Willis Towers Watson

INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT SERVICES MARKET INVESTIGATION

RESPONSE TO PROVISIONAL DECISION REPORT

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29 August 2018

INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT SERVICES

WTW RESPONSE TO PROVISIONAL DECISION REPORT[1]

1. Introduction and Overview

1.1 WTW welcomes the opportunity to respond to the provisional decision report published by the CMA on 18 July 2018 (the "**PDR**") with regard to its Investment Consultancy and Fiduciary Management Market Investigation (the "**Market Investigation**").

1.2 WTW notes that the findings of the CMA from the Market Investigation, as set out from chapters 4 to 10 of the PDR, taken together, demonstrate that the markets are broadly competitive and are ones in which customers are satisfied with the services they receive. We agree with the CMA's assessment that the market faces challenges stemming from the limited resources and expertise that many pension scheme trustees – in particular those managing mid-sized and smaller schemes – have at their disposal. This is a key feature of the industry and we welcome the fact that the CMA has articulated it in the PDR. While, for the reasons explained in section 3 below, we do not agree that this is having an adverse effect on competition in precisely the ways that the CMA contends, we do believe that it is impeding the take up of effective solutions that the market has developed to help pension scheme trustees manage and overcome the constraints that they face. Within our response, we have mainly focused on DB pension scheme trustees given that this accounts for the majority of our business.

1.3 We welcome well-designed measures that could help address these challenges and therefore broadly support the proposed remedies in the PDR (the "**Remedies**") that are designed to improve transparency of, and trustee engagement with, the investment consulting ("**IC**") and fiduciary management ("**FM**") markets. Care must be taken, of course, to ensure that these Remedies are proportionate and will be effective in enabling trustees of pension schemes to better assess the value for money of different IC and FM services. We set out our detailed thoughts and suggestions on the Remedies in section 5 below.

2. Summaries

2.1 Summary of WTW's views on the CMA's conclusions:

CMA Conclusion	Summary of WTW's views
IC market - AECs identified by the CMA: *There are low levels of engagement by some customers.*	In WTW's experience, many trustees are highly engaged and are able to effectively monitor, scrutinise and assess the advice received from investment consultants. Nonetheless, the CMA has rightly identified that some pension scheme trustees have limited bandwidth and capabilities with which to take and follow through on investment decisions, and that these limitations also constrain their ability to monitor and effectively scrutinise the investment advice they receive.
There is a lack of clear information for customers to assess the quality of	WTW acknowledges the CMA's finding that in the IC market, performance reports do not always demonstrate progress against trustees' strategic objectives. For the

[1] In this response and all responses to the CMA, Towers Watson Limited is the main regulated entity. We refer to both this entity and the relevant general business as "We", "Willis Towers Watson" or "WTW" throughout.

their existing investment consultant.	majority of WTW's clients, an investment objective is set and performance is reported against this objective. WTW nonetheless appreciates that, in the wider IC market, performance is likely not reported against investment objectives because trustees themselves have not set out investment objectives in a clear and measurable way. However, we maintain that the fact that there is scope for further improvement in the way that objectives are set does not in itself indicate that the current level of access to information is insufficient to support effective competition for IC services. The CMA's evidence indicates that trustees are overwhelmingly content with the performance information they receive. 94% of trustee boards say they find it very easy or fairly easy to monitor the overall investment performance of their scheme in an investment advisory context[2].
There is a lack of clear and comparable information for customers to assess the value for money of alternative investment consultants.	The CMA's survey results suggest that most trustees have sufficient and appropriate information to assess and compare alternative investment consultants on the basis of fees. 56% of trustee boards (who tendered / invited proposals for IC services in the last 5 years) say they found it very easy or fairly easy to understand and compare the investment track-record of rival bidders[3]. As expressed in our Response to the Fees and Quality Working Paper, this is a high percentage for IC services. We recognise that in the past there has been a lack of consistency in how information on third party fees are presented. For MiFID II products at least, this issue has been substantially addressed through the fee disclosure requirements introduced in January 2018 by MiFID II. The CMA should take this into account for the purposes of the design of any remedies.
FM market - AECs identified by the CMA: *IC-FM firms steering their advisory customers towards their own FM service.*	WTW disagrees with the CMA's finding that IC-FM firms steer their IC customers towards their own FM service. The evidence provided by the CMA simply indicates that IC-FM providers attempt to cross-sell by raising the existence of other services they offer which would be beneficial to trustees. This practice is not suggestive of an AEC in the market - but merely a normal function of a business attempting to provide a broad range of services to its customers.
Low levels of customer engagement at the point of first moving into FM.	WTW recognises that trustees face an important decision when switching from IC to FM which could have material

