had been possible in the survey script. This included exploring trustees' views on the information provided by investment consultants and fiduciary managers to trustee boards as part of an existing relationship or a tender.¹⁴²
- (*d*) In our provisional decision report, we consider the survey findings alongside other types of evidence, in the round.

Consultation on the proposed survey methodology and draft questionnaire

- 41. We invited comments from stakeholders to our investigation on the proposed survey methodology and a draft of the questionnaire between 16 and 20 October 2017. This coincided with IFF's cognitive testing of the survey script, but preceded the pilot stage of fieldwork, which didn't begin until 9 November. This timing meant that we were able to give consideration to stakeholders' input alongside IFF's feedback from their cognitive interviews.
- 42. In total, we received responses from 10 parties to the investigation; from TPR and the FCA; and from one other stakeholder. We reviewed all comments and suggestions received and made a number of revisions to the questionnaire as a result, ahead of fieldwork.
- 43. Amongst the submissions received were a number of requests to include additional questions or extensions to existing questions. At the stage when we consulted on the questionnaire, we already knew that existing questions would have to be prioritised and some cut to keep the average interview lengths within recommended ranges. In most cases, we decided not to add completely new questions (or to significantly lengthen existing read-out questions) in response to comments received; this was mainly because we did not consider the suggested additions to be higher priority for our purposes than existing questions.

¹⁴² CMA (30 May 2018) Note of CMA roundtable discussions with pension trustees.

Parties' responses to working papers

- 44. In responding to our working papers, notably the papers on 'information on fees and quality', 'trustee engagement' and 'supply of fiduciary management services by investment consultancy firms', some parties commented on methodological aspects of the CMA survey or on our interpretation of the results in our emerging findings. Comments of this nature made by one or more parties included the following (which are grouped by topic area and presented in summary):
 - (a) A number of parties commented on the high proportion of respondents who stated that they found aspects of monitoring to be 'very easy' or 'easy', for example, in respect of the information on fees and quality they receive from their providers. Some parties submitted that there is not sufficient evidence, including from the CMA survey, to justify our emerging findings concerning information on fees and quality.

CMA response:

Paragraphs 36 to 40 above provide our comments on the results from the CMA survey in relation to claimed ease of monitoring of providers and of assessing bids; these are intended to aid interpretation of these results.

(b) The question on conflicts was leading and may have biased, or otherwise affected, the objectivity of the results.

CMA response:

When designing and consulting on the guestionnaire, we considered this aspect, but decided that we wanted to seek views on specific potential conflicts that had been identified and that it was, therefore, important to ask the question in a prompted way. In order to mitigate the potential for leading the respondent, we looked very carefully at the wording of each part of the question and the response options and both randomised the order of the sub-questions and reversed the response scales for half the sample. We also asked about the market in general, not the respondent's own service providers (if any) and asked the question at the end of the questionnaire to avoid it possibly causing the respondents to have potential conflicts in mind when answering other questions. Nonetheless, we are aware that some respondents may have been led to think about specific potential conflicts at this question, where they may not otherwise have had them in mind. Overall, we consider that the CMA survey provides useful evidence on trustees' attitudes concerning potential conflicts in the markets for investment consultancy and fiduciary

management services, especially when viewed alongside other evidence that we have collected to inform our investigation.

(c) The survey was unbalanced in the topics it focused on.

CMA response:

When designing and consulting on the questionnaire, we considered all submissions made on content and structure. As explained above, it was necessary to prioritise topics and individual questions for inclusion to include those of most relevance to our investigation; in doing so, we recognise that other topics that we or others considered desirable could not be included.

(*d*) Alternative interpretations can be drawn if results are presented in different ways (eg how different response categories are combined, or how 'don't know' responses are treated).

CMA response:

We are aware of the potential for this to happen and these points have been addressed above or in IFF's report. In general, we have sought to present the survey results transparently throughout and in the way most appropriate to the analysis being undertaken.

Appendix A5: Quantitative analysis of investment consultancy and fiduciary management prices

Introduction

- 1. In this appendix, we set out our full quantitative analysis to understand whether there is a link between customer engagement and investment consultancy and fiduciary management price levels. This underlies the material presented in Chapter 10 in the main report.
- 2. In order to address this question, we have conducted a quantitative analysis using data provided by several providers of investment consultancy and fiduciary management services. In particular:
 - (a) For our analysis of investment consultancy, we include the following 13 providers: Aon, Barnett Waddingham, Cambridge Associates, Cardano, Hymans, JLT, KPMG, LCP, Mercer, Redington, River and Mercantile, Russell Investments, and WTW.
 - *(b)* Our analysis of fiduciary management prices focussed on the following providers: Aon, WTW, Mercer, JLT and River and Mercantile. These providers make up the majority of the fiduciary management market in revenue terms,¹⁴³ and are the firms for which a significant number of schemes had previously used the fiduciary management provider for investment consultancy.¹⁴⁴
- We have also conducted a more qualitative assessment of market outcomes which also using other sources of evidence; this is set out in Appendix 6. The same appendix contains our full analysis of quality parameters.
- 4. This appendix is structured as follows:
 - (a) First, we set out context surrounding the key concepts and parameters for this analysis, focussing on what we mean by 'engagement' and 'price'; how we measure these two variables; and what is the scope of this assessment.

¹⁴³ Mercer said that the total revenues implied from the summary statistics we present for the included firms made up less than 50% of the total fiduciary management revenues we set out in the Competitive Landscape analysis in Chapter 4. (source: Mercer's Response to the Gains from Engagement Working Paper, page 7) We note that we do not have full data on all schemes at these providers, and as such the total revenue of the included schemes will differ from the total revenues of the provider.

¹⁴⁴ This is consistent with the fact that many fiduciary management providers do not offer standalone investment consultancy services. Russell Investments is another large player in terms of Fiduciary Management. However, data provided by Russell Investments appeared to show that almost all of their schemes are Externally Acquired.

- *(b)* Second, we explain the economic framework we have applied to construct a meaningful comparison of scheme prices. We also outline the methodology used for our quantitative comparison, including the econometric models.
- (c) Third, we provide a description of our data and key variables
- (*d*) Fourth, we provide summary statistics as well as key descriptive statistics for important variables,
- (e) Fifth, we show the results of our quantitative analysis for investment consultancy and fiduciary management and discuss our interpretation of these.
- 5. We then summarise our provisional conclusions, which are set out in full in chapter 10.

Key context

- 6. In this section, we briefly explain in more detail relevant background to our treatment of:
 - (a) Price, the dependent variable of interest
 - (b) Engagement, our key independent variable of interest

Price as the dependent variable

- 7. Our dependent variable in this analysis is price. We use the following approach to measuring price:
 - (a) In investment consultancy, prices are generally charged on an hourly basis. We therefore analyse price as implied spend per hour, calculated from Parties' data.
 - (b) In fiduciary management, prices are almost always charged at least in part as a fraction of assets under management. We therefore analyse price as spend per unit of asset management, expressed in basis points (that is, percentages multiplied by 100). We calculate this using data provided by the parties on spend and AUM.¹⁴⁵

¹⁴⁵ For our analysis of schemes' transition into fiduciary management, we analyse spend rather than price. This is explained further in paragraph 36.

- 8. Three parties said that price is a relevant parameter of competition for analysis of market outcomes, amongst others. Russell Investments said that 'fees are a suitable metric for assessing client outcomes',¹⁴⁶ WTW said that 'fees paid to providers are a relevant dimension on which competition takes place',¹⁴⁷ and Redington said that 'we would expect that good engagement with Investment Consultants also benefits [non-price outcomes] as well'.¹⁴⁸
- 9. Nevertheless, several parties' questioned our decision to conduct in-depth analysis of the link between market outcomes and engagement focussing on price.
- 10. Aon said that analysis which ignores non-price measures of scheme outcomes was largely meaningless,¹⁴⁹ and even if analysis did reliably link higher prices to lower levels of engagement, Aon noted that higher prices could reflect higher returns or higher quality.
- 11. We consider for this to be true, less engaged schemes would need to be provided with higher quality services, and there do not appear to be strong reasons to expect that this is the case. ¹⁵⁰
- 12. LCP said that non-price gains from engagement, such as asset management fee discounts, risk-adjusted returns on assets, and quality of service factors, 'may be substantially higher than the gain from any reduction in [the] investment consultancy fee'.¹⁵¹ Aon,¹⁵² Mercer,¹⁵³ WTW,¹⁵⁴ and Russell Investments,¹⁵⁵ also highlighted various other non-price parameters.
- 13. We consider that price is an important market outcome in itself: although prices may appear relatively low when expressed as a percentage of scheme assets for example, they still represent significant monetary amounts in themselves.¹⁵⁶

¹⁴⁶ Russell Investments response to the Gains from Engagement Working paper, p 1; Russell Investments said that target returns would be suitable metrics for assessing return outcomes.

¹⁴⁷ WTW's response to the Gains from Engagement Working Paper, p 3. Although they said that price was a relevant parameter, WTW also stressed that they considered an exclusive focus on price to be inappropriate. ¹⁴⁸ Redington's response to the Gains from Engagement Working Paper, p 1.

¹⁴⁹ Aon's response to the Gain's from Engagement Working Paper, p 2.

¹⁵⁰ It is conceivable that engagement on these measures could be associated with schemes' focussing more on price than on quality, and consistent with this receiving low prices but low quality. We do not consider this likely however. For example, one piece of contrary evidence is that our qualitative review of internal documents (see Appendix 6 indicates that improvements rather than worsening of quality is likely to be associated with engagement.

¹⁵¹ LCP's response to the Gains from Engagement Working Paper, p 3.

¹⁵² Aon's response to the Gains from Engagement Working Paper, p 2-3

¹⁵³ Mercer's response to the Gains from Engagement Working Paper, p 5

¹⁵⁴ WTW's response to the Gains from Engagement Working Paper, p 3

¹⁵⁵ Russell Investments' response to the Gains from Engagement Working Paper, p 1

¹⁵⁶ Further, it is less clear that they are small when compared with the additional (risk-adjusted) return generated by the provider above the level which the scheme could generate by itself, which is the relevant benchmark.

- 14. Furthermore, the mechanisms through which more engaged schemes may receive better 'price' terms (for example, through trustee led negotiation and providers responding to actions such as tendering) are also those mechanisms through which they could achieve better 'quality' terms.¹⁵⁷ Therefore, our analysis of price could be indirectly informative of quality outcomes.
- 15. There are also practical considerations: prices can be more accurately measured than quality (which has many dimensions, not all of which are observable). As a consequence, we can have confidence that our analysis of price includes accurately measured variables, which would not necessarily be true of a quality analysis.
- 16. Nevertheless, we recognise that quality is a very important part of these services and we consider this further in Appendix 6.

Measuring engagement

- 17. By engagement, we mean the extent to which trustees can assess the value for money of providers, and (where necessary) act on the outcome of that assessment.¹⁵⁸ In this section we explain how we measure engagement, and present some key descriptive statistics for this variable.
- In order to test whether engagement by trustees affects the price they obtain, we need to have a measure of engagement. But we cannot directly observe engagement.
- 19. As in our analysis of the level of trustee engagement, our approach is based around whether schemes exhibit *indicators* of engagement. However, this analysis uses slightly different engagement indicators than our trustee engagement analysis because we use a different data source: our analysis of trustee engagement focussed on measures in the CMA Survey; here we focus on measures based on the Parties' data.
- 20. For this analysis we consider the following engagement indicators:
 - (a) The use of a formal tender. Schemes which have performed a formal tender have undertaken a process to evaluate those providers who submitted a response to a tender to supply them with investment consultancy or fiduciary management services and selected what they consider to be the best option. This indicates a scheme is engaged as

¹⁵⁷ Identifying a price relationship may therefore proxy for a broader effect covering non-price factors

¹⁵⁸ See paragraph 6.1.

the scheme is looking to ensure it is getting the best possible offer from its provider.

- *(b)* The use of a Third-Party Evaluator (TPE).¹⁵⁹ TPEs are companies which are externally employed to assess the value of providers on an ongoing basis or to evaluate whether the move to fiduciary management is right for the scheme. Where schemes have used a TPE, they have undertaken an independent assessment of the providers in the market and will be in a better position to assess which provider offers the best value deal.¹⁶⁰
- *(c)* The existence of a Professional Trustee (PT) sitting on the board of trustees. Professional trustees may have greater experience in dealing with providers allowing them to ensure the scheme is attaining the best market offering.¹⁶¹
- 21. Furthermore, for fiduciary management clients, we divide schemes into two groups depending on whether they were Internally Acquired or Externally Acquired (that is, whether they previously used the fiduciary management provider for investment consultancy or had not). Whilst this is not necessarily a measure of engagement per se, Externally Acquired clients will have changed provider when moving into fiduciary management, and could therefore be considered to have 'switched' provider.
- 22. Whilst some forms of engagement, for example tendering, are more likely to be effective than other forms, we acknowledge that there are many different ways in which schemes could apply pressure to their providers. As a consequence, we construct an engagement proxy which treats a scheme as likely to be more engaged if it has any of the three indicators (tendering, TPE usage or having a PT).
- 23. Aon,¹⁶² Mercer, ¹⁶³ WTW, and KPMG¹⁶⁴ told us that this way of measuring engagement was too narrow and that we should include other measures. We

¹⁵⁹ Parties submitted data firstly detailing, 'Whether the client has previously engaged a third party to recommend whether moving into fiduciary managed services was appropriate, within the last 5 years (if known)' then detailing, 'Whether the client engages a third party to recommend whether moving into fiduciary managed services was appropriate (if known)'. For our analysis we have considered a 'Yes' to either question to equate to the use of a TPE given some concerns about how use of TPEs has been classified between variables in responses.

¹⁶⁰ Our analysis of Trustee Engagement considered *external review of fees and/or quality,* see paragraph 6.53. The use of TPE is likely to overlap very closely with this measure.

¹⁶¹ Professional Trustees were not analysed as an engagement indicator in the Trustee Engagement section due to data limitations. We consider that Professional Trustees may have characteristics which enable schemes using them to challenge investment consultancy and fiduciary management providers' fee proposals and to push for discounts more effectively; see paragraph 6.53.

¹⁶² Aon's response to the Gains from Engagement Working Paper, p 1

¹⁶³ Mercer, Response to the Gains from Engagement Working Paper, p 4

¹⁶⁴ KPMG, Response to the Gains from Engagement Working Paper, p 5

consider that these measures capture a sufficiently broad set of different forms of engagement. Further, omitting measures from the CMA survey and other data sources is necessary in order to achieve a sufficient sample of schemes for analysis in the Parties data, due to challenges in matching these two data sources.¹⁶⁵

- 24. Aon also told us that engagement is complex and nuanced, rather than a binary concept.¹⁶⁶ We acknowledge this, however it is common practice in quantitative analysis to measure continuous variables in discontinuous ways, provided that the measure is interpreted correctly. Our analysis is not intended to suggest that schemes which have one of these indicators are definitively engaged, and those with none are entirely disengaged.
- 25. We consider that schemes which have at least one indicator are *more likely to have higher engagement levels, than schemes which have none*. We therefore refer to schemes with at least one indicator as 'more engaged', and those with no indicators as 'less engaged', in what follows.
- 26. We acknowledge that this approach of proxying engagement will prevent us from perfectly measuring the underlying concept in our analysis. ¹⁶⁷ Whilst the direction of any bias arising is difficult to assess exactly, we do not think there is any particular reason to suggest the bias would more likely overstate 'gains from engagement' than understate it.

Methodology

- 27. In this section, we explain the methodologies we have used to compare prices by engagement. The section is structured as follows
 - (a) First, we explain our approach in terms of the high-level methodologies and parameters of our analysis
 - (b) Second, we introduce our econometric model

¹⁶⁵ The low coverage of valid external IDs such as HMRC scheme identifiers has meant that it is not possible to combine the Parties' data with the survey to conduct analysis which relied on a wider set of engagement measures than those provided by the Parties to us directly through our data requests. Whilst the Parties data does include some limited additional engagement measures, namely whether the provider believes the scheme has an investment subcommittee, whether the client was acquired through less formal methods such as an 'informal tender', and the date of the last 'structured bidding process'. We consider that the three engagement indicators set out above are sufficient to capture information on engagement and are more likely to be objectively defined and therefore comparable across schemes and providers.

¹⁶⁶ Aon's response to the Gain's from Engagement Working Paper, p 1

¹⁶⁷ In particular, it will introduce proxy error (the indicators we have chosen are imperfect proxies for engagement, because there are other ways of engaging with the market not captured in these variables, even if perfectly measured), and potentially also measurement error (some more engaged schemes may be recorded as less engaged if, for example, the Parties had no record of the scheme having tendered).

Our approach

- 28. For both investment consultancy and fiduciary management, we have undertaken analysis of 2016 prices (the most recent full year before this inquiry began), for both investment consultancy and for fiduciary management. We term these the Static Assessment, for each type of scheme.¹⁶⁸
- 29. We have focussed on DB and Hybrid schemes. This is primarily because our dataset does not include schemes which paid comparatively low levels of fees. Because this is more common for DC schemes, we cannot be confident that the DC schemes in our data are representative.¹⁶⁹
- 30. Within the above scope, we have undertaken two different types of comparison for both investment consultancy and fiduciary management.
 - (a) A simple comparison of averages to understand whether schemes which are more engaged are charged higher prices than schemes which are less engaged. We undertake a number of related comparisons, although we place most weight on our comparison of median¹⁷⁰ prices amongst schemes of similar types and service purchasing decisions.¹⁷¹
 - (b) A regression analysis, which in simple terms is a statistical technique which allows us to model price and spend in terms of several hypothesised drivers of spend (eg engagement) whilst holding potentially confounding factors (eg size) constant.
- 31. In both cases, we account at least partially for confounding factors. These are drivers of spend which could cause more engaged schemes to pay more or less, on average, than less engaged schemes for reasons unrelated to their level of engagement. An example could be scheme size. Statistics

¹⁶⁸ We generally exclude schemes which had been with their investment consultancy or fiduciary management provider for less than a year, because the total fees they pay will be incomparable to schemes paying for a full year. Their fees could include some 'set up' costs, and could only be for a few months work. We also exclude schemes for which we did not know the join date, because some of these schemes may have joined in the last year.

year. ¹⁶⁹ Requests to four parties included a cut-off in revenue terms of £30,000 in 2016. Requests to other parties included a cut-off in revenue terms of £20,000 in 2016. Schemes which paid less than these values were excluded from the scope of the request to reduce the number of clients on which the Parties had to provide data. This threshold is sufficiently low to mean that our analysis is generally informative, although we remain cautious in extrapolating findings to the very smallest schemes.

¹⁷⁰ We focussed on medians rather than means, because the median is less affected by large values in our dependent variable. Our regression analysis uses the full distribution of values in the dependent variable, but includes more control variables which might adjust for characteristics which cause the variable to have large values. This is not true of our medians analysis, which controls for at most two confounding factors in order to preserve sample size.

preserve sample size. ¹⁷¹ We also compare the full distribution of prices paid by schemes, as well as median prices, depending on whether they are identified as more or less engaged without controlling for confounding factors. Whilst informative, we place less weight on these results.

which do not account for these other drivers could erroneously identify a relationship between engagement and price, or could erroneously imply such a relationship does not exist.

- 32. The comparison of medians has the benefit of simplicity, whilst the regression approach allows us to use the full distribution of prices, to control more comprehensively and flexibly for confounding factors, and to understand the statistical significance of any identified price differentials.¹⁷²
- 33. For fiduciary management, we were able to construct an additional analysis which used information on prices paid by the same scheme at earlier points in time. ¹⁷³ In particular, we compared price changes for schemes which moved from investment consultancy into fiduciary management with the same provider. We term this the Transition Assessment.
- 34. The logic to the transition analysis is as follows. Fiduciary management is more expensive than IC because it involves more services being delivered, and therefore schemes will face a price increase when moving from IC to FM. However, engagement may cause schemes to face a lower price increase than they otherwise would.
- 35. In particular, although it is possible that more complex schemes pay more overall, there is less reason to think that they would face a greater price increase when moving into fiduciary management relative to the prices they paid in investment consultancy, than less complex schemes. As a consequence, this analysis should be less affected by complexity as a confounding factor.¹⁷⁴
- 36. We measure the spend increase when moving into fiduciary management as the ratio of fiduciary management to investment consultancy spend.¹⁷⁵ For

¹⁷² Aon said that 'The CMA [uses] ...medians for its simple comparison of averages and means for it econometric models. To be consistent, the CMA should therefore also consider the simple comparison of mean averages and econometric models based on medians (ie quantile regressions).' Source: Aon's response to the Gain's from Engagement Working Paper, page 9. We do not see an inconsistency in using medians for analysis which is less sophisticated in accounting for confounding factors, and means in analysis which can more flexibly account for these factors; the type of average has been chosen to complement the nature of the comparison being made. Further, seeing whether using two different types of averaging show consistent results is a useful sensitivity test in itself.

¹⁷³ We have not considered it productive to design and conduct an analysis which uses data on investment consultancy spend or prices through time. This is because we do not have access to data on number of hours spent providing schemes with services, except for 2016. Number of hours is a key confounding factor. Further, in contrast to the case for fiduciary management, there is no obvious price discontinuity to exploit for a difference-in-differences estimation, as we have used in the fiduciary management transition analysis. Parties' did not propose any such analysis in response to consultation on the Gains from Engagement Working Paper.

¹⁷⁴ We assume that the scheme purchased the same level of advisory services before and after the transition; we test this assumption in a sensitivity.

¹⁷⁵ Because we do not have historical data on AUM for key parties and therefore cannot construct price per unit of AUM through time. For this reason, we consider spend increases. This means that the transition analysis is not fully comparable with our analysis of price in terms of, for example, the coefficients in the regression. Nevertheless, they address the same issue.

example, a scheme which pays twice as much in fiduciary management as it did for investment consultancy services will have a spend multiple of two.

- 37. We construct this multiple by using the average fiduciary management spend in all years in our data after a scheme has transitioned, and the average investment consultancy spend in all years in our data prior to the scheme's transition.
- 38. Because we consider only schemes which transitioned with the same provider,¹⁷⁶ we have a smaller number of schemes we can analyse than in the static model.¹⁷⁷ We exclude the spend for the year the scheme transitioned.¹⁷⁸ Therefore, this analysis has greater limitations in terms of sample size.
- 39. For each of the above-described analyses (static analysis of investment consultancy prices; static analysis of fiduciary management prices; and transition analysis of fiduciary management spend), we undertake both the comparison of medians and an econometric analysis.

Econometric Model

- 40. Given the additional complexities and assumptions in regression analysis, we provide a more detailed explanation of our econometric models. We first explain the model, before going on to provide more details of the control variables and the interpretation of the results.
- 41. In analysing the gains from engagement, we have run OLS regressions of the following form:

$$\log(M_i) = \alpha + E'_i \beta + C'_i \gamma + \varepsilon_i$$

42. Where subscript *i* denotes an individual scheme, *M* is the log of our dependent variable. In the fiduciary management static analysis, this is the

¹⁷⁶ Due to data limitations which created very significant challenges matching together schemes across providers' historical data, we are not in a position to compare reliably investment consultancy and fiduciary management prices for schemes which moved into fiduciary management with a provider other than their investment consultancy provider. We therefore draw conclusions from this analysis primarily in relation to Internally Acquired schemes.

¹⁷⁷ Due to the data requirements of the outcome measure, we base the analysis only on schemes which transitioned between 2011 and 2016, and for which we had sufficient data to compute pre- and post- transition average spends.

¹⁷⁸ This is because if Scheme A transitioned in January of a given year, whilst scheme B transitioned in December, the two schemes would have very different spends in investment consultancy and fiduciary management for that year for reasons unrelated to our variables of interest, and including this year of spend would therefore introduce a confounding factor we would have to control for.

implied price per pound of asset under management faced by the scheme;¹⁷⁹ in the fiduciary management transition analysis it is the IC-FM spend multiple; and in the investment consultancy analysis it is implied price per hour.

- 43. *E'* denotes a (row) vector of engagement-related dummy variables
 - (a) In the fiduciary management static approach, we use two dummy variables derived from the client's acquisition type: (i) one denoting whether the scheme is Internally Acquired and engaged (ie has at least one of the three engagement proxies set out above), and a second denoting whether the scheme was Externally Acquired.¹⁸⁰
 - *(b)* In the fiduciary management transition approach, we use one dummy variable indicating whether the scheme is engaged.¹⁸¹
 - *(c)* In the investment consultancy analysis, we use one dummy variable indicating whether the scheme is engaged.¹⁸²
- 44. *C'* denotes a (row) vector of control variables to account for drivers of log price which are potentially correlated with the engagement dummies. The set of controls used varies slightly between analyses. We provide a full description of control variables in paragraph 57 below.
- 45. The error term, ε , captures other factors that affect the log of price which are not captured by the explanatory variables.
- 46. The effects of primary interest are in the coefficient vector β' . That is, we are interested in the coefficient on our measures of engagement. γ' represents another vector of coefficients for the control variables. These are of interest only insofar as is useful to establish the reliably of our estimate of the abovementioned effects. α denotes the constant.
- 47. We log the dependent variable because we expect that any increase or decrease in spend will vary with the level of the price. That is, we consider

¹⁷⁹ Because prices are generally expressed as a percentage of the value of assets under management, we calculate implied prices as total spend divided by assets under management, and multiply the resulting figure by 10,000 to express the price in basis points as is conventional.

¹⁸⁰ The base category is therefore less engaged Internally Acquired schemes. We do not include a dummy for less engaged Internally Acquired schemes to avoid multi-collinearity.

¹⁸¹ The base category is therefore less engaged Internally Acquired schemes. There are no Externally Acquired schemes in this analysis.

¹⁸² The base category is therefore less engaged schemes. The concept of Internally and Externally Acquired clients is not relevant to investment consultancy, given how we have defined these terms.

that the regression is non-linear in price but is likely to be linear in the log of price.¹⁸³

- 48. Whilst the econometric analysis is more sophisticated than a simple comparison of medians, there remain important caveats. We are mindful of these potential limitations in interpreting our results, although on balance do not consider that any present very serious challenges to our analysis.
 - (a) We have discussed the possibility for measurement and proxy error for engagement in paragraph 26 and the associated footnote above.
 - *(b)* It is also possible that whilst high engagement reduces prices, high prices might increase engagement. ¹⁸⁴ That is, simultaneity could result in bias to the coefficients. Aon told us that to assess the direction of simultaneity bias, we would need to conduct an instrumental variables analysis.¹⁸⁵ In any event, there does not appear to be a clear argument that our analysis is more likely to overstate 'gains from engagement' than understate them.
 - (c) We might have omitted variables from the analysis which determine prices and are correlated with engagement, conditional on all other covariates. This could lead to bias. We discuss parties' specific challenges with respect to these variables in the interpretation of our results.

Dataset

- 49. This section describes the data used in this analysis, and also for other analyses relying on Parties' data. In particular:
 - (a) First, we describe the content of this data, and key points about our data cleaning approach.
 - (b) Second, we provide a description of key control variables used to control for confounding factors.

¹⁸³ In support of this, we note that the relationship in simple scatter plots between a key determinant of price (AUM) and price itself is approximately linear.

¹⁸⁴ At least for tendering, we think there are good reasons why the issue is not likely to be very concerning for our analysis of fiduciary management schemes. This is because we consider whether the mandate was acquired through tender, and assess prices post-acquisition. As such, high fiduciary management prices from the scheme's current provider will not have led to tendering as measured. Usage of TPEs to evaluate the move into fiduciary management provider post transition of post-transition prices, but the usage of TPEs to monitor the fiduciary management provider post transition could be. The same could be true of professional trustees. However, given that a high proportion of schemes in our data have been using fiduciary management for only a few years, we do not consider this to be likely to have a big effect.

¹⁸⁵ Aon's response to the Gains from Engagement Working Paper, page 13

Description of the data

- 50. Several Parties submitted data for all pension schemes which purchased either investment consultancy or fiduciary management from them in 2016. Using the parties' submissions, we merge data submitted across different templates by using client IDs. Each of the parties' merged data is then appended together to form a combined dataset.¹⁸⁶
- 51. As part of this process, we undertook a significant amount of data cleaning to address various inconsistencies in responses to our standardised data templates. This required some assumptions. We undertook relatively extensive follow-ups with a number of parties to reduce the proportion of unusable data as much as possible.
- 52. We have combined the advisory and fiduciary mandates for each client where clients were recorded as receiving each service. We did this by aggregating revenues together across the different mandates. We treat these clients as receiving fiduciary management.
- 53. We also removed a number of extreme values. For example, some schemes appeared to have spent a very high multiple of 'normal' spend levels. We are concerned that data points in this variable as well as others,¹⁸⁷ may reflect data entry errors. Even if they do not, they may represent schemes which have very different characteristics to most schemes in ways we do not observe, and from which we should not draw conclusions.¹⁸⁸
- 54. In analysing the effect of transitioning into fiduciary management we build on the data used in the fiduciary management snapshot analysis by merging this to timeseries data submitted by the parties. The timeseries data contains information on a subset of the variables listed above, most notably spend and services purchased. This allows us to track schemes who move from investment consultancy to fiduciary management with the same provider.¹⁸⁹
- 55. This data is used to calculate the increase in spend moving from investment consultancy to fiduciary management as a ratio of the initial spend. Our data

 ¹⁸⁶ In conducting this merging, we omit schemes which paid less than £20,000 per year in 2016 for consistency.
 ¹⁸⁷ Chiefly spend, number of hours and AUM

¹⁸⁸ Defining what is an extreme value and what is a regular but large value is not always straightforward. Our method of ignoring outliers depends on the specific case. Our preference is to use a conventional method where we ignore observations which have values further away than three standard deviations from the mean. However, where we remain concerned that extreme outliers could affect our analysis (for example, if a value is so extreme that it inflates the standard deviation such that it is not captured by the above method), we resort to alternatives such as dropping the largest 5% of values.

¹⁸⁹ Although we received some 'external' ID variables, such as tax code information, from providers which could have allowed us to link together the same pension scheme across providers, we found that the data quality provided was insufficiently high to allow us to do this. We therefore cannot identify schemes which moved into fiduciary management with a provider other than their investment consultant.

set covers most schemes which transition between investment consultancy to a fiduciary management relationship with the same provider.

Control variables

- 56. We use a range of control variables across different specifications. Our approach to collating the relevant data was informed by a number of early discussions with parties. Further, various hearings, submissions and roundtables with key participants provided us with a greater understanding of the key drivers of pricing, and informed our decision about which aspects were very important to control for.
- 57. Throughout the analyses below, we use 14 different control variables. These are defined as follows. We define the variables below for clarity:
 - (a) Hedging: A dummy variable which takes 1 if the scheme purchases bespoke liability hedging, and 0 otherwise. Bespoke liability hedging appears to be an expensive service (albeit one which appears to have brought significant benefits to pension schemes in recent years). We have found that hedging is disproportionately purchased by engaged schemes, and therefore it is important to control for this.
 - (b) Value of assets: The log of scheme assets under management/assets under advice. Fiduciary management/investment consultancy prices generally fall with the level of assets invested with the fiduciary manager. As such, we include a measure of this. We take logs because the effect of scheme size is likely to be nonlinear.
 - (c) Partial/full fiduciary management: A continuous variable which indicates the proportion of scheme assets which are delegated.¹⁹⁰ Schemes which have lower levels of delegation are likely to be charged less, all being equal.¹⁹¹
 - (*d*) **Number of asset managers**: The log of the number of asset managers used to manage the scheme's assets. We consider this will help control for differing complexity in the implementation of advice across schemes.

¹⁹⁰ Our data is not fully continuous, taking values of 0, 1-29%, 30-49%, 50-69%, 70-99%, 100%. We take the midpoints of these ranges. Arguably, a theoretically better specification would be to include this variable in nonparametric form by including dummy variables. We have not taken this approach in our baseline model for pragmatic reasons: we do not have a large number of observations and as such face practical limits on the number of variables we can include. Nevertheless, we undertake a robustness check including this information in a set of dummies, and find the results do not change our conclusions.

¹⁹¹ We note that some of this effect will be captured in the AUM variable. Nevertheless, there may be additional factors specific to the proportion of assets delegated which can influence prices. We control for these.

We include the variable in logs to account for likely nonlinearities in the effect of this measure.

- (e) Number of asset management products: We include the number of AM products (in logs) purchased by the scheme as an additional proxy for complexity
- (f) Firm indicators: A set of firm fixed effects, consisting in a dummy variable for each firm, which takes 1 if the scheme purchases fiduciary management/investment consultancy services from that firm, and 0 otherwise. We include these in the baseline regression to account for the possibility of systematic differences in firms' (i) complexity of services (ii) coding approaches in providing data to us.
- (g) Year of mandate acquisition: A set of dummies which identify the year the scheme moved into fiduciary management/investment consultancy. For example, a dummy for the year 2015 which takes 1 if the scheme moved into fiduciary management in 2015, and 0 otherwise, together with equivalent dummies for all other years schemes in our data might have moved into fiduciary management. We include these to account for the possibility that schemes moving in different years, at which point long term contracts¹⁹² may be signed. The same variable should also account for any direct influence of the length of time schemes have been in fiduciary management/investment consultancy on price.¹⁹³
- (h) Performance fees: A dummy variable sefor schemes which have performance fees. Engaged schemes are disproportionately likely to have performance fees. Schemes with performance fees will pay more on average if performance has been strong, and less otherwise.
- *(i)* **Fixed fees**: We include a dummy variable for schemes which have a fixed component to their fees, to allow average charge rates to differ from schemes which only use ad valorem and/or performance fees.
- (*j*) **Scheme type**: We include a dummy variable for hybrid schemes. These schemes might be more complicated and therefore might face higher prices
- (k) Client restrictions: We include a set of dummy variables on three types of restrictions schemes may place on their fiduciary management provider. In particular, we allow average prices to vary depending on whether schemes place restrictions or require deviations in the fiduciary

¹⁹² Or at least starting values for fiduciary management prices which will likely influence prices in later years
¹⁹³ We use a set of dummies rather than a continuous variable to increase the flexibility of our specification.

management's approach to hedging, and/or consultation with the client as changes to investments are implemented.

- (*I*) **Fiduciary management services**: We include dummies for whether the client purchases 'Monitoring and De-risking Service' and/or 'Strategic Asset Allocation Advice' from their fiduciary management provider
- (m) Actuarial services: We include a dummy for whether the fiduciary management/investment consultancy provider received revenues for actuarial services. Bundling may reduce costs, or could be associated with higher prices if it captures any additional scheme complexity or residual disengagement.
- (*n*) **Hours of service purchased:** For investment consultancy, we have reasonably good data on the number of hours service provided to each client. We control for this as a proxy for complexity. We do not have usable data for fiduciary management.

Summary statistics

- 58. In this section we describe the composition of the data used in our gains from engagement analysis. We present tables which detail the mean, median, standard deviation, minimum and maximum values.
- 59. We then go on to draw out some key descriptive statistics relating to engagement, our main dependent variable of interest.

Investment consultancy static approach

60. Table 18 shows the mean, median, standard deviation, minimum and maximum values of continuous variables in our investment consultancy data.

Statistic	Number of Observations	Mean	Median	Standard deviation	Minimum	Maximum
Scheme Spend (£ thousands)	1002	113	74	101	20	486
Scheme AUM (£ Millions)	1062	495	166	774	0	3,953
Total investment consultancy Hours spent on customer	944	561	342	706	76	7,226

Table 18: Summary statistics for investment consultancy snapshot – continuous variables.

Spend per hour	946	294	273	111	34	704
Number of services	1102	4.7	5	1.3	2	6
Year of Mandate acquisition	928	2008q3	2009q4	19	1988q1	2015q4

61. Our analysis includes a number of 'dummy' variables, which take only value zero or one. Table 19 shows summary statistics for these variables.

Table 19: Summary statistics for investment consultancy snapshot – dummyvariables.

Variable	Number of Observations	Percentage of schemes
Tendered	1102	50%
Use of TPE	1102	4.2%
Professional Trustee	1102	44%
Hybrid scheme	1102	14%
Bespoke Liability hedging	1102	62%

Fiduciary management static approach

62. Table 20 shows summary statistics for continuous variables in our Snapshot data. The table shows there is a skewed distribution in AUM and Spend with a large deviation between means and medians.

Table 20: Summary statistics for fiduciary management 2016 data – key variables.

Statistic	Number of Observations	Mean	Median	Standard deviation	Minimum	Maximum
Scheme Spend (£ thousands) ¹⁹⁴	333	306	173	415	6.7	2,994
Scheme AUM (£ Millions) ¹⁹⁵	329	416	75	1994	1.9	31,814
Implied basis points ¹⁹⁶	318	23.87	21.5	15.8	0.1	81.74
Year of Mandate acquisition	315	2013q2	2013q3	7	2010q1	2015q4

¹⁹⁴ Excluding the largest 5% of observations.

¹⁹⁵ Excluding the largest 5% of observations.

¹⁹⁶ Excluding the largest 5% of observations.

63. Table 21 shows the percentage of schemes in the data which possess a dummy variable in our snapshot. We see notably only 6% of schemes in our data are hybrid and half of all fiduciary management observations use bespoke liability hedging.

Table 21: Summary statistics for fiduciary management 2016 data dummies.

Variable	Number of Observations	Percentage of schemes
Tendered	334	30%
Use of TPE	334	15%
Professional Trustee	334	31%
Hybrid scheme	334	6%
Bespoke Liability hedging	334	50%
Partial fiduciary management	334	34%

Fiduciary management transition approach

64. Table 22 shows the mean, median, standard deviation, minimum and maximum values of continuous variables in our data. The table shows there is a wide distribution in the increase in spend with the median scheme spend increase being 3.2 times whilst the largest is a 24.8 times increase.

Table 22: Summary statistics for fiduciary management transition data

Statistic	Number of Observations	Mean	Median	Standard deviation	Minimum	Maximum
Increase in Spend as a ratio of investment consultancy spend	120	5.1	3.2	5.0	0.7	24.8
Scheme AUM (£ Millions)	181	365	79	1,203	2.2	13304
Year of fiduciary management acquisition.	174	2015q2	2015q1	27.8	2012q1	2105q1

65. Table 23 shows the percentage of schemes in the data which possess a dummy variable in our timeseries. Notably there is a larger proportion of schemes which buy partial fiduciary management in our Transition assessment dataset than in the snapshot.

Table 23: Summary statistics for fiduciary management transition data dummies.

Variable	Number of Observations	Percentage of schemes
Tendered	181	17%
Use of TPE	181	8%
Professional Trustee	181	24%

Hybrid scheme	181	8%
Bespoke Liability		
hedging	181	30%
Partial fiduciary		
management	181	48%

Variation in engagement

- 66. We also present some more detailed descriptive statistics of engagement, beginning with investment consultancy and then going on to fiduciary management.
- 67. Our analysis in the Trustee Engagement section (paragraph 6.49) shows that there is substantial variation in the bandwidth and capabilities of trustees to monitor and assess their investment advisors. We show here that there is variation in engagement in both investment consultancy and fiduciary management using the indicators for our 'gains from engagement' analysis.
- 68. In investment consultancy, we find that over half (50%) of all schemes have undertaken a formal tender and nearly half (46%) of schemes have a professional trustee sitting on the board of trustees. As such, there is are a sufficiently large number of more engaged and less engaged schemes to analyse independently. Only a small minority of schemes (5%) of schemes use a TPE.
- 69. When combined into our single indicator of engagement, we find that 70% of schemes demonstrated at least one of these characteristics.
- 70. Our analysis of the variation in engagement in fiduciary management is set out in Chapter 7, paragraphs 7.37 to 7.42. In summary however, we find that a minority of both Internally Acquired and Externally Acquired schemes had any single one of the three characteristics.
- 71. As set out above, for the purposes of this analysis we have created a single indicator which treats a scheme as more likely to be more engaged if it has at least one of the three indicators. We have also divided schemes by whether they were Internally or Externally Acquired. The proportions of each scheme in our 2016 data is set out in Figure 10 below.