[2] Page 42 of the Fees and Quality Working Paper
[3] Page 73 of the Fees and Quality Working Paper

	implications for pension scheme outcomes. Therefore, WTW supports measures to encourage trustees to engage in market testing when they first appoint a full FM provider (i.e. a FM provider to whom trustees delegate all investment decisions and day-to-day running of the portfolio). However, WTW disagrees that customer engagement at the point of first moving to FM should only be measured by whether customers "formally test" the market prior to moving into FM, with all other forms of market testing disregarded. We note that the CMA's definition of a "formal test" is a narrow definition limited to a tender run by a third-party.[4] The CMA has produced no evidence to support the claim that a tender run by a third party is a stronger form of market testing compared to running a tender process with no external help. This is relevant to the proportionality of the Remedy. As explained below, it is for this reason that while WTW agrees that a one-off tender is sufficient, it notes that all forms of tender process should be allowed to ensure that trustees have sufficient flexibility and that tendering remains an accessible and appropriate means of selecting FM providers.
Lack of clear and comparable information for customers to assess the value for money of alternative fiduciary managers.	WTW recognises that customers looking to appoint a fiduciary manager may struggle to compare the offers of different FM providers. For example, bundling of the FM service fees with third party fees and the use of performance fees are two fee structures that can make it difficult for customers to gauge what the total cost associated with the FM service of each provider is.
Lack of clear information for customers to assess the value for money of their existing fiduciary manager.	WTW agrees that more could have been done historically to provide additional information, in particular with regard to third party fees. WTW recognises the benefits of ensuring that trustees are given an appropriate level of information on fees and strives to provide clients with this on a regular basis. WTW notes that, from January 2018, MiFID II requirements have substantially addressed this issue. Such requirements should be extended to non-MiFID firms/products.
Barriers to switching fiduciary manager.	We note that there is no evidence to show that the costs and time associated with switching a FM provider are key factors which influence a customer's switching decision. The CMA acknowledges at paragraphs 6.93 and 6.94 of the PDR that the associated costs arise as a result of changing the client's underlying portfolio and are mostly

[4] Paragraphs 7.43 to 7.46 of the PDR

	paid to the brokers that trade the underlying securities (and not to the fiduciary managers themselves). FM contracts in general do not include restrictive exit clauses or penalties. WTW thus notes that there is no evidence to suggest that the costs and time associated with switching FM constitute in practice a barrier to switching.
CMA conclusions on Customer detriment: *The AECs may be expected to result in material customer detriment both in the IC and FM markets.*	Much of the evidence that the CMA has assessed indicates that both the IC and FM markets are functioning well and are delivering significant value for customers. By contrast, for reasons we explain below, the empirical evidence that the CMA has put forward to substantiate its claim that there is "material customer detriment" does not stand up to scrutiny. Nonetheless, as noted above, we recognise that the industry faces challenges arising from limited trustee bandwidth and expertise, and welcome well designed measures that could help to address or alleviate some of these issues. It is, however, critical that any remedies designed to address these market features do not inadvertently undermine those aspects of the IC and FM markets that are working well and are proportionate to the detriment established by the evidence.
The level of detriment is greater for FM than for IC.	We do not agree with this assessment. The CMA identifies additional AECs that it argues are specific to FM, but we disagree with these findings for the reasons summarised above and explained in detail in section 3 below. Furthermore, this does not take into account the significant benefits that many IC customers would gain from switching to FM services. A balanced assessment of the evidence would suggest that – to the extent that any material customer detriment does exist in the industry – it is likely to be concentrated amongst a subset of customers who would benefit from migrating to a delegated service model such as FM, but have not done so. Any remedies should not create barriers to the adoption of FM, to the detriment of customers.
As a result of the AECs, customers may be expected to pay higher prices for IC and FM than they otherwise would. The existence and significance of these price effects is demonstrated by the CMA's gains from engagement analysis, which found that engaged FM customers could pay around 24% less than disengaged customers.	The empirical evidence that the CMA presents to support its claim that low levels of engagement are materially impairing customer outcomes is undermined by material errors of fact and assessment, which we explain in detail in section 4 below. Once these errors are addressed, the evidence falls away. The CMA has itself rightly concluded that the remaining "market outcomes" it has considered yield no clear evidence of customer detriment. Specifically: • The CMA has concluded that evidence it has assessed on investment consultants' recommended asset manager products "hasn't clearly