Figure 10: Pie chart of fiduciary management schemes in this analysis by engagement type.

Source: CMA Analysis, Parties' Data.

- 72. Figure 10 shows that, of schemes at the five IC-FM providers on which we have based our analysis of fiduciary management, 50% were Internally Acquired and 50% of schemes who buy fiduciary management were Externally Acquired.¹⁹⁷
- 73. We note that Externally Acquired schemes may be considered to have switched provider and therefore may have higher levels of overall engagement, and this is borne out in the data above: a higher proportion of Externally Acquired schemes have an engagement indicator than Internally Acquired schemes.
- 74. We interpret these statistics as informative that some schemes are more engaged than others, rather than relating to the absolute levels of trustee engagement.

¹⁹⁷ Due to rounding there is a 1% difference from chart's stated value. The chart percentages total 99% due to this rounding.

Analysis and Results

- 75. In this section, we set out our analysis and results. These include both the comparison of averages, as well as the regressions. In particular:
 - (a) First, we set out our analysis of schemes in investment consultancy
 - *(b)* Second, we set out our analysis of schemes in fiduciary management, beginning with the Static Assessment before discussing the Transition Assessment.

Investment consultancy

76. We begin by comparing the distributions of the prices paid by more engaged and less engaged schemes. To do this, we produced a 'kdensity' plot which charts the level of spend against the density¹⁹⁸ of schemes associated with that spend (essentially, the proportion of schemes paying this price). The dark blue line shows the distribution of more engaged schemes, the light blue line shows the distribution of less engaged schemes. This is shown in Figure 11 below.

¹⁹⁸ Density should be interpreted as the area under which we expect a given number of schemes to fall. A density of 1 is equivalent to expecting 100% of schemes to fall at that value.

Figure 11: k density plot of investment consultancy spends per hour of service.



Source: CMA Analysis, Parties' Data

- 77. We see that the schemes who are more engaged (represented by the dark blue line) tend to have lower spend per hour than less engaged schemes.This indicates that less engaged schemes face higher prices on average.
- 78. This analysis does not account for potentially confounding factors. To do this, we undertook further analysis.
- 79. We compared the median spend per hour of work undertaken by the investment consultancy provider across schemes which are more engaged and less engaged. In doing so, we divide schemes into groups based on their size¹⁹⁹ and whether or not the purchase hedging. Comparing medians within these groups helps control for confounding factors.
- 80. We focus on size and hedging because larger schemes may pay more, as might schemes which purchase an additional and potentially expensive service.

¹⁹⁹ Specifically, we control for size by dividing schemes up into three brackets. Small schemes are defined as having assets under advice of less than £100 million, medium schemes having assets under advice of between £100 million and £1 billion, and large schemes as having assets of over £1 billion.

- 81. The results of this analysis are set out Chapter 10 paragraph 10.25 of the main report.
- 82. To control more fully for confounding factors, including the size of the scheme within the groups set out above, the amount of advice given (as proxied by the amount of time spent by consultants), and other key variables, we use a regression approach.
- 83. We restrict our regression to only those who purchase strategic asset allocation and manager recommendations to rule out cases of project work from our analysis, which might be incomparable with retained work.
- 84. Our baseline model controls for size as a log of AUM and the purchase of bespoke liability hedging (which, as noted, appears to add appreciable cost). We show sensitivities to this specification in other columns. ²⁰⁰ Results in this table do not include investment consultancy provider fixed effects.

 Table 24: Baseline and core sensitivities for the investment consultancy analysis

	(0)	(1) buj	(2) .s	(3) j <u>e</u>	(4) / Mu	(5)	(6)	(7)	(8)
	Baseline	Add Deriskı	Remove mi service restriction	Add Yr mandate ga	Hybrid Dum	Tender only	TPE only	PT only	Structured bidding process
Tender, TPE or PT (dummy)	- 0.13*** (0.00)	- 0.12*** (0.00)	- 0.10*** (0.00)	-0.14** (0.03)	- 0.13*** (0.00)				
Tender (dummy)						- 0.11*** (0.00)			
TPE (dummy)							-0.02 (0.67)		
PT (dummy)								-0.08*** (0.00)	
Structured Bidding Process (dummy)									- 0.16*** (0.00)
AUM (logs)	0.17*** (0.00)	0.17*** (0.00)	0.13*** (0.00)	0.17*** (0.00)	0.17*** (0.00)	0.17*** (0.00)	0.17*** (0.00)	0.17*** (0.00)	0.17*** (0.00)

²⁰⁰ Unlike our analysis of fiduciary management, we did not use asset manager information as a control variable because we either did not receive this data or received data which it was not possible to process sufficiently, for some firms in the investment consultancy sample, which considers a wider range of providers.

	(0)	(1) Ø	(2)	(3)	(4) 순	(5)	(6)	(7)	(8)
	Baseline	Add Deriskin,	Remove min service restriction	Add Yr mandate gair	Hybrid Dumn	Tender only	TPE only	PT only	Structured bidding process
Buys Liability Hedging	0.04	-0.08	0.01	0.07	0.05	0.04	0.03	0.04	0.00
(dummy)	(0.25)	(0.19)	(0.72)	(0.15)	(0.22)	(0.29)	(0.37)	(0.28)	(0.94)
Hours spent by consultant (logs)	- 0.39*** (0.00)	- 0.38*** (0.00)	- 0.37*** (0.00)	- 0.31*** (0.00)	- 0.39*** (0.00)	- 0.38*** (0.00)	- 0.39*** (0.00)	-0.39*** (0.00)	- 0.38*** (0.00)
Number of Services (cont)		0.10*** (0.00)							
Buys Monitor/Derisking		-0.15**							
Service (dummy)		(0.01)							
Acquired Mandate in 2012 (dummy)				-0.10 (0.13)					
Acquired Mandate in 2013 (dummy)				-0.12* (0.09)					
Acquired Mandate in 2014 (dummy)				- 0.18*** (0.01)					
Acquired Mandate in 2015 (dummy)				-0.10 (0.15)					
Acquired Mandate in 2016 (dummy)									
Hybrid (dummy)					0.05 (0.13)				
Provider fixed effects	NO	NO	NO	NO	NO	NO	NO	NO	NO
Constant	4.74*** (0.00)	4.47*** (0.00)	5.49*** (0.00)	4.32*** (0.00)	4.72*** (0.00)	4.71*** (0.00)	4.73*** (0.00)	4.74*** (0.00)	4.75*** (0.00)
Observations	957	957	1122	309	957	957	957	957	957
squared	0.373	0.377	0.335	0.349	0.373	0.374	0.364	0.370	0.383

(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Baseline	Add Derisking	Remove min service restriction	Add Yr mandate gain	Hybrid Dumm	Tender only	TPE only	PT only	Structured bidding process

p-values in parentheses * p<0.10 ** p<0.05 *** p<0.01

Source: CMA Analysis; Parties' Data

- 85. Our baseline specification in column (0) shows that more engaged schemes pay around approximately 13% less per hour than their less counterparts.²⁰¹ The control variables generally have the expected sign: A 10% increase the number of hours of service provided by the consultant is associated with approximately 3.9% lower prices; a 10% increase in AUM is linked to approximately 1.7% greater spends per hour.²⁰² Purchasing hedging is linked to 4% greater spends per hour (although this last was not statistically significant).
- 86. In isolation, these results did not change in response to adding additional control variables or changing the specification. In particular, we identified a significant and negative effect of engagement when we
 - (a) controlled for the purchase of a monitoring or derisking service in column(1)
 - (b) considered schemes which did not purchase strategic asset allocation or manager recommendations in column (2)
 - (c) controlled for the year the provider gained the mandate in column (3)
 - (d) controlled for whether the scheme was a hybrid in column (4)

²⁰¹ For ease of reference to the tables, we have applied the approximation that logged variables can be interpreted as percentages. This approximation is very close (with an error of less than 1 percentage point) for small values, up until around 15%, and would be well within the margin of error even at higher values. After rounding, the fully correct (ie non-approximated) value is 12%.

²⁰² This could arise because larger schemes purchase more complex advice, or because larger schemes tend to use particular firms which charge more per hour

- *(e)* changed the engagement proxy to be either just whether a scheme had tendered in column (5), had a PT in column (7) or had used a 'structured bidding process' in column (8) ²⁰³²⁰⁴
- 87. In the above table, we presented analysis that did not include provider fixed effects. These are a set of dummy variables, one for each firm. The dummy variable for Firm A takes 1 if the scheme buys investment consultancy from Firm A, and 0 otherwise.
- 88. Including these fixed effects may be advantageous because it allows us to control for any scheme-variant but provider-invariant drivers of quality, even if these are unobservable. That is, provided we can assume that the true level of engagement is no higher or lower at different providers, including provider fixed effects allows us to more fully control for confounding factors.
- 89. We present results which include provider fixed effects in below. For brevity, we show the coefficients of interest only.

	(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Baseline	Add Derisking	Remove min service restriction	Add Yr mandate gain	Hybrid Dummy	Tender only	TPE only	PT only	SBP
Engageme	-0.01	-0.00	-0.03	-0.07	-0.01	-0.02	0.05	0.01	-0.04
nt (combined)	(0.75)	(0.95)	(0.32)	(0.18)	(0.76)	(0.56)	(0.29)	(0.78)	(0.15)
Provider fixed effects	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observatio ns	957	957	1122	309	957	957	957	957	957
Adjusted R- squared p-values in pa	0.50 8 arenthes	0.51 3 ses * p<(0.538).10 ** p<0.	0.506 05 ***	0.51 0	0.50 8	0.50 8	0.50 8	0.50 9
p<0.01 Source: CMA Ar)<0.01 Source: CMA Analysis: Parties' Data								

Table 25: Additional sensitivities for the investment consultancy analysis – including firm fixed effects

²⁰³ Use of TPEs is insignificant in isolation, but this can be explained by the fact that our data request focussed on use of TPEs to (i) evaluate whether the scheme should move into fiduciary management, and (ii) monitor fiduciary management. As such, only a very small fraction of schemes in investment consultancy are recorded as having a TPE, and having one might not reduce investment consultancy prices directly at all (although it could still indicate that the scheme is engaged).

²⁰⁴ We show the coefficients for just tendering, just having a TPE, just having a PT or just running an SBP on the same line, rather than having a new line for each.

- 90. The table shows that, once we add provider fixed effects, the results are no longer statistically significant. Whilst some p-values indicate that the results are unlikely to have arisen by chance, they fall short of conventional levels.
- 91. KPMG said that 'It is reasonable to assume that there will be some price difference across providers, [and] ... If there are also differences in the share of "engaged" customers across providers, but provider fixed effects are not controlled for, the model may incorrectly infer a relationship between the price and engagement variables which is actually due to provider differences.²⁰⁵
- 92. We consider this could explain some of the difference in the results. This could demonstrate that more engaged customers select cheaper firms, demonstrating gains from engagement. When we include provider fixed effects, we are controlling for a 'selection effect' which is in fact relevant. If true, this could imply that the model without fixed effects captures more ways in which 'gains from engagement' could arise.
- 93. However, the difference could also arise because data submitted by firms is of insufficient quality to identify an effect, or because at least one of the models is not correctly specified. ²⁰⁶ This finding therefore limits the conclusions we can draw from this analysis.
- 94. For both specifications, several Parties raised additional potentially confounding factors we had not controlled for across these analyses.
 Potential omitted variables cited were staff experience; complexity; asset capacity constraints, perceived performance quality, active or passive fund usage, asset class mix, pricing model and performance targets.
- 95. For variables such as staff experience and perceived performance quality, it is not clear why less engaged schemes would receive better service than more engaged schemes.²⁰⁷ We have at least partially controlled for complexity by including controls for additional services. To the extent that other confounding factors remain, we are mindful of this in our interpretation of the results.
- 96. Considering this evidence in the round, whilst we note that there is some evidence that schemes which are more engaged pay lower prices, and

²⁰⁷ [×].

²⁰⁵ KPMG's Response to the Gains from Engagement Working Paper page 4. KPMG also noted that the regressions including provider fixed effects explain a significantly higher proportion of variation in prices, since the R-Squared values are higher. Given that we present the 'overall' and not the 'within' statistics for the fixed effect regressions, this is consistent with firms having different average prices.

²⁰⁶ The emerging picture of the results does not change when we consider spend rather than spend per hour as the dependent variable.

therefore schemes which are less engaged pay higher prices, we only place limited weight on the findings for investment consultancy.

Fiduciary management analysis

97. We now turn to our analysis of fiduciary management. We have undertaken two different approaches to analysis of these schemes, a 'static' analysis of 2016 prices, and a 'transition' analysis of the price changes for schemes moving from investment consultancy into fiduciary management. We discuss these in turn.

'Static' Approach

98. We began by comparing the distributions of price for more engaged and less schemes. Figure 12 shows a kdensity plot of spend per unit of asset under management. The dark blue line shows the distribution of more engaged schemes, the light blue line shows the distribution of less engaged schemes.





Source: CMA Analysis, Parties' Data

- 99. Figure 12 shows that the distribution of price levels is shifted towards lower prices for more engaged schemes, relative to the distribution of less engaged firms. This implies that engaged schemes may spend less, although this analysis does not account for confounding factors.
- 100. We also compared the median price paid by Internally Acquired and Externally Acquired schemes, according to whether these schemes exhibited

any form of engagement. For simplicity, we again do not initially control for confounding factors. Our analysis of this is set out in Chapter 10, paragraph 10.34.

- 101. These comparisons do not account for confounding factors. Therefore, as we did for investment consultancy, we split schemes by size and hedging decision and compare prices based on the schemes engagement.
- 102. This analysis is set out in Figure 13, a dot chart. The position of the red dot on the horizontal line corresponds to the median price differential between less engaged schemes and more engaged schemes. If the dot is to the left of the dark blue line, less engaged schemes pay less; to the right, they pay more.

Figure 13: Median fiduciary management price differential between less engaged and more engaged schemes, split by size & hedging.





Source: CMA analysis, Parties' data

- 103. For Internally Acquired schemes, the chart shows that less engaged schemes usually pay higher prices than their more engaged counterparts, although for large schemes this is not demonstrated.
- 104. Amongst Externally Acquired schemes, the picture is more mixed. Less engaged schemes pay a very similar amount to more engaged schemes for three of the subgroups. Of the rest, small less engaged schemes who don't buy hedging pay more, but both small less engaged and large less engaged schemes which do buy hedging pay *less* than their more engaged equivalents.

- 105. Less engaged schemes only appear to face lower prices where they are hedging; this may arise because the extent of hedging can vary and more engaged schemes may have sought a higher degree of hedging in recent years, given the benefits this appears to have brought to pension schemes. The additional complexity of this would not be captured in the above chart.
- 106. We have also broken down the comparison between more engaged and less engaged schemes at firm level, again using a dot chart.

Figure 14: Median FM price differential between less engaged and more engaged schemes, split by $\rm firm^{208}$

[%]

Source: CMA Analysis, Parties' data

- 107. This analysis shows that less engaged schemes (the red dots) generally, although not always, have faced higher prices than their more engaged counterparts within the same firm (the dark blue lines). The analysis is not conclusive in itself, given that the median less engaged scheme is sometimes found to pay higher prices than more engaged schemes but also sometimes lower prices. The former case is more common however.
- 108. To unpack these analyses further, we have also undertaken an econometric analysis. In our main specification, we regress price on a set of dummy variables which identify schemes which are Internally Acquired and more engaged, Internally Acquired but less engaged, and Externally Acquired respectively.²⁰⁹
- 109. Our key test of interest is whether less engaged Internally Acquired schemes pay more than their Internally Acquired but engaged counterparts. We also test whether Externally Acquired schemes pay less than either type of Internally Acquired schemes.
- 110. We control for a range of confounding factors including size; hedging; whether the scheme has a performance fee; whether the client imposed restrictions on the fiduciary management provider; the number of asset managers used by the client (as a proxy for complexity of investments); the

²⁰⁸ River and Mercantile do not have results shown for Externally Acquired schemes because all such schemes have at least one engagement indicator in their data. As such, the difference in price between those which have an indictor and those which do not cannot be computed.

²⁰⁹ We noted earlier that Externally Acquired schemes have demonstrated some form of engagement in that they have switched provider when moving into fiduciary management. For this reason, and given the limited number of observations in our data, we have not generally distinguished between 'more engaged' and 'less engaged' externally acquired schemes in our econometric analysis, although we do split them out in one sensitivity discussed below.

year the scheme moved into fiduciary management; and the firm used by the scheme. We include firm fixed effects in this analysis.

111. The results are set out in Table 26 below. Our baseline regression results are in column (0). We also report the results of six core sensitivities. The dependent variable is log of implied price. Figures are rounded to two decimal places.²¹⁰

 Table 26: Baseline results and core sensitivities for the fiduciary management static

 approach

	Baseline	Baseline, Transition Approach	Without firm Fes	Splitting ext. acquired into Eng vs Diseng.	Tender only	TPE only	PT only
Any Engagement Indicator, Internally Acquired (Dummy)	-0.26**	-0.24**	-0.29**	-0.26**			
	(0.02)	(0.01)	(0.01)	(0.03)			
All Externally Acquired (Dummy)	-0.14	-0.06	-0.13		-0.10	-0.07	-0.05
	(0.13)	(0.37)	(0.18)		(0.27)	(0.37)	(0.73)
Any Engagement Indicator, Externally Acquired (Dummy)				-0.11			
				(0.26)			
No Engagement Indicators, Externally Acquired (Dummy)				-0.20			
				(0.13)			
Tendered, Internally Acquired (Dummy)					-0.33***		
					(0.00)		

²¹⁰ In these tables, and their summary versions above, we always use heteroskedasticity robust standard errors as calculated by stata

TPE, Internally Acquired	Baseline	Baseline, Transition Approach	Without firm Fes	Splitting ext. acquired into Eng vs Diseng.	Tender only	Aluo JAL ouly -0.25	PT only
(Dunniy)						(0.11)	
PT, Internally Acquired (Dummy)							-0.04
							(0.61)
Client buys hedging (Dummy)	0.31**	0.38***	0.08	0.30**	0.34***	0.30**	0.30**
	(0.02)	(0.00)	(0.46)	(0.02)	(0.01)	(0.03)	(0.03)
Performance fee (Dummy)	0.38**		0.50***	0.38**	0.38**	0.37**	0.35**
	(0.02)		(0.00)	(0.03)	(0.02)	(0.03)	(0.04)
Number of AM Firms (Log)	0.14***		0.06	0.14***	0.12***	0.15***	0.15***
	(0.00)		(0.11)	(0.00)	(0.01)	(0.00)	(0.00)
AUM (Logs)	-0.39*** (0.00)	-0.37*** (0.00)	-0.36*** (0.00)	-0.39*** (0.00)	-0.39*** (0.00)	-0.40*** (0.00)	-0.40*** (0.00)
Percent assets in FM	0.00	0.00	0.01***	0.00	0.00	0.00	0.00
	(0.28)	(0.11)	(0.00)	(0.26)	(0.18)	(0.24)	(0.28)
Firm Fixed Effects	YES	YES	NO	YES	YES	YES	YES
Constant	9.34*** (0.00)	9.33*** (0.00)	8.96*** (0.00)	9.36*** (0.00)	9.33*** (0.00)	9.45*** (0.00)	9.55*** (0.00)
Observations Adjusted R- squared	198	290	198	198	198	198	198
	0.575	0.567	0.549	0.574	0.574	0.570	0.563

p-values in parentheses * p<0.10 ** p<0.05 *** p<0.01

Source: CMA Analysis; Parties' Data

- 112. In our baseline specification, Internally Acquired schemes exhibiting at least one engagement indicator receive prices which are approximately 28%²¹¹ lower than Internally Acquired schemes exhibiting no engagement indicators.²¹² This effect is statistically significant at the 5% level. Whilst there was some variation in the exact effects shown across the sensitivities, the identified fee differential between engaged and less engaged schemes was fairly robust.
- 113. The fee differential between Internally Acquired but less engaged schemes, and Externally Acquired schemes, has the expected sign and a significant magnitude across all sensitivities. However, its p-value falls short of the levels conventionally required for statistical significance.²¹³ We therefore do not place much weight on this result.
- 114. The control variables all have the expected signs, and are either statistically significant or reasonably close to being so. Schemes which purchase liability hedging face prices which are approximately 25% higher, and schemes with performance fees face prices which are approximately 32% higher.²¹⁴ A 10% increase in the number of asset management firms in the schemes' portfolio (a proxy for complexity) is associated with prices which are approximately 1.4% higher, and a 10% increase AUM is associated with prices which are approximately 3.8% lower. A 10% point increase in assets delegated into fiduciary management is associated with prices which are approximately 2.4% higher, although this effect was not statistically significant at conventional levels.²¹⁵
- 115. Table 26 also shows that the model appears to be robust to four of the six sensitivities. In particular, the model was robust to:

²¹¹ Again, we have provided the approximations in the text for ease of reference to the tables (values are rounded in the table to 2 dp, though where it makes a difference we have not rounded them in the text). The non-approximated value of the coefficient on Any Engagement Indicator, Internally Acquired (Dummy) is 24% after rounding, and we report this figure in the main body.

 ²¹² Note that we measure both Internally Acquired and Engaged schemes, and Externally Acquired schemes, relative to Internally Acquired, Less Engaged schemes. We do not include a variable for these schemes to avoid problems with multicollinearity.
 ²¹³ Mercer highlighted that our comparison of medians set out above shows the contrary, namely that internally

²¹³ Mercer highlighted that our comparison of medians set out above shows the contrary, namely that internally acquired clients pay much lower median prices than externally acquired clients. (Source: Mercer's response to the Gains from Engagement Working Paper, page 8). We note that the comparison of medians does not control for as many confounding factors and whilst potentially indicative, may therefore be less reliable.

²¹⁴ This is logical in the context of reasonably strong performance of the included firms' fiduciary management portfolios in recent years

²¹⁵ Since that we already control for AUM, this variable is controlling for differences of the percentage delegation for schemes with a given values of assets managed by the fiduciary management. It does not seem implausible for schemes which had the same AUM, one in full fiduciary management and the other in partial fiduciary management, to be charged the same price all else being equal.
- *(a)* Using the set of controls from the Transition Approach as a consistency check column (1);²¹⁶
- (b) Excluding firm indicator variables column (2)
- (c) Splitting Externally Acquired schemes by engagement, as we have done for Internally Acquired schemes column (3), and
- (d) Using tendering to proxy for engagement column (4).
- 116. The engagement coefficient became statistically insignificant when the underlying variable was replaced a dummy for using a TPE column (5), or having a PT column (6). However, in both cases the coefficients had the expected sign, and in the case of using a TPE, a very similar magnitude.
- 117. In a further robustness checks we find that the results are robust to using log spend rather than price per unit of AUM: the p-value on Internally Acquired and engaged schemes is 2%. When using the dependent variable in levels, the p-value drops to 10% for Internally Acquired and engaged schemes, although the coefficient remains negative and economically significant.²¹⁷
- 118. Several Parties again raised additional potentially confounding factors we had not controlled for across these analyses. Potential omitted variables cited were staff experience; complexity; asset capacity constraints, perceived performance quality, active or passive fund usage, asset class mix, pricing model and performance targets.
- 119. For variables such as staff experience and perceived performance quality, it is not clear why less engaged schemes would receive better service than more engaged schemes. Further, we have partially accounted for performance targets and pricing models by including a dummy variable for performance fees, and complexity by including variables such as the number of asset managers used and service-level controls.
- 120. It is possible that additional confounding factors remain (and for this reason we have gone on to conduct the Transition Approach). However, the we note that for most of the above variables, we have some degree of control already in the model.

²¹⁶ We use a different baseline for the Transition Approach (discussed below) due to (i) the greater number of observations here and (ii) the need to control more for scheme complexity in a simple cross-sectional model than one relying on changes in spend for the same scheme through time. We find that if we used the same baseline (shown in column 1 above) with the exception of maintaining the firm fixed effects, our headline results (column 1) would not differ in any notable way. We also test excluding the firm fixed effects in column 2 above, the results do not change.

²¹⁷ The p-value on Externally Acquired schemes is very high and the coefficient much smaller.

121. Overall, our view from the static analysis is that more engaged schemes pay significantly less than less engaged customers when moving into fiduciary management with the same provider they had used for investment consultancy.

'Transition' Approach

- 122. We also considered the evolution of prices at *the same* scheme before and after a transition into Fiduciary Management.²¹⁸
- 123. Again, our starting point is to compare the distributions of price for more and less engaged schemes. We use a kdensity plot (Figure 15) where the distribution for more engaged schemes is shown in dark blue, and less engaged schemes in light blue.



Figure 15: Distribution of IC-FM spend multiples, split by engagement

Source: CMA Analysis, Parties' Data

124. Figure 15 shows that the increase in spend is generally less than ten times the initial investment consultancy spend, and for a high proportion of scheme

²¹⁸ As set out above, due to the limited number of data points, the transition analysis is based on all scheme types including DC except where noted. Mercer said that "including DC schemes creates … uncertainty about the reliability of the results given the very different nature of DC schemes and their fee structures". (Source: Mercer's response to the Gains from Engagement Working Paper, page 10). We have included a sensitivity test where we exclude DC schemes.

face an increase of less than five times. ²¹⁹ There does not appear to be a marked difference between the distributions for more engaged and less engaged schemes, however this analysis does not account for confounding factors.

- 125. Again, without controlling for confounding factors, we find that the median spend increase of schemes moving into fiduciary management is about the same whether they have an engagement indicator or not. Schemes moving into partial fiduciary management spend about two times more than they did in investment consultancy, and schemes moving into full fiduciary management spend about 4.75 times more than they did in investment consultancy.²²⁰
- 126. To account for confounding factors, we undertake a comparison of averages between schemes of similar types, noting the small sample size that results. In particular, we compare the increase in spend moving to either partial or full fiduciary management (i) for schemes which do not purchase hedging and (ii) for schemes which purchase hedging.²²¹
- 127. We have shown the results of this analysis in the bar chart belowError! Reference source not found. Dark blue bars indicate the IC-FM spend multiple for schemes with no engagement indicators, light blue bars the IC-FM spend multiple for those with at least one engagement indicator.

²¹⁹ In some cases, the increase is over 20 times, this may reflect schemes who do not buy the full range of services moving into fiduciary management such as schemes who undertake project work before moving into fiduciary management. Equally some of the lesser increases in fiduciary management may be due to schemes moving into partial fiduciary management with a small amount of delegation.

²²⁰ For DB schemes only

²²¹ Unlike the 'static' analysis, we do not split this comparison by scheme size. This is because there is less particular reason to think that larger schemes will face a greater/smaller spend multiple, than that they will face higher/lower prices. The dependent variable difference influences our decision about which confounding factors are key. Further, not breaking this analysis down by size increases the 'sample size' for these subgroups; if we also broke them down by size we would have a very small number of schemes in each 'bucket'.

Figure 16: Spend multiples (fiduciary management over investment consultancy), split by partial/full fiduciary management and whether scheme purchases hedging in fiduciary management.



Number of observations: Partial FM hedging: 19; Partial FM not hedging: 57; Full FM hedging: 35; Full FM not hedging: 47

Source: CMA Analysis, Parties' Data222

- 128. The chart shows that in three of the four subgroups, the spend increase is higher for schemes which have no engagement indicators than those that have a least one indicator. In full fiduciary management where the percentage of assets delegated is not a potentially confounding factor, less engaged schemes spend more in both subgroups. As a consequence, we place more weight on the full fiduciary management results.
- 129. For completeness, as for our 'static' fiduciary management analysis, we tested whether we obtained similar results when we used individual engagement measures, rather than the combined proxy. This analysis is shown in Figure 17 below.²²³

²²² For DB schemes only

²²³ Each horizontal line represents a comparison on a different measure of engagement, made for the first three lines on schemes which do not purchase hedging, and for the last three lines on schemes which do purchase hedging. The left-hand panel shows the IC-FM spend multiples for partial fiduciary management schemes, and the right hand panel shows this multiple for full fiduciary management schemes. Orange dots represent the spend multiples for schemes which are not engaged on the measure listed at the left-hand side of the line, blue dots schemes which are engaged on that measure.

Figure 17: Spend multiples (fiduciary management over investment consultancy), partial/full fiduciary management and whether scheme purchases hedging in fiduciary management, for different measures of engagement



Each line cuts the data in a different way: they are not mutually exclusive

- 130. Figure 17 does not show any particular relationship between the spend increase and engagement: in some subgroups, less engaged schemes pay more, whereas in others they pay less.
- 131. We also undertook a regression analysis.²²⁴ In our main specification, we regressed the (log of the) IC-FM spend multiple for each scheme on a dummy variable indicating whether the scheme is engaged or not.²²⁵ We control for whether the scheme purchases bespoke liability hedging; scheme size; and the percentage of assets delegated (which will be 100% for full fiduciary management schemes).²²⁶
- 132. For this analysis, our baseline regression results are in Table 27 column (0) below follows. Our baseline includes fewer control variables than in the static approach. The reason for this is that we have fewer data points, and therefore face greater risk of overfitting the data if we include more controls.

Source: CMA Analysis, Parties' Data

²²⁴ Whilst regression analysis is again unlikely to be fully robust given the low sample size, it allows us to analyse the entire set of data available, controlling for confounding factors, rather than analysing several different and very small cuts of data independently of each other

²²⁵ We take logs of the dependent variable to avoid violating the assumption in OLS regression that the model is linear in parameters. We allow the effect of any given independent variable to be lower as levels of spend increase. For example, doubling scheme size is likely to have more of an effect when schemes are small. ²²⁶ Because we compute the multiple separately, and analyse data where one row represents one scheme, the model is cross-sectional in structure. We consider this has advantages over a timeseries structure (for example, a model of spend because we can allow the increase in spend to vary according to scheme characteristics more easily. Arguably, it is also more intuitive.

We test the sensitivity of the analysis to using the baseline approach, as well as five other sensitivities.

Table 27: Fiduciary	management transitio	n analysis, baselir	ne and core sensitivi	ties,
full table				

	(0)	(1)	(2)	(3)	(4)	(5)	(6)
	Baseline	Baseline, Static Approach	DB/Hybrid only; w/ hybrid control	Schemes buying 2+ investment	Tender only	TPE only	PT only
Tender, TPE or PT	-0.31** (0.04)	-0.22 (0.28)	-0.27* (0.08)	-0.25 (0.24)			
Tender (dummy)					-0.43** (0.05)		
TPE (dummy)						-0.23 (0.31)	
PT (dummy)							-0.28 (0.12)
% Delegation (cont, pp)	0.01*** (0.00)	0.01** (0.01)	0.01*** (0.00)	0.01*** (0.01)	0.01*** (0.00)	0.01*** (0.00)	0.01*** (0.00)
AUM (logs)	0.11** (0.04)	0.15* (0.06)	0.12** (0.02)	0.16** (0.03)	0.10* (0.06)	0.09* (0.10)	0.10* (0.06)
Client buys hedging (dummy)	0.42*** (0.01)	0.54* (0.04)	0.33** (0.04)	0.58** (0.04)	0.52*** (0.00)	0.40** (0.01)	0.33** (0.04)
Performance fee (dummy)		-0.96 (0.17)					
Number of AMs (logs)		0.03 (0.74)					
Firm Fixed Effects	NO	YES	NO	NO	NO	NO	NO
Hybrid (dummy)			-0.58** (0.01)				

²²⁷ WTW are omitted from this particular regression due to missing data, however they are included in the baseline.

	(0)	(1)	(2)	(3)	(4)	(5)	(6)
	Baseline	Baseline, Static Approach	DB/Hybrid only; w/ hybrid	Schemes buying 2+ investment consultanc	Tender only	TPE only	PT only
	-1.61	-0.42	-1.87*	-2.48*	-1.51	-1.29	-1.44
Constant	(0.11)	(0.39)	(0.06)	(0.05)	(0.13)	(0.20)	(0.15)
Observations	104	63	101	51	104	104	104
Adjusted R- squared	0.345	0.490	0.373	0.455	0.344	0.325	0.336
p-values in par	entheses *	p<0.10 ** p	o<0.05 *** p	<0.01			

Source: CMA Analysis; Parties' Data

- 133. The regression shows that schemes which tendered, had a TPE or used a PT faced spend increases which were approximately 31% less²²⁸ than schemes with none of these engagement proxies. The control variables are generally significant and have the expected signs: a scheme buying liability hedging is associated with approximately 42% larger spend multiples, a 10% increase a scheme's AUM is associated with approximately 1.1% larger spend multiples (although this effect is only marginally significant), and putting an additional 10% points of a scheme's assets into fiduciary management is associated with approximately 10% larger investment consultancy-fiduciary management spend multiples.
- 134. Table 27 also shows that the model appears to be reasonably robust to all of the six sensitivities. In particular, the model was robust to:
 - (a) Accounting for scheme type by including a dummy for whether the scheme is a hybrid and excluding DC schemes column (2)
 - (b) Changing the engagement proxy to use only a tender dummy column (4),
 - (c) Changing the engagement proxy to use only a PT dummy column (4),
- 135. The engagement coefficient became statistically insignificant when we undertook the other sensitivities listed below, although in each case the magnitude and sign was unchanged.
 - (a) Used the set of controls from the Static Approach as a consistency check column (1);²²⁹

²²⁸ The non-approximated value is 26%

²²⁹ We use a different baseline for the Transition Approach (discussed below) due to (i) the greater number of observations here and (ii) the need to control more for scheme complexity in a simple cross sectional model than one relying on changes in spend for the same scheme through time. We find that if we used the same baseline

- *(b)* Restricting the analysis to schemes which bought at least two services in investment consultancy, to account for schemes which might have just bought project work column (3), and
- (c) Changing the engagement proxy to use only a TPE dummy column (4),
- 136. Table 28 shows the results of further significance testing to see whether the results changed when we used full fiduciary management clients only column (1), changing the way we measure partial fiduciary management to use dummy variables rather than a continuous one column (2), controlling for performance fees column (3), controlling for restrictions imposed by the client on the fiduciary manager column (4), controlling for the number of services purchased in fiduciary management column (5), controlling for the number of years the scheme had been in fiduciary management column (7), and putting the dependent variable in levels rather than in logs column (8)

Table 28: Fiduciary management transition analysis, additional sensitivities, full table

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Full fiduciary management	NP %Partial	Perf Fee	Client restrictions	Fiduciary management services	AM count	Years fiduciary management	Levels
Tender, TPE or PT (dummy)	-0.31 (0.12)	- 0.32** (0.04)	- 0.32** (0.04)	-0.30* (0.05)	- 0.31** (0.04)	-0.27 (0.18)	-0.27* (0.08)	-1.91* (0.06)
AUM (logs)	0.06 (0.49)	0.11* (0.06)	0.12** (0.03)	0.11** (0.05)	0.11** (0.04)	0.17** (0.04)	0.10* (0.09)	0.77** (0.04)
Client buys hedging (dummy)	0.44* * (0.05)	0.45** * (0.01)	0.35** (0.05)	0.30* (0.09)	0.45** (0.02)	0.60** (0.01)	0.40** (0.01)	1.66 (0.13)
30-49% Delegation (dummy)		-0.06 (0.93)						
		0.50						

(shown in column 1 above), our results are not statistically significant, although the magnitude has not changed. Breaking this down, we find that modifying the baseline to include firm fixed effects does not change our results; the loss of significance appears to be associated with adding the additional controls. However, because doing this also reduces the sample size significantly due to missing data, the change in p-value could be a result of the lower number of data points rather than controlling for additional potential confounders.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Full fiduciary management onlv	NP %Partial	Perf Fee	Client restrictions	Fiduciary management services	AM count	Years fiduciary management	Levels
50-69% Delegation (dummy)		(0.11)						
70-99% Delegation (dummy)		0.67** (0.02)						
100% Delegation (dummy)		0.98** * (0.00)						
% Delegation (linear, pp)			0.01** * (0.00)	0.01** * (0.00)	0.01** * (0.00)	0.01** * (0.00)	0.01** * (0.00)	0.05** * (0.00)
Performance Fee (dummy)			0.19 (0.42)					
Client has hedging restriction (dummy)				0.28				
Client has consultation restriction				0.42				
(dummy)				(0.23)				
Client has restriction on assets (dummy)				0.02 (0.89)				
Buys Monitor/Deriskin g Service					-0.06			
(dummy)					(0.76)			
Number of Asset Managers (logs)						-0.03 (0.60)		
Mandate acquired in 2012 (dummy)							0.00 (.)	
Mandate acquired in 2013 (dummy)							-0.33 (0.18)	

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Full fiduciary management	NP %Partial	Perf Fee	Client restrictions	Fiduciary management services	AM count	Years fiduciary management	Levels
Mandate acquired in 2014 (dummy)							-0.16 (0.53)	
Mandate acquired in 2015 (dummy)							-0.09 (0.68)	
Constant	0.47 (0.75)	-1.36 (0.19)	-1.73* (0.09)	-1.59 (0.13)	-1.63 (0.11)	-2.60* (0.06)	-1.22 (0.27)	- 12.10* (0.08)
Observations Adjusted R- squared	63 0.086	104 0.328	104 0.343	101 0.348	104 0.339	63 0.473	104 0.344	104 0.152
p-values in parent	theses *	p<0.10 **	′ p<0.05 *	** p<0.01				

Source: CMA Analysis, Parties' Data

- 137. There was some variation in the exact effects shown across the sensitivities. Parties told us this meant our analysis was not robust. For example, Mercer highlighted that the results were not statistically significant when the sample is restricted to those schemes buying 2+ IC services only, or schemes in full fiduciary management.²³⁰
- 138. We note that in both cases, in the sign and magnitude of the effect is not very different from the baseline, although the sample size is notably smaller. Small sample sizes can result in wide confidence intervals even if there is a 'true' effect, and the lack of statistically significant results is not evidence that there is no such effect.
- 139. More generally, the identified increase (spend multiple) between more engaged and less engaged schemes was reasonably robust: p-values were generally low although some plausible specifications were not statistically significant at conventional thresholds.
- 140. As for the Static Approach, some parties again raised potentially confounding factors (as in paragraph 118). Our response can be found in that paragraph.

²³⁰ Mercer's response to the Gains from Engagement Working Paper, page 11

141. Overall, our provisional view from the transition analysis is that more engaged schemes pay significantly less than less engaged customers when moving into fiduciary management with the same provider they had used for investment consultancy.

Provisional conclusions

- 142. Our provisional conclusions as regards investment consultancy and fiduciary management prices are set out in full in paragraphs 10.119 to 10.124 of the main report.
- 143. In summary, we find that: there is some limited evidence for schemes in investment consultancy that less engaged schemes pay higher prices than more engaged schemes; and in fiduciary management there is evidence that less engaged schemes pay significantly higher prices than more engaged schemes, when they use the same provider they had used for investment consultancy.