	demonstrated one way or the other whether providers collectively add value through this service". For the reasons we explain in section 4 below, there is clear evidence that investment consultants do add value, both through their product recommendations and their wider services. Nonetheless, we agree with the CMA that, at the very least, this evidence cannot be used to substantiate the CMA's AEC and customer detriment concerns. • The CMA has also rightly concluded that it would not be feasible to estimate the economic profitability of IC or FM services because of the difficulties associated with calculating the capital bases of the firms involved.
In terms of the total detriment from higher prices, even if fees are on average only 10% above those in a well-functioning market, this would in aggregate lead to IC customers paying around £250 million and fiduciary management customers paying around £200 million more over ten years. This impact on prices represents a lower bound for the total detriment, which may be significantly higher, because the problems identified may also be expected to result in customers receiving a lower quality service.	We fully agree that – given the widespread use of investment consultants and the significant resources invested in UK pension scheme assets – even a modest improvement or deterioration in the performance of these schemes net of costs can be highly beneficial or detrimental for scheme sponsors. By the same token, we also agree with the CMA's assessment that changes in the quality of IC advice or FM service can be even more consequential for scheme sponsors than changes in IC or FM fees. However, the calculations that the CMA has set out to illustrate the potential level of detriment are entirely hypothetical and in themselves provide no evidence that such detriment exists unless coupled with evidence to support the proposition that the AECs that the CMA has identified are leading to systematically poorer scheme performance. For the reasons summarised above and explained further below, the CMA has found no clear evidence to support this.

2.2 Summary of WTW's comments on the Remedies:

Remedy	WTW comments
Remedy 1 – Mandatory competitive tendering on first adoption of fiduciary management	WTW is broadly supportive of Remedy 1, but careful consideration must be given to its scope, particularly with regard to how competitive tendering is defined under Remedy 1, as well as the practicalities of how mandating competitive tendering will work. Failure to do this could result in a disproportionate and ineffective requirements on pension schemes that reduce, rather than increase, trustee engagement.

	In particular, for the reasons we explain below: • The scope of Remedy 1 should exclude partial fiduciary management mandates and appointments for internal schemes. • Competitive tendering under Remedy 1 should be defined appropriately to include, amongst others, the use of a third party evaluator ("**TPE**") and a closed tendering process. These will be more appropriate and proportionate for many schemes than an open tendering process.
Remedy 2 – Mandatory warning that alerts trustees to the nature of the information being provided	WTW is broadly supportive of Remedy 2, subject to some important refinements in relation to: • the choice of language; • the placement of the notice; and • the timing and frequency of disclosures. These modifications are critical if the Remedy is to be proportionate and avoid inadvertently deterring trustees from considering FM services, which would be highly detrimental for many pension schemes.
Remedy 3 – Enhanced trustee guidance on competitive tender processes	WTW is supportive of Remedy 3 in principle. However, for the guidance to be effective, it should avoid proposing overly burdensome and prohibitively expensive processes, especially for smaller pension schemes. In addition, the guidance materials themselves should be written in a way that is easily digestible for trustees.
Remedy 4 – Requirement on firms to report disaggregated fiduciary management fees to existing customers	WTW is supportive of Remedy 4 in principle, but notes that there is significant overlap with MiFID II disclosures, and that a significant proportion of FM providers and services are currently subject to the MiFID II regime. Therefore, in order to be proportionate and effective, it is important that any Remedy proposed by the CMA is consistent with current regulatory requirements and the work currently being completed by the IDWG. In this regard, WTW recommends that Remedy 4 also extends all disclosure requirements under the MiFID II regime to all FM providers, including any service not currently subject to the MiFID II regime.
Remedy 5 – Minimum requirements on firms for fee disclosures when selling fiduciary management	WTW is supportive of Remedy 5 in principle, but – similar to comments made above to Remedy 4 – the requirements should be consistent with other regulatory requirements under MiFID II. In addition to this, care needs to be taken on disclosing the assumptions being used by different providers, so that customers are better