Appendix 6: Market outcomes

Introduction

- 1. In this appendix, we set out additional analysis on market outcomes. This underlies the material presented in Chapter 10 in the main report, where our conclusions on these issues can also be found.
- 2. This appendix primarily contains analysis of quality factors, with the exception the qualitative analysis of internal documents and responses (item c below) which covers both price and quality. We consider the following:
 - (a) First, a quantitative analysis of asset management fees and discounts paid by investment consultancy and fiduciary management providers, assessing the importance of discounts; whether providers achieve higher discounts for their clients than trustees could achieve alone; and whether discounts achieved vary significantly in response to engagement.
 - (b) Second, analysis of asset allocation advice, assessing how far the level and sophistication of work conducted by providers is consistent with the claims made by firms; the extent to which the analysis is tailored; and whether there are indicators that providers have given effective asset allocation advice.
 - (c) Third, analysis of responses and internal documents to assess whether more engaged clients are likely to receive different levels of value for money (in terms of higher prices, lower quality or both) than others – and whether there is evidence that this has in practice occurred.
 - (*d*) Fourth, analysis of broader quality measures, focussed on satisfaction and trustee-perceived quality of service, to understand how well the market is working in these terms, and whether there is a relationship between overall quality of service and market success.

Asset management fees: impact of investment consultants and fiduciary managers

 Asset management fees are important costs for pension schemes.²³¹
 Investment consultants and fiduciary managers influence the level of asset management fees actually paid by clients. They may do this in several ways.

²³¹ See Figure 1 of Chapter 10.

- (a) First, because asset managers list (rack rate) prices depend upon the volume invested, providers can 'unlock' lower rack rates by aggregating together their clients' assets.
- *(b)* Second, and related to this, providers can also negotiate discounts from the rack rate prices.
- (c) Third, because providers' recommendations are influential in where their clients invest their assets, and because their recommendations typically account for price at least to a degree, they can encourage restraint in pricing.
- 4. In some cases, investment consultancy and fiduciary management providers make explicit claims to clients about the discounts they are able to achieve.
- 5. We have therefore undertaken analysis of the effectiveness of providers' role in reducing asset management fees. We have focussed on price deviations from asset managers' 'rack rate' fees; that is, primarily on providers' role in achieving discounts.

Background

- 6. As a starting point, we undertook analysis to understand the prevalence of discounting overall for pensions scheme clients of asset managers (whether or not these discounts are attributable to investment consultancy and fiduciary management providers).
- 7. Figure 18 below shows the median fees actually paid by investment consultant clients and by clients in both partial and full fiduciary management across all of their investments. The chart uses data provided by the Parties on their clients' asset management products, and shows these fees relative to rack rate prices; ie the prices posted by asset managers as their list prices.

Figure 18: Median overall implied asset management prices across clients, comparing the prices actually paid and the implied rack rate price.



Source: CMA Analysis, Parties' Data

- 8. Figure 18 shows that actual asset management prices paid by clients differ substantially from the rack rate asset management prices, particularly for fiduciary management clients. The overall discount received across all investments added up to just over 15% in investment consultancy and just over 30% in fiduciary management.²³²
- 9. In addition, our analysis showed that:
 - (a) Discounts are material in value: comparing simple averages, the median investment consultant client's total annual saving across all products is equivalent to just under £38,000 whilst in fiduciary management it is even higher at around £90,000.
 - (b) Discounts are common: in our data, the clear majority of investment consultancy clients and almost all fiduciary management clients received a discount of at least 10% on at least one product.
 - *(c)* There is significant variation in discounts across clients, implying that some may not be receiving a good deal.

²³² Taking the median values across clients of the overall discount percentage.

- 10. Both asset managers and investment consultancy/fiduciary management providers supported the view that discounting is an important characteristic of the industry.²³³
- 11. We considered how rack rate prices and discounts are determined.
- 12. Asset manager 'rack rate' prices are generally calculated as a percentage of the underlying assets under management, and expressed in basis points. Asset manager prices can vary significantly, for example between passive and active products,²³⁴ the method of accessing the product,²³⁵ the asset class of the product, and the asset manager chosen.236
- 13. For the same product, prices decline with amounts invested, and there is some evidence that fees in some asset classes have been falling in recent years for new clients.²³⁷ Variations in price will reflect differences in the underlying cost of providing the products, as well as the degree of competitive constraint faced by the asset manager.
- 14. Investment consultancy and fiduciary management providers told us that drivers of discounts include whether the fund is nearing a capacity limit,²³⁸ the newness of a fund; the prestige of an opportunity, whether there have been certain recent changes at the asset manager (eg underperformance, change of staff); and the level of investment in the fund.
- 15. Providers also told us that they were often able to achieve greater discounts than clients would be able to alone (although both might leverage characteristics above in their negotiations).
- 16. We therefore considered how negotiations take place.
- 17. There were differences in the way that investment consultancy and fiduciary management providers described their approach. However common themes included supporting individual clients in their negotiations (for example, by

²³³ Summary of roundtable with Asset Managers: 12 February 2018, paragraph 9

²³⁴ The 2017 Ernst and Young Fiduciary Management Fee Survey shows, for global equity products, a median fee of under 10 basis points for passive products, whilst a median fee of around 50 basis points for actively managed products. Page 10 http://www.ey.com/Publication/vwLUAssets/EY-2017-fiduciary-management-feessurvey/\$FILE/EY-2017-fiduciary-management-fees-survey.pdf

²³⁵ LCP's investment management fee survey 2017 (page 16) shows that DC platforms have generally been able to negotiate some fee discount from asset managers and pass these onto to their clients.

²³⁶ On average over 80% of the total fund cost is the asset management charge, with the remaining fund cost potentially comprising of factors such as fees to custodians and fees to legal advisers. We have focussed on the asset manager charges. LCP's investment management fee survey 2017, pages 11 and 29

²³⁷ LCP's investment management fee survey 2017 states on Page 10 that 'of the 22 major strategies ... covered, only 8 have seen rises in the average fee rate whilst 13 saw falls This means a new investor today is typically coming in at a lower fee rate. If existing investors have not recently asked for a fee reduction, they could be paying more than other clients of the asset manager.' ²³⁸ A defined amount of investments above which the fund becomes too large to execute its chosen investment

strategy.

providing them with fee surveys), negotiating on individual clients' own behalf, and negotiating on behalf of several clients to leverage the combined value of assets under advice or management at the investment consultancy and fiduciary management provider.

- 18. Indeed, using the combined assets across clients is a strategy used by several investment consultancy firms to increase the level of investments being leveraged in negotiations. For example, [≫], [≫], and [≫] are investment consultancy-only firms which told us they have previously achieved success taking this approach. However, as highlighted by the spectrum of fiduciary management providers, there are reasons to expect it will be particularly effective in fiduciary management, due to the inherent aggregation of client assets into funds of fund in this model.²³⁹
- 19. Investment consultancy and fiduciary management providers emphasised that discount negotiations were typically closely linked together with their manager recommendations services and teams.²⁴⁰ For example, [≫] told us that 'Fee and terms and conditions negotiations will typically take place as part of the client manager selection process. In most cases [≫] will conduct this negotiation on the client's behalf';²⁴¹ and [≫] told us that 'When proposing or advising on a new investment strategy or product, fees are part of the discussion from the outset'.
- 20. Several providers said that clients are able to, and do, negotiate discounts on their own behalf. For example, [≫] told us 'In some cases, our clients (typically the larger ones) will choose to negotiate their own commercial terms and keep this confidential'.²⁴² Nevertheless, a majority of providers told us it was very common for them to negotiate on a clients' behalf, and some said they did so whether a client explicitly asked them to or not.²⁴³

²³⁹ This approach will not only potentially lead to greater discounts, but also cheaper underlying prices to the extent that individual clients become able to access the price bands for the highest level of investments.
²⁴⁰ These services are purchased, potentially implicitly, by a large majority of schemes in fiduciary management as a consequence of delegating decision making to the fiduciary management provider.

²⁴¹ At least, 'where an asset manager has not entered into a specialist [&]. Paragraph 86.2 of [&] response to the Market Questionnaire.

²⁴² Consistent with this, [\aleph] told us that 'If the client is a [\aleph], we are constrained by auditor independence rules and can't negotiate the fee on their behalf. We will encourage the client to negotiate fees for themselves and can provide them with anonymised information on fee levels achieved by other clients or offered by other providers for the same service to help them in their negotiations'. Source: [\aleph] response to the market information request. ²⁴³ [\aleph] told us 'for our smaller clients it is often unrealistic to expect to be able to negotiate a discount; ... we do only do this if in the individual consultant's judgement, the likelihood and size of any fee saving is justified by the additional expense of our time carrying out the negotiations'. Source: [\aleph] response to the Market Information Request

Methodology

- 21. In order to understand whether activity by investment consultancy and fiduciary management firms helps their clients to achieve materially higher discounts than those clients could achieve by themselves, we compared discounts achieved by clients who use manager recommendations with those who don't. This should broadly represent the group of clients for whom investment consultants negotiate with asset managers.
- 22. There are two potential problems with making this comparison, although we do not consider either undermines our analysis. We set these out below.
- 23. Firstly, our use of schemes which do not purchase manager recommendations as a comparator group relies on the assumption that purchasing manager recommendations²⁴⁴ is a good proxy for whether a scheme's investment consultancy negotiates on their behalf. In practice, some clients purchasing manager recommendations may do their own negotiations. On the other hand, some clients who don't purchase recommendations may rely on their investment consultant's support or resources in negotiations.
- 24. From what Parties' have told us, we expect these 'mismatches' to constitute a minority of the data. Further, we expect that many schemes which do not purchase manager recommendations from the provider are either larger schemes capable of undertaking this work themselves, or purchase the service from another provider. These factors could mean that the average discount for the comparator group is higher than it would be if we could perfectly identify schemes' which received no assistance in negotiations, and therefore may understate the true impact of having investment consultant or fiduciary manager support.
- 25. Second, we expect customers who do not purchase manager recommendations to benefit from 'spillovers' from customers who do purchase the manager recommendations service: that is, they will likely invest in at least some of the same asset managers as those customers who do purchase negotiations, and where investment consultants leverage the total value of their customers' investments with particular asset managers, these negotiated discounts could be passed on.
- 26. However, we expect investment consultancy and fiduciary management providers to focus their negotiating effort on those asset managers (and

²⁴⁴ It also relies on the scheme level data provided by various parties being sufficiently consistently coded across clients.

products) in which higher proportions of customers paying for the service are invested. Any spillovers would again inflate the discount achieved by schemes which do not receive investment consultant support, and therefore cause an understatement in the effect identified.

Dataset

- 27. Our analysis relies on a very similar dataset to that used in our analysis of investment consultancy and fiduciary management fees, discussed in Appendix 5.²⁴⁵ The key difference is that here we make use of data which is at customer investment level, where in the analysis of investment consultancy and fiduciary management fees we conducted analysis at customer level.²⁴⁶
- 28. In particular, our main dataset contains information on the investment product chosen by the customer, the date they invested, the fee they actually paid, the percentage by which this fee was lower than the rack rate fee (the Implicit Discount), the asset class,²⁴⁷ the asset manager they used,²⁴⁸ the investment consultancy or fiduciary management provider they used, as well as a set of customer characteristics imported from the gains from engagement dataset such as the scheme type and the mix of services they purchased.
- 29. We relied on providers to calculate the implicit discount and to provide the rack rate that would have applied for particular customers. The implicit discount could reflect not only effectiveness of negotiating down from the rack rate, but also the effect of aggregating together assets to achieve lower rack rate starting points.
- 30. We present some key summary statistics for this data in Table 29 below.

²⁴⁵ Our dataset contains data from Aon. Barnett Waddingham, Cardano, Hymans, KPMG, Mercer, Redington, River and Mercantile and WTW.

²⁴⁶ We conduct some analysis on data which is re-aggregated to customer level data where this makes more sense in that context.

²⁴⁷ We created the asset class variable by an algorithm which reads in the names of the investment products used, and looks for key indicators of whether the product is, for example, a bond product. We do not believe that the algorithm will have correctly classified all products in all instances; nevertheless, since we are only using the resulting variable as a control (acknowledly subject to measurement error) in an indicative regression, we do not consider that any miscategorisation could have any fundamental impact on our results.

²⁴⁸ Likewise, our creation of a consistent asset manager ID variable relied on a similar algorithm, and could either group together a small number of asset managers who should not be grouped, or not group together some which should be grouped. For the same reasons, we do not consider this to be concerning.

Table 29: Summary statistics on our asset manager data

Variable Name	Obs	Mean	St.Dev.
Implicit Discount (%)	10,957	24	26
Investment Fee (£)	10,957	61040	126915
Client Investment (AUM, £m)	10,957	20	46
Price paid (implied basis points)	10,956	53	99
Firm-AM combined Investment (AUM, £m)	10,957	6564	9533
Number of years ago investment		-	
made	10,818	6	3
Hybrid dummy	10,957	0	0
Engagement dummy	10,957	1	0

Source: CMA Analysis; Parties' data²⁴⁹

Results

31. We begin by comparing the median discounts achieved across each group. Considering the distribution of clients, we compared the median percentage of investments which had achieved at least a 10% discount, and also the median overall discount achieved.





²⁴⁹ Figures rounded to 0 dp

- 32. We found that customers using manager recommendations have an overall discount rate of 17%, compared to 11% for those not using manager recommendations. We also find that they have a greater proportion of material discounts. The median discount increases with the size of the provider's investments, both in investment consultancy and fiduciary management. This might imply that a strategy of aggregating together assets is effective in increasing discount rates.
- 33. We found that the level of discount was correlated with the combined value of both investment consultant and fiduciary management providers' customers' assets. Taking the level of combined assets as a given, we found that fiduciary management customers received very similar discounts, whereas investment consultancy customers received highly varying discounts.
- 34. However, there are a range of potentially confounding factors which could influence discount rates. We use a regression approach to go some way to addressing these issues.²⁵⁰
- 35. For our main results, in order to test whether purchasing investment consultancy or fiduciary management services leads to higher discounts, we compared the discount rates received by customers *invested with the same firm and asset manager*. That is, we included provider-asset manager fixed effects. This strips out a number of possible confounding factors, such as the asset manager's preparedness to offer discounts at all. We controlled for the asset class; whether the scheme is a hybrid rather than a DB scheme; and the level of the customer's individual investment.
- 36. Our variables of interest divide schemes into six 'buckets' depending on the services purchased and whether they have at least one engagement indicator. We treat schemes which have no engagement indicators AND purchase neither fiduciary management nor investment consultancy manager recommendations as the base group: all discounts are therefore measured relative to this group.
- 37. Specification (1), our main results, considers schemes purchasing both fiduciary management and investment consultancy together in the same regression.
- 38. However, doing so constrains the effect of all control variables to be the same regardless of whether the scheme is in IC or FM. Specifications (2)

²⁵⁰ For our main regressions, we exclude schemes in partial fiduciary management for simplicity, although include them in a robustness check reported below. We find our results are not sensitive to this treatment.

and (3) account for this by focussing on IC schemes only; they differ in that (2) allows engagement to influence discount rates for schemes which do not purchase manager recommendations, whereas (3) constrains schemes not purchasing manager recommendations to have the same discount rate regardless of whether they are engaged or not. We show the results of this regression analysis in Table 30 below.

	(1)	(2)	(3)
	Both	IC only	Simple IC
FM, engaged	24.10***		
	(0.00)		
FM, not engaged	24.63***		
	(0.00)		
IC Mgr, engaged	4.34**	2.94*	5.03***
	(0.02)	(0.05)	(0.01)
IC Mgr, not engaged	-0.74	-0.99	1.09
	(0.80)	(0.53)	(0.52)
No Mgr, engaged	-1.06	-2.46	
	(0.69)	(0.33)	Combined
No Mgr, not engaged	Base	Base	into one base
			category
Client investment (AUM - Logs)	0.57	0.56	0.56
	(0.47)	(0.66)	(0.65)
Hybrid Dummy	-3.43**	-3.13**	-3.14**
	(0.05)	(0.02)	(0.01)
Investment in bonds	6.29**	4.01**	4.03**
	(0.02)	(0.03)	(0.03)
Investment in equity	8.74***	8.96***	8.96***
	(0.00)	(0.00)	(0.00)
Investment in LDI	0.36	-2.25	-2.13
	(0.93)	(0.33)	(0.34)
Investment in property/infrastructure	-11.14**	-6.13***	-6.12***
	(0.01)	(0.01)	(0.01)

Table 30: Main results for our analysis of asset manager discounts

	(1)	(2)	(3)
	Both	IC only	Simple IC
Provider-Asset Manager Fixed Effects	YES	YES	YES
Constant	7.63**	11.55***	9.45***
	(0.02)	(0.00)	(0.00)
Observations	9241	5272	5272
Adjusted R-squared	0.556	0.306	0.306

p-values in parentheses * p<0.10 ** p<0.05 *** p<0.01

Source: CMA Analysis, Parties' Data

- 39. For investment consultancy, specifications (1) to (3) show that investments made by customers which purchase manager recommendations are associated with discount rates which are two to five percentage points higher than schemes which do not purchase manager recommendations, but this was only true for more engaged schemes.²⁵¹
- 40. For fiduciary management, specification (1) shows that schemes receive discount rates which are around 24% points higher than schemes in investment consultancy which do not purchase manager recommendations.²⁵² The discount rates are also significantly higher than investment consultancy customers which do purchase manager recommendations. This appears to be the case regardless of engagement.
- 41. The effects are economically and statistically significant. These results imply that purchasing investment consultancy is likely to help schemes achieve greater discounts than they could themselves, but only if the scheme is engaged. Purchasing fiduciary management appears also to be associated with higher discounts, regardless of engagement indicators.
- 42. The effect demonstrates that low trustee engagement could have adverse effects in ways other than investment consultancy and fiduciary management pricing, as discussed in Appendix 5.²⁵³

²⁵¹ Further, being engaged but not purchasing manager recommendations does not appear to be associated with higher discounts.

²⁵² Although our data contains some schemes which are not indicated as purchasing asset manager selection, this seems to us a key part of the fiduciary management offering. We therefore have not used these schemes as a comparator group in case these arise due to anomalies or special cases in the data provided to us. We consider that schemes not purchasing manager recommendations in investment consultancy are a good alternative comparator group and have therefore used that.

²⁵³ Our dataset contains a relatively high proportion of observations from [\gg]; however, our conclusions were not sensitive to excluding that firm.

- (a) We undertook a range of sensitivity tests to understand the robustness of the above analysis. In particular, we tested whether the results were sensitive to:
- (b) Including partial fiduciary management schemes in the dataset
- (c) Including schemes' funding levels, which might account for differing investment profiles of schemes
- (d) Including the number of years ago the investment was made
- *(e)* Using the discounted price per unit of AUM as the dependent variable, rather than the discount rate
- *(f)* Omitting provider asset manager specific controls (that is, including only controls relating to each separately rather than in combination).²⁵⁴
- (g) As for (e), but applied to the simple IC model (specification (3) above)
- 43. We present each of these sensitivities in turn in Table 31 below.

Table 31: Asset manager discount sensitivities



²⁵⁴ We do this because there is a risk that including fixed effects, or individual control variables which control for providers' choice of asset manager suffers from the 'bad control' trap; ie because the choice of asset manager and the combined level of assets with that asset manager is an outcome of choosing fiduciary management or investment consultancy, *controlling* for that outcome in a regression in which we test the effect of purchasing fiduciary management or investment consultancy could cause the regression to understate the effect of purchasing these services. We find that our analysis of investment consultancy is not robust to this change of specification, but the results for fiduciary management do not change much.