	equipped to compare providers.
Remedy 6 – Standardised methodology and template to report past performance	WTW is supportive of Remedy 6 and notes that there has been significant progress already made within the industry. Remedy 6 should allow providers to provide tailored information that may be of specific interest to specific schemes (and that indeed may be requested by the scheme trustees themselves) while at the same time providing the standardised "base line" information that ensures that the performance of different providers can be directly compared.
Remedy 7 – Duty on trustees to set their investment consultants strategic objectives	WTW is supportive of Remedy 7 as greater clarity and emphasis on strategic objectives should assist trustees in decision making, as well as in evaluating the performance of their investment consultants against these objectives. However, in order for Remedy 7 to be effective, we would propose that more guidance be provided to trustees on what should be included and considered as part of setting investment objectives.
Remedy 8 – Establish basic standards for how investment consultants and fiduciary managers report performance of recommended asset management 'products' and 'funds'	WTW is supportive of Remedy 8 in principle. However, in order for it to be proportionate and effective, care should be taken to ensure that the resulting standards are well-designed and are not overly restrictive. In particular: • The standards should specify a "base line" level of information that should be provided to pension scheme trustees (and should leave room for additional information over and above this where useful) • The standards should work with, and not cut across, existing regulatory requirements and industry standards. The standards should encourage trustees to take a balanced view of IC and FM performance.

2.3 Summary on the regulation of Remedies:

As set out in further detail below, WTW is supportive of the extension of the FCA regulatory perimeter.

Remedies that should be regulated by the FCA	Remedies that should be regulated by the Pensions Regulator
Remedy 2 – Mandatory Warnings when selling FM services	**Remedy 1** – Mandatory competitive tendering on first adoption of fiduciary management
Remedy 4 – Reporting of disaggregated fiduciary management	**Remedy 3** – Enhanced trustee guidance on competitive

fees to existing customers	tender processes
Remedy 5 – Minimum requirements for fee disclosure when selling FM	**Remedy 7** – Duty on trustees to set their investment consultants strategic objectives
Remedy 6 – Standardised methodology and template for reporting past performance of FM services to prospective clients	
Remedy 8 – Basic standards for how IC and FM report performance of recommended asset management products and funds.	

3. Competition Assessment of the Market Investigation

3.1 WTW welcomes the CMA's general view of competition in the IC and FM markets[5], and in particular the inferences that can be made from the CMA's findings as follows:

(a) **Both IC and FM create significant value for customers**. In particular, we note the CMA's conclusions that:

(i) trustees are generally satisfied with their IC and/or FM providers;

(ii) FM providers can achieve significant discounts from asset managers for their customers;

(iii) the asset allocation advice of IC/FM providers appears to be tailored and has added value in recent years, particularly through the hedging of interest rate risks and;

(iv) asset manager recommendations on average were found to provide value gross of fees to a statistically significant extent and some firms were found to provide asset manager recommendations that have added value on a net of fees basis to a high degree of statistical significance.

(b) **Both IC and FM are markets are not characterised by a high degree of concentration**, with a large number of competitors offering a diverse range of services. In particular:

(i) There are many players in the industry – 37 players in IC and 17 players in FM[6].

(ii) The Herfindahl-Hirschman Index ("**HHI**") for the IC Market is 1,023 and for the FM Market is 1,324. Both of these measures are well below the threshold of 2,000 set by the CMA for the market to be considered highly concentrated.

(iii) There are no "dominant" firms in the industry – no firm has more than 20% market share and the largest three firms by market share have less than 50% combined.

(iv) Concentration in the IC market has fallen further over the past 10 years.

[5] Paragraph 11.2 of the PDR
[6] Paragraph 7 of the PDR

(v) The FM market has trebled in size since 2011 due to high levels of consumer demand, with a wide range of providers growing their businesses.

(vi) Large and small competitors alike face competitive pressure – out of the largest three firms in IC, one has seen a sharp decline in its IC market share and not all have been able to achieve the same position in the FM market.

(c) **The barriers to entry and expansion are not high in both IC and FM markets.** Firms have successfully used a range of entry strategies including vertical and horizontal expansion, expansion into the UK from overseas, and by focussing on particular client types or asset classes.

3.2 WTW further welcomes the CMA's finding that even though potential conflicts of interest between suppliers and customers are common in many industries, there is no evidence that any of the potential conflicts of interest in relation to IC and FM services give rise to a competition problem.

3.3 In addition, WTW observes that the CMA has not found any evidence of IC-FM providers raising FM where it was not in the client's best interest.

3.4 WTW notes that, notwithstanding the positive findings summarised above, the CMA has found that there is an adverse effect on competition ("**AEC**") in respect of each of the IC market and the FM market.

<u>*AEC identified in the IC market*</u>

3.5 The CMA has found three features of the IC market which have an AEC:

(a) There are low levels of engagement by some customers.