IC Mgr, engaged	4.65**	9.91**	4.98**	0.12	1.16	4.58**
	(0.01)	(0.04)	(0.01)	(0.28)	(0.72)	(0.01)
IC Mgr, not engaged	-0.48	3.25	-0.08	0.23**	-3.48	0.57
	(0.87)	(0.54)	(0.98)	(0.04)	(0.35)	(0.73)
No Mgr, engaged	-0.32	4.23	-0.62	0.22*	-3.12	Combined
	(0.89)	(0.38)	(0.84)	(0.08)	(0.31)	into one
No Mgr, not						base
engaged	Base	Base	Base	Base	Base	category
Percentage Funded	0.16	1.17*	0.53	-0.05***	0.80	0.40
	(0.82)	(0.08)	(0.52)	(0.00)	(0.28)	(0.74)
Number of vegre	0 50*	7 05***	2 25*	0 10***	2 00*	2 00**
since investment	-3.53	-7.05	-3.30	0.13	-3.00*	-2.99
	(0.07)	(0.00)	(0.06)	(0.01)	(0.07)	(0.03)
O II			0.50**		0.04444	1.00**
(AUM - Logs)	7.27**	4.54	6.53**	-0.53***	6.64***	4.20**
	(0.04)	(0.11)	(0.02)	(0.00)	(0.01)	(0.02)
Hybrid Dummy	8.15**	9.40***	8.90***	-0.24**	9.43***	9.83***
	(0.02)	(0.00)	(0.00)	(0.03)	(0.00)	(0.00)
Investment in	3.40	1.72	0.35	-0.39***	3.22	-0.31
bonds						
	(0.54)	(0.71)	(0.94)	(0.00)	(0.47)	(0.90)
Invootmont in anyth	10 00***	10 15**	11 00**	0 50***	10 50***	7 01***
investment in equity	-12.30	-10.15	-11.20	0.52	-12.38	-1.01
	(0.01)	(0.03)	(0.01)	(0.00)	(0.00)	(0.00)

Investment in LDI		0.07**				
		(0.03)				
Investment in property/ infrastructure			-0.06			
			(0.70)			
Provider-Asset Manager Fixed Effects	Yes	Yes	Yes	Yes	No	No
Provider Fixed Effects	No	No	No	No	Yes	Yes
Asset Manager Fixed Effects	No	No	No	No	Yes	Yes
Constant	9.66***	-6.51	7.44**	3.65***	19.79***	21.06***
	(0.00)	(0.37)	(0.01)	(0.00)	(0.00)	(0.00)
Observations	10889	8083	9107	9207	9241	5272
Adjusted R-squared	0.569	0.580	0.556	0.757	0.514	0.263

p-values in parentheses * p<0.10 ** p<0.05 *** p<0.01

Source: CMA Analysis; Parties' Data

- 44. These sensitivity tests show that schemes in fiduciary management have higher discount rates than schemes in investment consultancy, regardless of whether those schemes purchased manager recommendations, in across all models testing this, ie specifications (4) (8). More engaged schemes in fiduciary management always had similar discount rates to less engaged schemes. (4) showed this effect persists even when we include partial fiduciary management schemes.
- 45. More engaged schemes who purchase investment consultancy manager recommendations are also associated with greater discount rates across

specifications (4) to (7) and (9). The effect did not hold for (8), in which we replaced provider-asset manager combined fixed effects with a set of separate provider fixed effects and asset manager fixed effects in the baseline model.²⁵⁵

- 46. Including percentage funded as a control in specification (5) increases the discount rates but no key variable change significance.²⁵⁶ We found no robust evidence when we use discounted prices paid by the scheme as the dependent variable in specification (7), but we note that this is less likely to account for potentially higher quality products which have higher prices.
- 47. We conducted two further regressions of a similar nature: first, we used fractional regression on our base specification (1). Second, we used logit regression with the dependent variable as a dummy encoded as 1 if the discount as at least 10%, and 0 otherwise. These are tabulated below.

Table 32: Fractional and Logit regression for asset manager discounts

	(10) Fracreg	(11) Logit
FM, engaged	1.38*** (0.00)	3.31*** (0.00)
FM, not engaged	1.40*** (0.00)	3.56*** (0.00)
IC Mgr, engaged	0.36* (0.05)	0.77* (0.07)
IC Mgr, not engaged	0.04 (0.86)	0.37 (0.36)
No Mgr, engaged	-0.24 (0.34)	-0.07 (0.86)
No Mgr, not engaged	Base	Base

²⁵⁵ We also did this in specification (9) where the results did not change much, the difference between (8) and (9) being that (9) constrains schemes not purchasing manager recommendations to have the same discount rate regardless of whether they are engaged or not.

²⁵⁶ We do not take this as our base case despite percentage funded being significant because there is a concern that the level of the discount of the schemes' investments could influence funding levels – this endogeneity concern reduces the weight we can place on this specification. Nevertheless, we consider that it useful as a sensitivity test because it allows us to proxy for the type of investment the scheme might chose, aside from the simple dummy variables for asset classes.

Client investment (AUM - Logs)	0.03 (0.56)	0.20*** (0.01)
Hybrid Dummy	-0.21* (0.06)	-0.38** (0.05)
Investment in bonds	0.40** (0.02)	0.03 (0.95)
Investment in equity	0.60*** (0.00)	0.50 (0.12)
Investment in LDI	-0.03 (0.91)	-0.37 (0.25)
Investment in property/infrastructure	-1.32*** (0.00)	-1.66*** (0.00)
Constant	-2.72*** (0.00)	-0.01 (0.98)
Provider-Asset Manager Fixed Effects	YES	YES
Observations p-values in parentheses * p<0.10 ** p<0.05	9241 5 *** p<0.01	6182

Source: CMA Analysis; Parties' Data

- 48. Importantly, the interpretation of the coefficients is not the same as in OLS regression, and therefore we focus on the statistical significance and the sign of the coefficients. The results are broadly consistent with our baseline regression.
- 49. For investment consultancy, where we identify an effect of engagement, we have tested whether this effect varies depending on whether we use individual measures of engagement rather than the combined measure. This analysis is shown in Table 33 below. For simplicity, we exclude all fiduciary management customers as well as customers in investment consultancy who do not purchase manager recommendations.

Table 33: Effect of individual engagement measures on asset management discounts

(12)	(13)	(14)
Tender	TPE	PT

Tender

4.08***

TPE		-2.45* (0.08)	
PT			-1.62** (0.03)
Client investment (AUM -	0.49	0.66	0.65
Logs)	(0.70)	(0.62)	(0.62)
Hybrid Dummy	-3.24***	-2.97**	-2.88**
	(0.00)	(0.01)	(0.01)
Investment in bonds	4.19**	3.99**	4.03**
	(0.03)	(0.03)	(0.03)
Investment in equity	9.43***	9.33***	9.30***
	(0.00)	(0.00)	(0.00)
Investment in LDI	-2.28	-2.60	-2.62
	(0.32)	(0.27)	(0.25)
Investment in	-5.63**	-5.92**	-6.08**
property/infrastructure	(0.02)	(0.01)	(0.01)
Provider-Asset Manager Fixed Effects	YES	YES	YES
Constant	11.63***	13.66***	14.39***
	(0.00)	(0.00)	(0.00)
Observations	4936	4936	4936
Adjusted R-squared	0.305	0.299	0.300

(0.00)

p-values in parentheses * p<0.10 ** p<0.05 *** p<0.01

Source: CMA Analysis

50. In these regressions, TPEs and PTs are associated with a negative effect on discount rates when considered in isolation, and are cases where our analysis appears less robust. However, schemes which tendered are

associated with greater discount rates. This is consistent with our view that tendering is likely to be a stronger form of engagement.²⁵⁷

- 51. The above regressions have not allowed us to test independently the effect of aggregation of assets across clients. This is because we have implicitly controlled for the aggregated level of assets in any specification in which we have included provider – asset manager combined fixed effects.
- 52. We conducted an indicative regression on the effectiveness of asset aggregation by comparing the discount rates achieved by the same client (that is, we include client fixed effects). Because there is no within-client variation in whether they purchase fiduciary management or investment consulting, or in whether they are engaged, we cannot test these effects in this way. But it works for asset aggregation, and accounts implicitly for any characteristics of the client which would lead them to get a higher or a lower discount. The regression is shown in Table 34 below.

²⁵⁷ However, because our regression does not control for the characteristics of schemes which are more or less likely to tender, we do not interpret this coefficient as 'the effect of tendering'.

Table 34: Effect of asset aggregation on discount rates

	(1) Within Client	
Client investment (AUM - Logs)	0.36 (0.20)	
Combined Provider-AM investment (AUM - Logs)	0.48* (0.09)	
Number of years ago investment made	0.07 (0.63)	
Investment in bonds	4.08*** (0.00)	
Investment in equity	4.33*** (0.00)	
Investment in LDI	-0.29 (0.89)	
Investment in property/infrastructure	-5.83*** (0.00)	
Constant	7.52*** (0.00)	
Observations Adjusted R-squared	4525 0.385	
n-values in narentheses * n<0 10 ** n<0 05 ***		

p-values in parentheses * p<0.10 ** p<0.05 *** p<0.01 Source: CMA Analysis; Parties' Data

53. Our analysis here shows that the client's investment might have increased the discount rate, but the effect is not statistically significant. The level of combined provider-asset manager discounts may have increased the discount rate even more, and this effect was significant at the 10% level.²⁵⁸

²⁵⁸ We cluster standard errors at the client level

Analysis of Asset Allocation Advice

- 54. This section contains our analysis of asset allocation. We proceed in this order:
 - (a) First, we assess the relative importance of asset allocation and manager recommendations
 - (b) Second, we explain our approach as regards the effectiveness of asset allocation advice
 - *(c)* Third, we detail the quantitative and qualitative analysis we have undertaken on tailoring

Asset allocation vs manager recommendations

- 55. Numerous parties told us that asset allocation is the key driver of returns, and is more important than manager recommendations. For example, Mercer said that 'As the primary driver of risk and return, asset allocation is the most important decision an investor can make';²⁵⁹ Redington said that 'Performance of manager recommendations, whilst more easily measurable, are not the key driver of member outcomes'.²⁶⁰
- 56. Several parties, including Redington, IC Select, LCP and Mercer, highlighted papers in the academic literature suggesting asset allocation determines around 90% of performance.²⁶¹
- 57. However, a range of other papers find that a significant amount of variation in performance is determined by factors other than asset allocation, such as manager selection. In particular:
 - (a) Ibbotson (2010) concludes: 'The time has come for folklore to be replaced with reality. Asset allocation is very important, but nowhere near 90 percent of the variation in returns is caused by the specific asset allocation mix...';²⁶² and
 - (b) Hensel, Ezra and Ilkiw (1991) concludes that '...Relative to a naïve diversified mix, any specific asset allocation policy may have a sizable

²⁵⁹ Mercer's response to the Issues statement.

²⁶⁰ Redington's response to the Issues statement.

²⁶¹ Most made references to the paper '*Determinants of Portfolio Performance*' by Brinson, Hood and Beebower (1995).

²⁶² Ibbotson, R. (2010), 'The Importance of Asset Allocation'. CFA Digest, 40(2), p20

impact on total return, but nothing like the dominance frequently (and erroneously) attributed to it.²⁶³

- 58. The CMA survey showed that almost all trustees consider both services are either important or fairly important to meeting the scheme's objectives.²⁶⁴ We therefore consider that the effectiveness of both asset allocation and manager recommendations is important.
- 59. We have discussed manager recommendations in Appendix 2 and continue discussing asset allocation here.

Analysis of the effectiveness of asset allocation

- 60. We considered whether it was appropriate to undertake a large scale quantitative analysis into how far investment consultancy and/or fiduciary management providers' asset allocation advice improved, for example, scheme level returns or risk.
- 61. We asked Parties to comment on the feasibility and methodology to undertake this work. Most parties told us that bespoke quantitative work in this area would not be feasible, or at least would present significant challenges, particularly for investment consulting. For example, WTW told us that 'by its nature the quality of asset allocation advice is very difficult to assess given that there is no obvious single counterfactual'.²⁶⁵
- 62. These parties generally told us that we should instead consider the historical performance of their full fiduciary management customers to understand outcomes for both fiduciary management and investment consultancy services. This is discussed further in paragraphs 10.84 to 10.87. Parties did not propose other methodologies.
- 63. Additionally, although some providers such as Hymans, Redington and LCP maintain internal 'ratings' of asset classes to provide guidance to consultants in their asset allocation advice,²⁶⁶ we noted that there is no one set of consistent asset class definitions, and therefore constructing a comparable dataset of asset class ratings (where these exist) and performance would be extremely challenging.
- 64. We therefore concluded that it would not be pragmatic to conduct such a large scale quantitative analysis. We considered whether there was higher

²⁶⁴ CMA analysis of CMA survey

²⁶³ Chris R. Hensel, D. Don Ezra and John H. Ilkiw, *The Importance of the Asset Allocation*, Decision Financial Analysts Journal, Vol. 47, No. 4 (Jul. - Aug, 1991), pp. 65-72.

²⁶⁵ WTW Response to the Issues Statement, paragraph 4.16.

²⁶⁶ Hymans, MI Response Q13; Redington, MI Response Q17; and LCP's MI response.

level, qualitative evidence that parties' asset allocation advice had improved customers' returns, which might be indicative of the quality of this service. Advice in respect to hedging is one such indicator. We note in paragraph 10.76 that providers' asset allocation advice with respect to hedging decisions may have produced value for their customers.

65. We are however not in a position assess the extent in general to which asset allocation has improved customers' returns.

Analysis of tailoring in asset allocation

- 66. Parties told us that asset allocation advice is highly scheme specific, in that advice is tailored based on factors such as the strength of the employer covenant; investment risk appetite; funding position; scheme maturity; the level and profile of contributions; cash flow demands and liquidity; correlation of asset class returns with sponsor health; and schemes' appetite for and tolerance of complexity. Parties also told us that asset allocation is not formulaic, and is often arrived upon as part of a conversation with trustees.
- 67. We undertook analysis to verify this point of view. Given the costs associated with investment consultancy and fiduciary management services, at a minimum, we would expect advice to be tailored to the scheme. If we found evidence that asset allocation advice were 'one size fits all', this would indicate that market outcomes for this service are comparatively poor.
- 68. We were not able to observe the *advice* given to schemes, but considered their final asset allocation positions to represent a reasonable proxy for the advice given, particularly in fiduciary management. We focussed on the bond/equity ratio (expressed as the percentage of assets in bonds, out of all assets allocated into either equity or bonds). Our main analysis focussed on four significant providers of IC and/or FM services: Aon, Mercer, WTW and Hymans.
- 69. Our analysis relied on the dataset created for our analysis of investment consultancy and fiduciary management prices. Our dataset for this analysis contained information on asset allocation positions, and some characteristics such as funding levels.
- 70. As for our analysis of other outcome parameters, we were unable to match data on all customers between all data sheets provided by the Parties. As a consequence, we analysed only a subset of customers. We consider that even if the analysis is not fully representative of firms' customer base,²⁶⁷ it is

²⁶⁷ Excluding as it does most of the smallest customers as well as for most analyses all DC customers,

a sufficiently good cross section of the Parties' customer base to allow us to draw general if indicative provisional conclusions.

- 71. Our analysis is relatively simple, and is set out in what follows. We considered the variation in asset allocation positions overall, and when we control for one key driver of asset allocation (funding level). We make this comparison individually for each firm, split also by the type of customer (investment consultancy or fiduciary management).²⁶⁸
- 72. We considered their final asset allocation positions rather than the asset allocation advice because we were not able to observe the latter. We considered that the asset allocation positions represented a reasonable proxy for the advice given, particularly in fiduciary management.
- 73. We focussed²⁶⁹ on the bond/equity ratio (expressed as the percentage of assets in bonds, out of all assets allocated into either equity or bonds). Our main analysis focussed on the largest three IC-FM providers, but the results were similar when we used data from another significant investment consultancy provider (Hymans).
- 74. The analysis is shown in Figure 20 below. This is a scatter chart showing the different bond-equity positions of each scheme against their funding levels²⁷⁰ as well as the fitted relationship between these two variables.

²⁶⁸ For this analysis we exclude customers in partial fiduciary management because these customers may have particularly high asset allocations within these mandates to particular asset classes. As such, we might not have sufficient coverage of their full strategic asset allocation.

²⁶⁹ Given challenges in allocating assets into particular classes and concerns about the representivity of the data submitted, we consider that lower level asset allocation analysis could provide misleading results. By contrast, we do not expect there to be much ambiguity about what is an equity and what is a bond.

²⁷⁰ We have introduced a disturbance around each funding position to reduce identifiability concerns in this chart. The data underlying the trend in our analysis of the relationship is the actual data, not the disturbed data.

Figure 20: Asset allocation positions compared to funding levels



Applying a 10 percentage point disturbance to the scatter; omitting data outside the 0-100% interval Excluding all assets not invested in bonds or equities

Source: CMA Analysis; Parties' Data

- 75. Our analysis showed a clear relationship between funding level and a tilt towards bonds in fiduciary management, and similar evidence for at least three of four providers in investment consultancy.
- 76. The relationship between funding level and bond equity ratio implies that asset allocations are tailored to give lower returns and less risk for schemes, which is evidence of tailoring to scheme characteristics. Further, that there is significant variation around the average (even in full fiduciary management) implies that a range of other scheme-specific factors are considered in determining asset allocation positions.
- 77. As a further sense check, we analysed an additional set of data provided by TPR and the PFF, which contained information on schemes' asset allocations. This analysis also supported the provisional conclusions drawn from our primary asset allocation analysis.
- 78. This dataset contained data on (schemes' self-reported) percentage of assets in equities provided through their scheme returns to TPR. The data contained around 4,000 schemes; we dropped schemes not in the PPF index, all DC and Hybrid schemes; and schemes which appeared to have potentially invalid or complex data (such as proportions of assets across all asset classes which did not sum to one).

- 79. Considering pension schemes as a whole,²⁷¹ we allowed bond-equity positions to vary according to the following: scheme size (measured in 5 dummy variables); funding ratios (defined as total assets divided by total *protected* liabilities); the percentage of members who were active (ie non-pensioners); scheme status (measured in four dummy variables: open / closed / frozen and winding up) and scheme maturity (measured by the percentage of the schemes' liabilities which related to active members joining between 1997 and 2009).
- 80. We found a statistically significant relationship between each scheme characteristic variable and bond-equity positions in almost all cases.²⁷² Where coefficients were significant, they had the expected sign. However, even controlling for these factors, a large amount of variation remained. Both of these facts support the proposition that asset allocation advice is likely to be tailored to scheme characteristics.
- 81. Our provisional conclusions in relation to asset allocation are set out in Chapter 10.

Analysis of responses and internal documents

- 82. We have undertaken analysis of parties' responses to our Market Information Request and internal documents. Our review has sought to identify whether investment consultancy and fiduciary management firms monitor levels of engagement; whether price and service factors are negotiated or personalised to individual schemes; and whether there is evidence that demand side engagement can and does influence price and service levels.
- 83. Our review has considered views from the spectrum of parties who responded to our Market Information Request. Our review of internal

²⁷¹ We note that this analysis will have included schemes which do not purchase investment consultancy or fiduciary management services (and relatedly, we could not conduct analysis separately for investment consultancy and fiduciary management services). However, the vast majority will purchase at one of these services, therefore we do not think this is a fundamental issue.

²⁷² Specifically, we used both a linear OLS and a fractional regression with a logit link to assess the relationship between the percentage of schemes' assets in bonds (out of all assets in bonds or equities) and the variables mentioned above. All coefficients for named had effects which were statistically significant at the 5% level, except for where mentioned in what follows. The percentage of scheme members who were active had a marginally significant effect in both regressions. The same was true of the dummy variable representing schemes being 'open'. The dummy for schemes being 'Paid up (frozen)' was not significant at any conventional level. The dummy on 'Winding up' was significant indicating an association with higher bond/equity ratios, and 'closed' schemes were the omitted category. We also included the percentage of liabilities relating to members who had joined between 1997 and 2009 but were *deferred*, but the effect was not statistically significant at conventional levels. We note that these are just associations, and do not interpret any causality in either direction.
documents focussed on the largest three IC-FM providers, namely Aon, Mercer and WTW, though we have received only limited evidence from [\gg].