(b) There is a lack of clear information for customers to assess the quality of their existing investment consultant.

(c) There is a lack of clear and comparable information for customers to assess the value for money of alternative investment consultants.

<u>*Low levels of engagement by some customers*</u>

3.6 As stated in WTW's response to the Trustee Engagement Working Paper, in WTW's experience, many trustees are highly engaged and are able to effectively monitor, scrutinise and assess the advice received from investment consultants. This is supported and confirmed by the findings of the CMA's survey, which found that:

(a) 73% of pension schemes surveyed have carried out at least one of the headline indicators set out by the CMA (switching, tendering, formal reviews of fees/quality).[7]

(b) In relation to switching, over 80% of trustees found it very or fairly easy to switch investment consultant.[8] 57% of trustees responded that nothing would make the switching process easier.[9]

(c) Over 90% of trustees surveyed found it very easy or fairly easy to monitor the performance of their scheme's investments and approximately 90% of trustees found it very easy or fairly easy to monitor the overall quality of service.[10]

[7] Table 3, Page 19 of the Trustee Engagement Working Paper; Table 4, Page 21 of the Trustee Engagement Working Paper.
[8] Paragraph 96 of the Trustee Engagement Working Paper.
[9] Paragraph 97 of the Trustee Engagement Working Paper.

3.7 Nonetheless, the CMA has rightly identified that some pension scheme trustees have limited bandwidth and capabilities with which to take and follow through on investment decisions, and that these limitations also constrain their ability to monitor and effectively scrutinise the investment advice they receive.[11] WTW recognises these challenges associated with trustee limited bandwidth and capabilities and agrees that they are most prominent amongst small pension schemes. As elaborated in WTW's Market Investigation Discussion Paper[12] and reiterated in WTW's responses to the Information on Fees and Quality Working Paper and the Trustee Engagement Working Paper:

(a) Some trustees lack both the resources and the expertise to make informed judgements about risk management and investment. WTW thus welcomes any further action or guidance from the Pensions Regulator which will assist trustees effectively. These problems have arguably deepened in recent years as the IC industry has developed increasingly sophisticated strategies to improve pension scheme risk management and performance. In many cases, these strategies can lead to better risk adjusted outcomes. However, the additional complexity and fast-moving nature of the market means that trustees face an ongoing challenge to update their knowledge in a timely fashion about the best set of strategies available. While some of the largest schemes have the resources, in-house expertise and best-in-class governance structures required to continue with up-to-date best practices, many do not.

(b) Challenges faced by trustees are leading to sub-optimal decision making and outcomes for UK pension schemes. The average UK DB scheme has experienced a high degree of volatility in performance, with no material improvement in funding levels to show for it. While some level of risk is unavoidable for any investment strategy that seeks to make a positive return on the capital invested, WTW's analysis shows that the level of risk that the average UK DB scheme is exposing itself is unnecessarily high, in the sense that the same expected returns can be delivered with systematically lower levels of expected volatility.

(c) Most UK pension schemes get advice from investment consultants, meaning that these problems have arisen despite the existence of this advice. However, we have separately submitted evidence to the CMA that demonstrates that our own FM clients achieve significantly better outcomes (in terms of improved funding levels and/or lower volatility) than the average UK pension scheme when they delegate their investment decisions to us through our FM service.[13] We return to this evidence in section 4 below.

(d) We do not believe that this discrepancy in the performance of IC and FM clients relates to any fundamental difference in the advice that is provided to clients – it is essentially the same advice whether we provide it to a pension scheme trustee on an advisory basis, or act on it ourselves for a FM client. Rather, our experience is that UK DB pension schemes exhibit this excessive level of risk and volatility as a result of the following factors:

(i) Pension scheme trustees may spend a lot of time on implementation and execution, leaving little time for strategic decision making.

(ii) Managing investment portfolios is an activity that is best conducted in real time (responding to events as they occur) and in which multiple investment decisions can be made at the same time, given their interdependence. A committee structure –

[10] Paragraph 72(a) of the Trustee Engagement Working Paper; Table 5, Page 24 of the Trustee Engagement Working Paper.
[11] Paragraph 11.6 (a) of the PDR
[12] Paragraphs 2.9-2.14 and 2.23-2.26 of the Market Investigation Discussion Paper (dated 2 March 2018)
[13] WTW Submission on Performance Measurement Issues, 16 January 2018

meeting infrequently and making decisions sequentially – will rarely be able to operate as effectively as a full-time investment function.

(iii) Pension scheme trustees may place excessive focus on the wrong aspects of the advice (for e.g. fund manager selection, rather than strategic objectives and liability hedging).

(iv) Pension scheme trustees may lack a true understanding of the nature of capital markets, leading to a failure to properly assess the optimal investment and risk management strategies. A simple example is that many trustees have failed to hedge interest rate risk in recent years because interest rates are low, and they fear "locking in" to low bond yields. Given the macroeconomic and monetary policy environment, substantial expertise is required to understand the levels of risk schemes are exposed to and the rationale behind pricing in the current market environment.

(v) Pension scheme trustees may have a "bias to action" in response to periods of poor performance by particular managers or asset classes, leading to excessive changes of strategy (and transaction costs) rather than recognising that performance is inherently variable.

3.8 Investment consultants must recognise, respond to and – wherever possible – help alleviate these constraints facing pension trustees in order to ensure that they deliver value for money. FM was developed in response to customer demand for greater support and stronger accountability.

3.9 We would welcome any well-designed and proportionate measures that could help address the challenges pension schemes face, including measures to encourage further uptake of this market solution where appropriate. In this vein, we note that the CMA has proposed Remedy 3 to address low levels of engagement by some customers in respect of FM. WTW will discuss this Remedy – and other proposed measures that we believe could help address the challenges resulting from a lack of trustee bandwidth and expertise – in further detail in section 5.

The lack of clear information for customers to assess the quality of their existing investment consultant

3.10 WTW notes that the results of the CMA's survey indicate that an overwhelming majority of trustees surveyed are highly satisfied with the information available to them on the quality of their investment consultants and find it easy to monitor the performance of investments and quality of service. In particular:

(a) 94% of trustee boards say they find it very easy or fairly easy to monitor the overall investment performance of their scheme in an investment advisory context.

(b) 91% of trustee boards say they find it very easy or fairly easy to monitor the investment performance of their schemes' asset managers.

(c) 94% of trustees in IC found it very easy or fairly easy to monitor the performance of their scheme or investments. 89% of trustees in IC found it very easy or fairly easy to monitor the overall quality of service.

3.11 As the CMA has acknowledged at paragraph 5.51 of the PDR, "[the CMA's] evidence indicates that trustees generally have access to clear and regular information on the investment performance of their scheme". Therefore, WTW maintains that customers have sufficiently clear information to assess the quality of their existing investment consultants.

3.12 Nonetheless, WTW acknowledges the CMA's finding that in the wider IC market, there are cases where performance reports do not always demonstrate progress against trustees' strategic investment objectives. For the majority of WTW clients, an investment objective is set and performance is reported against this objective. However, in the wider IC market, the lack of clear performance reporting is likely to be because trustees themselves have not set out investment objectives in a clear and measurable way. WTW agrees that remedies designed to address this could further improve transparency in the IC market and welcomes such remedies if appropriately designed. However, this does not in itself indicate that the current level of access to information is insufficient to support effective competition for IC services.

The lack of clear and comparable information for customers to assess the value for money of alternative investment consultants

3.13 WTW notes that there are two aspects in relation to value for money within this statement – fees and performance. We address each in turn below.

3.14 In relation to information on fees, the CMA has observed that:

(a) there is a lack of transparency for third party fees; and

(b) there is a lack of standardisation in fee structures and the presentation of fee information across different IC providers.

3.15 These concerns do not appear to be borne out by the results of the CMA's survey:

(a) 89% of trustee boards say they find it very easy or fairly easy to monitor the fees they pay to their investment consultant.

(b) 74% of trustee boards say they find it very easy or fairly easy to monitor third party fees relating to their investment advisory work.

(c) 81% of trustee boards (who had tendered / invited proposals for advisory services in the last 5 years) say they found it very easy or fairly easy to understand and compare the fees of rival bidders.

3.16 This would suggest that most trustees have sufficient and appropriate information to assess and compare alternative investment consultants on the basis of fees.

3.17 Nonetheless, we recognise that more could be done to provide additional information on third party fees, especially the total expense ratio ("**TER**") of underlying manager fees and expenses, as well as any changes to fees as a result of portfolio changes. As the CMA has stated at paragraph 5.28 of the PDR, the introduction of MiFID II[14] and the related IDWG templates significantly improves the availability and clarity of such information.