84. Whilst in the main body of this report, we split the results of this analysis between price and quality (see paragraphs 10.14 to 10.19 for the analysis of price and 10.96 to 10.101 for the analysis of quality), we have presented both together in this Appendix.

Parties' submissions

- 85. In their responses to the Market Information Request, Parties told us that improvements in terms or discounts may be based on specific characteristics of the service purchased, for example a discount based on the size of the schemes' assets or a discount for purchasing multiple services.
- 86. In addition to this, although many have standard fees, investment consultants appeared prepared to negotiate on fees in order to secure appointments, and will revisit fees for existing schemes. These negotiations appear to be initiated both by Parties and by schemes.
- 87. [≫] told us that 'Clients are able to, and have in practice, exerted downward pressure on fees.'²⁷³ They provided a number of examples of occasions when schemes had managed to do this:

Table 35: Examples of occasions where [st] customers have exerted downward pressure on fees

- Client [%] Example
- Client A 'The client negotiated aggressively on fees during the sales process, [%]
- Client B '...The client had benefitted from a negotiated discount on our fees which was due to expire, ie the fees were about to revert to higher levels. [%]
- Client C 'The client [≫] We offered a set of options for the client to choose between...'

Source: [%] internal documents.

88. [≫] told us in the context of its investment consultancy services that 'We believe our prices are competitive in the market... that said we operate in a commercial environment and will negotiate with new or existing schemes on

 $^{^{273}}$ [\gg] response to the market information request, paragraph 40.

charge out rates or project costs related to the scope of work to be undertaken'²⁷⁴

- 89. [≫] told us that 'we periodically review the level of fees we charge all schemes and approach any outliers to reduce their fee basis. ... Of course, we are also approached to review fee levels by schemes and/or their independent advisers as well'²⁷⁵
- 90. Others also said they negotiate fees, other aspects of service provision, or both together including at schemes' requests. These included [≫],²⁷⁶ [≫],²⁷⁷ and [≫].²⁷⁸
- 91. It appears to be reasonably common for discounts to be given on an 'in-kind' basis, rather than as a reduction in the retainer fee. For example, [≫] told us that '[≫] we decided to offer [≫] data base access for free for the first year, [≫].' ²⁷⁹
- 92. It also appears to be reasonably common for firms to use write-offs where scheme trustees are unhappy with general fee levels or the quality of services they have received.
- 93. The firms' responses appear to indicate that negotiations can improve the offering given to schemes. Therefore, at least some of the variation in fees between schemes for a given level of service quality can be attributed to negotiation. Where negotiations occur surrounding service quality, this may also be improved. If negotiations are less frequent or less successful where schemes are less engaged, a weak demand side may mean that competition may not be functioning effectively.

Parties' internal documents and processes

94. The evidence set out above is consistent with that which we find in internal documents. It appears that several parties carefully monitor existing schemes, and record information on who they consider to be 'at risk' of switching provider.²⁸⁰ It appears that this process is linked to firm-led negotiations on fees, targeted improvements in service quality, and other

 $^{^{274}}$ [\gg] response to the market information request, paragraph 40.

 $^{^{275}}$ [%] response to the market information request, paragraph 43.

 $^{^{276}}$ [\gg] response to the market information request, question 44.

 $^{^{277}}$ $[\ensuremath{\bowtie}]$ response to the market information request, question 40.

²⁷⁸ [%] response to the market information request, question 43.

 $^{^{279}}$ [\approx] response to the market information request, paragraph 40.

²⁸⁰ In a more general way, investment consultants and fiduciary managers generally told us that they undertake client surveys and interview processes in order to understand schemes' perceptions of the service qualities and value for money that they are receiving. Some Parties conduct these anonymously, others in an attributable way.

efforts to improve outcomes for such schemes. There were references in the documents to concerns that otherwise these schemes would switch.

- 95. If more engagement leads clients to be more likely to be considered 'at risk' and therefore to receive better outcomes, this implies that schemes which are less engaged (or which face barriers to engagement) may receive comparatively less favourable outcomes.
- 96. We set out a summary of the evidence on this monitoring process, and potential links to market outcomes.
- 97. [≫] told us that they maintain a 'Clients at Risk' register which is regularly reviewed for progress by leaders within the business,²⁸¹ including at [≫].²⁸² Reasons for including schemes mostly relate to service issues, but also include upcoming tenders and reviews.²⁸³
- 98. Actions to manage risk generally tend [\gg]. For example, [\approx]²⁸⁴
- 99. In the register presented (for fiduciary management schemes) [≫], schemes are assigned a rating of Red, Amber or Green. Red means '[≫]'.²⁸⁵ [≫]. ²⁸⁶
- 100. Reasons for being 'at risk' appear to include $[\aleph]$.²⁸⁷ $[\aleph]$.
- 101. [≫] appeared to conduct a similar process, at least for its fiduciary management schemes. A presentation to the [≫] contained a list of fiduciary management schemes each with a 'risk status' ranging from red to green.²⁸⁸ Several of the 'red' and 'amber' risk schemes have notes mentioning that trustees intend to conduct reviews or tenders. In at least one case²⁸⁹ customer engagement appeared to be linked to improvements in customer outcomes.

[\gg] 'Trustees looking for savings, largely driven by [\gg], Company advisors' and noted the action 'fiduciary management fee was due to rise from [\gg] bps to [\gg] bps after 3 years (ie start of 2015), but we have agreed to retain a [\gg] bps fee'.²⁹⁰

²⁸¹ [%] response to the market information request, question 42
²⁸² [%].
²⁸³ [%].
²⁸⁴ [%].
²⁸⁵ [%] 08 March 2017
²⁸⁶ [%].
²⁸⁷ [%] 08 March 2017, page 46
²⁸⁸ [%].
²⁸⁹ [%].

- 102. [≫] also told us that they 'actively collate feedback from schemes and carry out [regular] [≫] reviews. These involve approx. [≫] customer interviews per year in the UK'.²⁹¹ [≫] provided us with the results of these surveys.
- 103. Overall, the interviews indicate that, whilst [≫] generally monitors and responds to concerns about its service levels, it monitors the engagement of its customers particularly closely. In some instances, [≫] appears to have taken actions to improve its offering to customers in response to this engagement: ²⁹²

Table 36: Examples of [≫] taking	action to improve its	offering to	customers i	n
response to engagement.				

Customer ID	Column from which information copied	Quote
[*]	How to Mitigate the issues	They had said they wanted something that was fairly generic and based on data and information we already had. They were staggered to be quoted £4K although this had been reduced to £3.5k when they had pushed back
[%]	SWOT Analysis - Threats ²⁹³	Robust tender process will happen in 2019 ? retention action plan required for next 18 months
[*]	SWOT Analysis - Weaknesses	(Linked to a point in an earlier part of interview: where scheme is noted to have 'severe financial constraints and [be] carefully looking at all fees') We have time to find a way to address their fee issue (and perception).
[≫]	SWOT Analysis – Opportunities	Avoid competitive tender by urgently reviewing team, scope, fees and offering some level of investment to demonstrate our commitment.

Source: [%] internal documents

104. From these documents, it was also clear that prices were not the only relevant factors: [%] also improved or sought to maintain quality in response

²⁹¹ [%] response to the market information request, question 42

²⁹² [×].

^{293 [%].}

to engagement. They monitor customers and have acted to improve the quality of service provision to schemes which are going to tender.²⁹⁴ Specifically, [*****] stated plans to improve team proactivity, identify areas of weakness, provide innovation risk management, and invest time to better understand changes to the scheme.

- 105. In a small number of cases, [≫] appeared to be preparing the ground with trustees for future tender processes by discussing how to give trustees control over the tender process and suggesting that, at least in the past, other firms have proposed low prices which were not credible.²⁹⁵
- 106. The survey often noted cross-selling opportunities, often in the 'SWOT Analysis – Opportunities' column. Sometimes, these opportunities appeared to be linked to whether a customer was perceived as loyal. [≫]'.
- 107. [≫] told us that they have 'established a separate team ... to have oversight of client satisfaction and provide more pre-emptive action where a client appears at risk.'²⁹⁶ Results from this program are reported up to the Investment Executive Committee. The information is used to identify trends or themes and deal with these on a wider basis, and also to address issues specific to these schemes.
- 108. However, [≫] did not provide us with the internal documents relating to this team/programme, so we have not had the opportunity to review them to understand whether this 'pre-emptive action' involves substantially improving its offering.

Analysis of overall quality of service factors

109. We set out our assessment of trustee perceived quality in paragraphs 10.91
 - 10.109 of the main report. In this subsection, we set out further detail.

Analysis of satisfaction

- 110. In paragraph 10.94 of the main report, we noted that the CMA survey showed high satisfaction rates. We provide additional discussion here.
- 111. There are a number of potential benefits from considering satisfaction measures. In particular, ratings which take into account quality as it matters to customers, rather than potentially less central aspects. As a result,

^{294 [%]}

^{295 [%]}

²⁹⁶ [%] response to the market information request, paragraph 56

customer satisfaction ratings are widely used as measures of overall service quality.

- 112. However, there remain challenges with taking these statistics at face value. We set out some general points about interpreting the survey in Appendix 4 which apply here. Furthermore:
 - (a) If high satisfaction relates more to relatively low expectations than it does to the quality perceived by trustees, this would cause the responses to be somewhat misleading.
 - (b) Further, low expectations could be driven by low customer engagement.
- 113. We therefore place some weight on satisfaction as a metric of the extent to which investment consultancy and fiduciary management providers are performing. In particular, we found that:
 - *(a)* In investment consultancy, a substantial proportion (56%) of schemes were very satisfied with their provider and 94% of schemes were either very satisfied or fairly satisfied.²⁹⁷
 - *(b)* For fiduciary management, we observed very similar proportions: 59% of schemes were very satisfied with their provider, and 97% were either very satisfied or fairly satisfied.²⁹⁸
- 114. These statistics indicate trustees consider that they are receiving positive outcomes.

Analysis of quality and market shares

- 115. As set out in the main report paragraphs 10.102 to 10.109, we have analysed a measure of quality provided by Greenwich Associates. Here, we explain further our interpretation of this measure, and additional robustness checks to our headline analysis.
- 116. Within a well-functioning market, we would expect providers which have higher quality of service (on a reasonably objective and consistent metric) to have high or growing market shares, all else being equal.
- 117. We have analysed this using data on service quality provided by Greenwich Associates (GA). GA's quality of service research is based on in-depth

²⁹⁷ CMA analysis of CMA survey, question J1 (Investment Consulting)

²⁹⁸ CMA analysis of CMA survey, question O4 (Fiduciary Management)

interviews of the largest institutional funds in the UK^{299,300} to produce the Greenwich Quality Index (GQI).

- 118. The relative quality of each provider is determined through a series of questions on aspects of service provision. Each client evaluates their investment managers using a 5-point Likert scale, ranging from 'poor' to 'excellent,' on the individual measures of investment capabilities and client satisfaction. The qualitative evaluations provided by the respondents are then summarised using a Rasch model into a single score. This score is normalised and transformed to a scale from 0 to 1,000, with a mean score of 500 and a standard deviation of 166.7
- 119. As for our analysis of satisfaction in the CMA survey, discussed in paragraphs 111 to 113 above, there are challenges in interpreting customers' views on the quality of providers. Similar considerations may hold for the GQI, although in our context we consider that they are less severe.
- 120. We note in particular that:
 - (a) The measure is targeted to individual aspects of services (ie it asks about specific service aspects rather than requiring an overall judgement).
 Responses may therefore be more targeted and higher quality.
 - (b) The measure asks about performance of the scheme against particular metrics, rather than about satisfaction. It is therefore possible for schemes to have high expectations but feasibly still rank a service as either 'poor' or 'excellent' in terms of quality
 - *(c)* The GQI is well respected across the investment consultancy industry as a survey to monitor the quality of competitors. A range of substantial players in the market, including Aon,³⁰¹ WTW,³⁰² LCP,³⁰³ Redington³⁰⁴ and Cardano,³⁰⁵ participate in and access the survey. Its wide usage by Parties may imply that it communicates valuable information.
- 121. This analysis does not trade off this quality measure independently from price. It could be that higher quality firms have low market shares (and are not gaining market share) because they charge higher prices. However, we do not think this is a large concern in this context: 'Reasonable Fees' and

²⁹⁹ Institutional investors with over £100 million in assets under management.

³⁰⁰ Institutional funds include Corporate pension, Local Authority Pension and other institutional funds.

³⁰¹ Aon MIR Q60, paragraph 60.5.

³⁰² WTW MIR Q30, paragraph 30.3.

³⁰³ LCP MIR Q34

³⁰⁴ Redington MIR Q34

³⁰⁵ Cardano MQ p 13

'Keeping to Budget Estimates' are two components of the measure itself, and therefore the GQI may already account for varying prices.

- 122. Overall, we consider that this measure is appropriate to analyse in our context for quality.³⁰⁶ Given the set of customers included in GA's data, we conducted this analysis for schemes in investment consultancy only.
- 123. We analysed whether providers of above average market shares (using our own data from Chapter 4 have higher or lower quality.
- 124. We also tested the correlation between market shares and concentration. A negative correlation means that as market shares increase, quality falls. These correlations are shown in Table 37 below.

Table 37: yearly correlation of GQI with market shares for each year

Year	Correlation	Observations
2010	-0.31	10
2011	-0.15	13
2012	-0.27	13
2013	-0.29	12
2014	-0.61	14
2015	-0.53	12
2016	-0.62	11

Source: CMA Analysis; Greenwich Associates Data; Parties' Data

- 125. The table shows that higher quality is associated with lower market shares in all seven years.
- 126. In order to test the statistical significance of this, we regressed quality on market share in various specifications. This analysis is shown in Table 38. Column (1) shows our baseline which uses pooled OLS and year fixed effects.³⁰⁷ We also present sensitivities in Column (2) (7).
- 127. Columns (2) (4) again consider whether higher quality firms have larger market shares, but change the specification. (2) uses the log of market

³⁰⁶ 2017 data is omitted as the first year of our inquiry and one for which we do not have complete market shares information

³⁰⁷ The year fixed effects control for the possibility that quality is systematically higher or lower in any given year, allowing us to focus on the relative differences between firms.

shares as the dependent variable; (3) logs both market shares and quality; and (4) uses a ranking of quality, rather than the GQI values themselves.

128. Columns (5) - (7) assess whether higher quality is associated with gains in market shares. (5) includes firm fixed effects to do this; (6) uses the year-onyear change in market shares as the dependent variable; and (7) considers both change in market shares and change in quality. 308

	(1)	(2)	(3) Log MS	(4)	(5)	(6)	(7)
	Baseline	Log MS	Log Log Quality	Quality in Ranks	Firm FEs	ΔMS	∆MS, ∆Quality
Quality	-0.04* (0.08)	-0.01** (0.03)	-3.08* (0.05)	-0.92* (0.06)	-0.00 (0.85)	0.00 (0.23)	0.00 (0.83)
Year fixed effects	YES	YES	YES	YES	YES	YES	YES
Constant	29.55* (0.05)	4.65** (0.01)	20.58** (0.04)	14.11** (0.03)	8.30*** (0.00)	-1.31* (0.07)	-0.11 (0.71)
Observations Adiusted R-	85	85	85	85	85	85	70
squared	0.051	0.081	0.059	0.095	-0.075	-0.068	-0.094
p-values in par	entheses *	p<0.10 **	p<0.05 *** ı	o<0.01			

Table 38: Regression Results: Quality and Market shares.³⁰⁹

Source: CMA Analysis; Greenwich Associates Data; Parties' Data³¹⁰

- 129. Models (1) - (4) show that higher quality firms are associated with lower market shares, and that this relationship is statistically significant at either the 5% or the 10% level.
- Models (5), $(6)^{311}$ and (7) show that there is no evidence that higher quality 130. firms are associated with gaining market share at conventional levels of significance.

³⁰⁸ The year 2011 becomes the base case as there is no 2010 data for change in quality

³⁰⁹ For each regression we have clustered standard errors at the firm level

³¹⁰ We have omitted the year fixed effects for brevity; none are statistically significant at the 5% or the 10% level; p-values range from around 20% to around 90% ³¹¹ In this analysis, we have clustered standard errors at firm level. Our conclusions remain the same if we do not

cluster standard errors.

Appendix A7: Financial and profitability analysis

Introduction and role of profitability analysis

- 1. In this appendix we explain the analysis we carried out on the profitability of investment consultancy and fiduciary management providers. We also discuss the issues in assessing the profitability of investment consultancy and fiduciary management providers.
- 2. The purpose of profitability analysis is to understand whether the levels of profitability (and therefore prices) achieved by firms are consistent with levels that would be expected in a competitive market. A situation where profitability of firms representing a substantial part of the market has exceeded the cost of capital over a sustained period could be an indication of limitations in the competitive process.³¹²
- 3. When reaching a view concerning the functioning of a market, we consider the outcomes of the competitive process in that market: including prices and profitability, product quality and range, and levels of innovation.³¹³ While profitability analysis provides a framework for assessing the level of prices, broader financial analysis can provide insight into the various factors affecting the performance of firms and hence the competitive dynamics of the sector.
- 4. We do not regard 'excess' profitability in itself to be a problematic feature of any market, but instead a market outcome that provides an indicator that competition problems may exist. In other words, excess profitability is one of the possible symptoms of, rather than a cause of, ineffective competition. Profitability findings may also be used in the context of determining the scale of the consumer harm or detriment that might arise, for example in the form of higher prices.
- 5. In reaching our findings, profitability is only one of the outcomes of the competitive process we consider.

Our usual approach

 In measuring profitability, our approach is often to start with accounting profit produced in line with UK Generally Accepted Accounting Practice (GAAP).³¹⁴
 We then make adjustments to arrive at an economically meaningful measure

³¹² Guidelines for Market Investigations: Their role, procedures, assessment and remedies, April 2013, adopted by the CMA, (CC3 Revised), paragraph 118.

³¹³ Ibid, paragraph 103.

³¹⁴ Now likely to be International Financial Reporting Standards (IFRS) for most of the parties.

of profitability, usually in terms of rates of return on capital, where the capital base is valued accordingly,³¹⁵ and compare the economic profit to the cost of capital of the firms involved.³¹⁶ It is necessary to obtain an appropriate value for capital employed, and we may consider adjustments to accounting data produced in line with UK GAAP for example relating to the difference between historical cost and replacement cost, and relating to the inclusion of certain intangible assets where certain criteria are met.³¹⁷

Scope of our assessment

- 7. Consistent with our terms of reference (see Chapter 1), we examined the profitability of the provision of investment consultancy and fiduciary management services separately, by examining the relevant revenues, costs, and capital base of investment consultancy and fiduciary management providers. We have not presented financial information on investment consultancy or fiduciary management-only providers, consistent with our theory of harm concerning incentives of IC-FM providers to steer their clients to their own in-house fiduciary management services. In practice, there are few large stand-alone investment consultancy and fiduciary management providers. Investment consultancy and fiduciary management services are generally provided by integrated firms who undertake investment consultancy and fiduciary management services of work.
- 8. We examined the profitability of the three largest combined providers of investment consultancy and fiduciary management services in the UK, namely Aon, Mercer and WTW (the three largest providers). Collectively, they make up close to but below 50% of investment consultancy and fiduciary management revenues.³¹⁸ We note that these three providers are not the three largest providers of fiduciary management: Aon is the [≫] largest provider of fiduciary management services. River & Mercantile and Russell Investments are [≫] and [≫] largest, and although these two larger providers also provide investment consultancy services, they are not in the top ten investment consultancy providers.
- 9. We also examined the profitability of three smaller IC-FM providers who were in a position to provide us with net profit margin figures for investment consultancy and fiduciary management, namely, [%], [%], and [%].