3.18 In relation to information on performance, the CMA has stated that, "for prospective clients, there is limited information to assess providers' investment abilities and performance information on their recommended asset management products and funds is not directly comparable". The CMA has further commented that "the ways used to calculate track records for consultants' recommended investment products makes it difficult to interpret and compare the quality of advice across providers".

3.19 At the outset, WTW refers to the CMA's survey, which has found that:

[14] See https://www.fca.org.uk/markets/mifid-ii

(a) 82% of trustee boards say they found it very easy or fairly easy to understand and compare the overall quality of each proposal during a bid for advisory services.

(b) 56% of trustee boards (who tendered / invited proposals for advisory services in the last 5 years) say they found it very easy or fairly easy to understand and compare the investment track-record of rival bidders.[15]

3.20 As stated at paragraph 5.62 of the PDR, "the CMA survey results indicate that trustees generally feel that they can understand and compare the overall quality of each proposal when tendering for IC services". WTW thus submits that the trustees have sufficient and appropriate information to assess and compare alternative investment consultants on the basis of performance.

3.21 Nonetheless, WTW is open to the CMA introducing measures which set sensible standards for the disclosure of information on performance to customers, if the measures would genuinely help trustees better assess the value for money of different advisory products. WTW remains committed to providing transparency to enable trustees to make the best possible decisions with regard to their investments.

3.22 WTW notes that the CMA has proposed Remedy 8 to address the lack of clear and comparable information (with regard to performance) to assess the value for money of alternative investment consultants. We discuss this Remedy in detail in section 5 below.

AEC identified in the FM market

3.23 The CMA has found five features of the FM market which it believes constitute an AEC:

(a) IC-FM firms steering their advisory customers towards their own FM service.

(b) Low levels of customer engagement at the point of first moving into FM.

(c) Lack of clear and comparable information for customers to assess the value for money of alternative fiduciary managers.

(d) Lack of clear information for customers to assess the value for money of their existing fiduciary manager.

(e) Barriers to switching fiduciary manager.

3.24 The CMA has further asserted that:

(a) features (a) to (c) above result in an incumbency advantage for the existing IC-FM firms; they prevent, restrict or distort competition at the point of customers first moving into FM; and

(b) features (d) to (e) prevent, restrict or distort competition once customers have bought FM services.

The incumbency advantage of IC-FM firms: IC-FM firms steering their advisory customers towards their own FM service

3.25 WTW disagrees with the CMA's finding that IC-FM firms steer their advisory customers towards their own FM service. The CMA has presented certain aspects of its analysis as apparently supportive of

[15] In relation to the two percentages in the 50-60% range, it is important to understand the nature of the services they relate to. For advisory, each project is typically subject to a bidding process (formal or informal) and it is not possible to know what services are required upfront before the important mission/beliefs/strategy work has taken place.

the fact that incumbent IC providers are "steering" trustees towards in-house FM services. However, the evidence provided by the CMA simply indicates that IC-FM providers attempt to cross-sell by raising the existence of other services they offer which would be beneficial to trustees. WTW also notes that the CMA has not found any evidence to suggest that IC-FM firms are raising FM where it is not in the best interests of clients. This practice is not suggestive of an AEC in the market - it is merely a normal function of a business attempting to provide a broad range of services to its customers.

3.26 As previously stated in WTW's Wrap Up Paper[16], WTW considers that, in order for there to be an actual conflict, the IC provider would have to be holding itself out as acting as an "independent advisor" in the selection process for FM services. This is a fundamentally different situation from merely mentioning the existence of the in-house service. The CMA has not provided any evidence to suggest that such behaviour is taking place. WTW would certainly never hold itself out as acting as an "independent advisor" in an existing IC customer's selection for FM services.

3.27 WTW reiterates its position that, as expressed in various previous submissions to the CMA, FM can be a more appropriate service model for many pension schemes which in the long run provides a number of additional benefits. WTW has provided evidence to the CMA of the value its FM service has created for pension scheme trustees to date.[17] In particular, this evidence shows that the funding levels of full FM clients of WTW experienced significantly better risk-adjusted outcomes since the inception of the service (although we expect similar results to apply across the industry). These results are statistically significant and robust, and they go to the heart of the value added by the FM industry, namely helping their clients achieve better risk-adjusted returns for their assets. We note that, as stated at paragraph 7.9 of the PDR, other stakeholders such as the PLSA, trustees, in-house investment staff and asset managers have likewise acknowledged the numerous benefits which FM services bring to pension schemes.