³¹⁵ CC3 Revised, Annex A, paragraph 9.

³¹⁶ Ibid, Annex A, paragraph 16.

³¹⁷ ibid Annex A, paragraph 14.

 $^{^{318}}$ 2016 revenues. Between 45% and 49% of the IC market and between [\gg]% and [\gg]% of the FM market

Collectively, they make up 8% of investment consultancy revenue and 17% of fiduciary management revenue. $^{\rm 319}$

We originally analysed the parties' financial information for the five years 2012 to 2016, however, it was only possible to examine net profit margins³²⁰ for 2016 for all the parties on a consistent basis.³²¹

Issues in assessing profitability of investment consultancy and fiduciary management services

Return on capital employed

- 11. Return on capital employed (ROCE) is a standard measure of profitability that compares profits with the investment in the company and that figure can be compared to the company's weighted average cost of capital (WACC). In order to calculate ROCE, we needed to obtain an appropriate value for profits and capital employed to calculate ROCE. We considered whether it was possible to obtain appropriate data from the providers of investment consultancy and fiduciary management services to assess the profitability of investment consultancy and fiduciary management and provisionally found that there were a number of issues to consider in assessing profitability, including cost allocation and capital base.
- 12. We provisionally found that the issue of cost allocation, albeit time-consuming and somewhat difficult, was not a major hurdle to overcome in this profitability analysis.³²² However, we considered that the most difficult issue in considering this analysis was the assessment of a capital base. First, as the investment consultancy and fiduciary management businesses are not standalone but part of a wider set of services offered by firms, we thought that it would have been very resource intensive for the parties to create separate balance sheets for the investment consultancy and fiduciary management businesses, and that any estimates would have been subject to a high level of estimation due to the number of assumptions which would have needed to be made. Second, we thought that it would have been very resource intensive, and practically and conceptually difficult, to identify costs relating to the creation of any intangible assets. We considered that it would be

³¹⁹ 2016 revenues.

³²⁰ Gross profit is revenues less direct costs; net profit is revenues less all costs (direct and indirect costs); net profit margin is net profit divided by revenues, usually expressed as a percentage. Net profit margin is equivalent to return on sales.

 $^{^{321}}$ [\gg] told us that, prior to 2016, indirect shared costs were not allocated to FM in its management accounts, and thus its margins for IC and FM were not comparable from year to year or between each other.

³²² Mercer disagreed with our finding, stating that cost allocation would be complex for individual firms, and even more complex to undertake on a reliable basis across IC and FM firms (with different structures and business models) and across time; any conclusions on the basis of these assumptions would be unreliable.

disproportionate to attempt to calculate the tangible and intangible asset base relating to the investment consultancy and fiduciary management businesses. We also considered that even if we were in a position to calculate the capital base, it was unlikely to be robust enough for us to draw any conclusions from it. As a robust assessment of the capital base is essential to the ROCE calculation, we were not in a position to calculate ROCE.

- 13. In considering the parties' responses to our initial financial questionnaire and published Working Paper³²³ and the available data, we took into account the possibility that in this sector, detriment could also arise from low quality advice provided by investment consultancy and fiduciary management providers resulting in poor investment decisions by pension schemes, as well as in relation to excess profits earned by investment consultancy and fiduciary management providers.³²⁴
- 14. Due to these various difficulties it is not proportionate to undertake an assessment of economic profitability. Hence, we are not in a position to conclude whether providers representing a substantial part of the investment consultancy and fiduciary management sectors have earned profits that are persistently in excess of their cost of capital.

Alternatives to ROCE

- 15. The Guidelines state that in situations where capital employed cannot be reliably valued, the CMA may consider alternative measures, such as the return on sales (ROS) or other relevant financial ratios. For instance, comparisons with businesses operating in different but similar markets may on occasion be helpful.³²⁵
- 16. Although we were not in a position to assess economic profitability, we carried out an alternative financial analysis which examined net profit margins for each of the parties' investment consultancy and fiduciary management businesses, and also looked at the financial analysis the FCA carried out on asset managers.
- 17. We asked the parties what the best measure of profitability would be, if they considered that ROCE would not be appropriate: none of the parties

³²⁵ CC3 Revised, Annex A, paragraph 15

³²³ Financial Performance and Profitability Working Paper.

³²⁴ Mercer told us in response to our Working Paper, that it was concerned by this suggestion (that detriment in this sector could arise from low quality advice by IC or FM providers resulting in poor investment decisions by pension schemes) given that we had not identified any evidence that advice was of a low standard. It told us that there was positive evidence of good quality IC and FM services and that the limited evidence suggested that profitability was comparable with relevant sectors, and that this should lead the CMA to conclude that there was no detriment to clients in this sector.

suggested an alternative measure of profitability to ROCE. None of the parties recommended a suitable benchmark against which to compare profit margins and a number of parties told us that any benchmarking exercise would not be proportionate, and would be challenging and resource intensive.

Margins analysis: net profit margins

- 18. Table 39 and Table 40 below set out summary financial information (revenues, total costs, net profit and net profit margin) for the three largest providers of investment consultancy and fiduciary management services combined and for the three smaller providers of investment consultancy and fiduciary management services combined for 2016.
- Overall, the aggregate net profit margin for investment consultancy and fiduciary management combined for the six providers in 2016 was [20% -30%].³²⁶
- 20. For investment consultancy, the aggregate net profit margin for the six providers was [20% 30%] and [20% 30%] for fiduciary management.

³²⁶ These figures are a weighted average margin, that is, total profits divided by total revenues for the six providers.

Table 39 summary financial informati	on, three largest providers o	f investment consultancy and fi	duciary management se	ervices combined, 2016
, , , , , , , , , , , , , , , , , , ,		,	, ,	,

														£m
				[%]	[≫]				[≫]	[≫]				[%]
	[%]	[≫]	[≫]	[%]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[%]
	[%]	[≫]	[≫]	[%]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[%]
Revenues	[※]	[≫]	[≫]	[※]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[%]
Total costs	[%]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[※]
Net profit	[※]	[≫]	[≫]	[※]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[※]
Net profit margin	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]	[≫]

Source: CMA from party responses to initial financial information request

Table 40 summary financial information, three smaller providers of investment consultancy and fiduciary management services combined, 2016

				[%]	[«	≫]			[%]	[\$	≪]			£m [≫]
	[※]	[※]	[%]	[≫]	[%]	[≫]	[※]	[%]	[※]	[%]	[%]	[≫]	[≫]	[%]
Revenue s	[%]	[%]	[%]	[≫]	[%]	[%]	[%]	[%]	[%]	[%]	[%]	[%]	[%]	[%]
Total costs	[≫]	[≫]	[%]	[%]	[≫]	[≫]	[≫]	[≫]	[%]	[%]	[≫]	[≫]	[%]	[≫]
Net profit	[≫]	[≫]	[≫]	[※]	[≫]	[%]	[≫]	[≫]	[%]	[%]	[※]	[%]	[※]	[≫]
Net margin %	[※]	[※]	[※]	[※]	[≫]	[≫]	[※]	[≫]	[%]	[%]	[≫]	[≫]	[≫]	[※]

Source: CMA from party responses to initial financial information request

Profit margins of asset managers

- 21. We considered reported data on the profit margins of asset managers as we thought they were reasonably comparable: a similar industry, parts of the same value chain, similar staff with a similar skill set and similar customers, high human capital and low tangible capital base.
- 22. As part of the FCA's asset management market study,³²⁷ the FCA analysed profitability of asset managers. It looked at 16 asset management firms from 2010 to 2014 and 14 firms for 2015. It found what it termed high levels of profitability, with average profit margins of 36% for the firms it sampled.





Source: FCA market study interim report, annex 8

23. It also compared operating margins for asset managers with operating margins of firms in the FTSE All Share (including asset manager firms) and showed that the average operating margin of these was around 16% with only one industry group achieving margins above the average margin found for asset managers. A comparison of industry groups in the FTSE All Share with similar business structures (high human capital, relatively low physical or financial capital) found margins in the four to 33% range. By comparison half of the asset management firms in the FCA's sample had an average operating margin above 30%. Three quarters of the asset management firms in the FCA's sample had an average operating margin above 20%.

³²⁷ FCA Asset Management Market Study, final report June 2017



Source: FCA market study interim report, annex 8, from Bloomberg and FCA data

24. By comparison, the aggregate net profit margin for investment consultancy and fiduciary management combined for the six-investment consultancy and fiduciary management providers in 2016 were lower than the margins the FCA found for asset managers, but higher than the average operating margins in the FTSE All Share sample created by the FCA. However, we did not think that a comparison with the FTSE All Share index is meaningful because the index was an average of margins across a wide range of industries, subject to different degrees of risk.

Glossary AEC Adverse effect on competition. AM-FM Firms Fiduciary management firms which also offer asset management products but do not offer investment consultancy services. The management of investments, including selecting and Asset management trading individual securities, on behalf of individual retail investors and institutional investors such as pension schemes. Asset manager(s) Businesses supplying Asset management services. AUA Assets under advice. Assets under management. CC3 Revised Guidelines for market investigations: Their role, procedures, assessment and remedies, CC3 Revised, April 2013, adopted by the CMA. СМА Competition and Markets Authority. **CMA** survey The **CMA** commissioned survey of pension scheme trustees (carried out by IFF Research). IFF Research's Report was published on 29 March 2018.328 COBS The FCA's 'Conduct of Business sourcebook'. 329 DB Defined Benefit pension scheme. DC Defined Contribution pension scheme. TPR's 'Code of Practice 13'.³³⁰ DC Code DPB Designated Professional Body, such as the Institute and Faculty of Actuaries. **EA02** Enterprise Act 2002.³³¹ EBC Employee Benefit Consultant. Provide advice in relation to the design and implementation of pension schemes and other employee benefits.

³²⁸ CMA Survey. https://www.gov.uk/cma-cases/investment-consultants-market-investigation#survey-of-pension-scheme-trusteespublication-of-iff-researchs-report.

³²⁹ Conduct of Business sourcebook. https://www.handbook.fca.org.uk/handbook/COBS.pdf.

³³⁰ TPR Code of Practice 13, http://thepensionsregulator.gov.uk/codes/code-governance-administration-occupational-dc-trustbased-schemes.aspx

³³¹ Enterprise Act 2002. http://www.legislation.gov.uk/ukpga/2002/40/contents.

EBIT	Earnings Before Interest and Tax.
EU	European Union.
Externally Acquired	Fiduciary management mandates that were not awarded to the incumbent Investment consultant.
FCA	Financial Conduct Authority.
FCA Final Decision	FCA's 'Asset Management Market Study, Final Decision: Market Investigation Reference (MIR) on Investment Consultancy Services and Fiduciary Management Services'. ³³²
FCA Final Report	FCA's 'Asset Management Market Study Final Report'. ³³³
FCA Interim Report	FCA's 'Asset Management Market Study Interim Report'. ³³⁴
Fiduciary management market	The relevant market for the supply of fiduciary management services to pension schemes in the United Kingdom.
Fiduciary management services	Fiduciary management services means the provision of a service to institutional investors where the provider makes and executes decisions for the investor based on the investor's investment strategy in the United Kingdom. This service may include responsibility for all or some of the investor's assets. This service may include, but is not limited to, responsibility for asset allocation and fund/manager selection.
Fiduciary manager	A firm or individual providing fiduciary management services.
GAAP	Generally Accepted Accounting Practice.
GQI	GA's Greenwich Quality Index
Guidelines	<i>'Guidelines for Market Investigations: Their role, procedures, assessment and remedies',</i> April 2013, adopted by the CMA. ³³⁵
нн	Herfindahl-Hirschman Index; a measure of market concentration

³³² FCA'a Asset Management Market Study, Final Decision: Market Investigation Reference (MIR) on Investment Consultancy Services and Fiduciary Management Services, September 2017, https://www.fca.org.uk/publication/market-studies/final-decisionmarket-investigation-reference.pdf

market-investigation-reference.pdf ³³³ Asset Management Market Study Final Report, June 2017, https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf ³⁴⁴ Asset Management Market Study Interim Report, November 2016, https://www.fca.org.uk/publication/market-studies/ms15-2-2interim-report.pdf

³³⁵ Guidelines for Market Investigations: Their role, procedures, assessment and remedies, April 2013, adopted by the CMA, (CC3 Revised),

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284390/cc3_revised.pdf

Hybrid	Pension schemes that have a DB and a DC element.
IC-FM firms	Firms that offer both investment consultancy and fiduciary management services to clients.
IFRS	International Financial Reporting Standards.
IMA	Investment Management Agreement.
Institutional investors	Institutional investors means legal entities invested in funds or mandates, including pension schemes, charities, insurance companies, and endowment funds.
Internally acquired	Fiduciary management mandates that were awarded to the incumbent Investment consultant.
Investment consultancy market	The relevant market for the supply of investment consultancy services to pension schemes in the United Kingdom.
Investment consultancy services	Investment consultancy services means the provision of a service to institutional investors where the provider advises the investor in relation to the investors' investment strategy in the United Kingdom. This service may include, but is not limited to, advice on strategic asset allocation, fund/manager selection, advice on whether fiduciary management services are appropriate for the investor, and advice to employers in the United Kingdom.
Investment consultant	Firm or individual offering investment consultancy services.
Investment strategy	The investor's strategy for the allocation of their assets amongst asset classes. This may include an assessment of the investor's approach to risk, and may include details such as the investor's approach to the use of risk hedging instruments.
Issues Statement	The CMA's issues statement on the investigation published on 21 September 2017. ³³⁶
ІТТ	Invitation to tender.
KPMG Survey	²⁰¹⁷ KPMG UK Fiduciary Management Survey ³³⁷

 ³³⁶ 'INVESTMENT CONSULTANCY SERVICES AND FIDUCIARY MANAGEMENT SERVICES - MARKET INVESTIGATION: Statement of issues', 21 September 2017. https://assets.publishing.service.gov.uk/media/59c376f7ed915d408c10d131/investment-consultancy-market-investigation-issues-statement.pdf
 ³³⁷ 2017 KPMG UK Fiduciary Management Survey, https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/11/CRT086217_KPMG_FM_Survey_2017.pdf

LDI	Liability Driven Investment. An umbrella term to cover an investment strategy whereby approaches are taken to hedge against expected risks such as low interest rates.
Master trust	Master Trust is a form of multi-employer occupational trust- based pension scheme established under trust and intended for employers that are not connected with each other.
MiFID II	The European Union legislation comprising a package of instruments in relation to markets in financial instruments, of which the MiFID II Directive and the MiFID II Delegated Regulation are the most directly relevant in the context of the present market investigation.
MiFID II Delegated Regulation	Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, OJ L 87, 31.3.2017, p1. ³³⁸
MiFID II Directive	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, 12.6.2014, p349. ³³⁹
NOI	Net Operating Income.
PA04	Pensions Act 2004. ³⁴⁰
PA08	Pensions Act 2008. ³⁴¹
PA95	Pensions Act 1995. ³⁴²
PBIT	Profit before Interest and Taxes.
PERG	FCA's 'Perimeter Guidance Manual'.343
PPF	Pension Protection Fund.
PRIN	FCA's 'Principles for Businesses sourcebook'344.
РТ	Professional trustee
РТІ	Pre-Tax Income.

 ³³⁸ https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0565&from=EN
 ³³⁹ https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN
 ³⁴⁰ Pensions Act 2004. http://www.legislation.gov.uk/ukpga/2004/35/contents.
 ³⁴¹ Pensions Act 2008: http://www.legislation.gov.uk/ukpga/2008/30/contents.
 ³⁴² Pensions Act 1995. http://www.legislation.gov.uk/ukpga/1995/26/contents/enacted.
 ³⁴³ Perimeter Guidance Manual. https://www.handbook.fca.org.uk/handbook/PERG.pdf.
 ³⁴⁴ Principles for Businesses sourcebook. https://www.handbook.fca.org.uk/handbook/PRIN.pdf.

RAO	Regulated activities set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001., SI 2001/516, ³⁴⁵ as amended.
RCB(s)	Relevant Customer Benefit(s)
ROCE	Return on Capital Employed.
ROS	Return on Sales.
SFP	Statement of funding principles
SIP	Statement of Investment Principles.
SYSC	FCA 's 'Senior Management Arrangements, Systems and Controls sourcebook' ³⁴⁶ .
Terms of Reference (ToR)	In this investigation, the FCA's 'Asset Management Market Study, Final Decision: Market Investigation Reference (MIR) on Investment Consultancy Services and Fiduciary Management Services'. ³⁴⁷
TPE	Third-party Evaluator.
UIL	Undertakings in lieu of a reference.

Companies included in the report

AHL	Aon Hewitt Limited.
Albourne	Albourne Partners Limited.
Allenbridge	MJH Group Holdings Limited, its subsidiaries and associated businesses.
Alliance Bernstein	AllianceBernstein Limited.
Aon	Aon Hewitt Limited and Aon Hewitt Risk Management Services Limited.
Baillie Gifford	Baillie Gifford and Co

³⁴⁵ Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. http://www.legislation.gov.uk/uksi/2001/544/contents/made.

 ³⁴⁶ Senior Management Arrangements, Systems and Controls sourcebook. https://www.handbook.fca.org.uk/handbook/SYSC.pdf.
 ³⁴⁷ FCA'a Asset Management Market Study, Final Decision: Market Investigation Reference (MIR) on Investment Consultancy Services and Fiduciary Management Services, September 2017, https://www.fca.org.uk/publication/market-studies/final-decision-market-investigation-reference.pdf

Barnett Waddingham	Barnett Waddingham LLP.
BBS	BBS Consultants & Actuaries Ltd.
Blackrock	BlackRock Investment Management (UK) Limited.
BNP Paribas	BNP Paribas Asset Management UK Limited.
Cambridge Associates	Cambridge Associates Limited.
Capita	Capita Employee Benefits Limited and Capita Employee Benefits (Consulting) Limited (part of Capita plc).
Cardano	Cardano Risk Management Limited.
Charles Stanley	Charles Stanley & Co. Limited.
Conduent	Conduent HR Services. (Conduent HR Services is a trading name in the UK for Buck Consultants Limited, Buck Consultants (Administration & Investment) Limited, and Buck Consultants (Healthcare) Limited.)
DWP	Department for Work and Pensions.
First Actuarial	First Actuarial LLP.
GA	Greenwich Associates
Goldman Sachs	Goldman Sachs Asset Management International.
HRMSL	Hewitt Risk Management Services Limited.
Hymans	Hymans Robertson LLP.
IA	The Investment Association.
Jagger and Associates	Jagger & Associates Limited.
JLT	Jardine Lloyd Thompson Group plc.
Kempen	Kempen Capital Management N.V.
KPMG	KPMG LLP.
LCP	Lane Clark & Peacock LLP.
Legal and General	Legal and General Investment Management Limited.
Mercer	Mercer Limited.

Momentum	Momentum Investment Solutions & Consulting, a division of Momentum Global Investment Management Limited.
PLSA	The Pensions and Lifetime Savings Association.
PPF	Pension Protection Fund.
Punter Southall	XPS Investment brand. (See Xafinity and Punter Southall Investment Consulting Limited.)
Quantum	Quantum Actuarial LLP.
Redington	Redington Limited.
River and Mercantile	River and Mercantile plc.
Russell Investments	Russell Investments Limited, Russell Investments Implementation Services Limited and Russel Investments Systems Limited.
Schroders	Schroder Investment Management Limited and Schroder Investment Management North America Limited.
SEI Investments	SEI Investments (Europe) Limited.
Spence and Partners	Spence and Partners Limited.
Stamford Associates	Stamford Associates Limited.
TPR	The Pensions Regulator.
Xafinity	XPS Investment brand. (See Xafinity and Punter Southall Investment Consulting Limited.)
	Xafinity Consulting Limited.
WTW	Willis Towers Watson Limited.