3.28 Furthermore, we note that FM was developed by the market in response to the constraints on bandwidth and expertise faced by pension scheme trustees (a feature identified in the PDR as resulting in an AEC in the IC market). As the CMA is aware, the FM service delegates responsibility for portfolio management and execution to the FM provider, freeing up trustees to focus on higher level strategic issues.

3.29 Therefore, any proposal by an IC-FM firm to consider FM services must be viewed in the context of the many benefits and advantages of FM.

3.30 The CMA has reviewed the firms' internal documents including strategy documents and concluded that some IC-FM firms have had particularly strong cross-selling strategies. This is slightly surprising as, on the face of the PDR, there is limited, if any, evidence that IC-FM firms are steering trustees towards in-house FM services. Indeed, it is striking that the CMA's survey indicates that it is only in around 20% of situations that the incumbent provider has sought to recommend FM and, when this does occur, on 45% of occasions a competitive alternative is referenced[18].

3.31 The CMA has further asserted that IC-FM firms have financial incentives to sell FM to their existing IC clients on the basis that FM mandates generate higher profits than IC mandates. We submit that the profitability of the FM services does not of itself indicate that firms would steer their existing clients towards their in-house FM services when an alternative solution or deal could have been in their best interests. On the contrary, as we have explained in our response to the CMA's Financial Information

[16] Response to the Evidence Presented to Date, dated 8 June 2018
[17] See section 2 of WTW's Submission on Performance Measurement Issues, 16 January 2018
[18] Paragraph 112-114 of the Working Paper on the Supply of Fiduciary Management Services by Investment Consultancy Firms

Request and in subsequent correspondence, FM services require higher average profit margins to compensate IC-FM firms for the higher operational and market risks associated with these services. The CMA has presented no evidence to suggest that FM services are more profitable than advisory-only services on a risk-adjusted basis.

3.32 WTW has put in place rigorous procedures to avoid any conflict and does not provide any services advising trustees on the suitability of FM or the selection of an FM provider. Nonetheless, while maintaining that IC-FM firms do not steer trustees towards in-house FM services, WTW acknowledges that not all providers may have robust procedures. Therefore, as existing IC customers move closer to deciding to purchase FM services, the introduction of measures to further distinguish between impartial advice and marketing-related information on an IC-FM firm's own FM products would be beneficial as set out in Remedy 2. We provide more detail on our views in section 5.

The incumbency advantage of IC-FM firms: low levels of customer engagement at the point of first moving into FM

3.33 The CMA has concluded that there are "low levels of customer engagement at the point of first moving into FM. A substantial proportion of customers do not formally test the market prior to moving into FM. As a result, many take this service from their incumbent IC-FM firm without considering alternatives."[19]

3.34 WTW recognises that trustees face an important decision when switching from IC to FM which could have material implications for pension scheme outcomes. Therefore, WTW supports measures to encourage trustees to engage in market testing when they first appoint a full FM provider.

3.35 However, WTW disagrees that customer engagement at the point of first moving to FM should only be measured by whether customers "formally test" the market prior to moving into FM, with all other forms of market testing disregarded. We note that the CMA's definition of a "formal test" is a narrow definition limited to a tender run by a third-party.[20] The CMA has produced no evidence to support the claim that a tender run by a third party is a stronger form of market testing compared to seeking third party advice and running a tender process/inviting proposals with no external help.

3.36 In any case, we note that customer engagement should not be measured and determined by only one indicator. For instance, the Trustee Engagement Working Paper refers to, amongst many other indicators, at least four headline indicators of switching, tendering, formal reviews of fees and quality when measuring customer engagement generally.

3.37 Furthermore, the fact that a formal market test was not held by a third party prior to choosing the FM service of their incumbent IC-FM firm does not indicate that alternatives were not considered when making such a decision. As the CMA has acknowledged in section 7 of the PDR, trustees can consider alternatives by either seeking third party advice or running a tender process/invite proposals with no external help.

3.38 WTW considers that the CMA should review how it is currently measuring customer engagement at the point of first moving into FM by taking into account all relevant forms of market testing (and not only tenders run by third parties). In particular, it is important to consider the fact that a tender run by a third party is not suitable for smaller schemes (e.g. those with AUM of <£100m) as the costs of a competitive tender would likely be disproportionate compared to the benefits it would offer.

[19] Paragraph 11.8(b) of the PDR
[20] Paragraphs 7.43 to 7.46 of the PDR

3.39 We refer to the results of the CMA's survey which indicate that approximately half of pension schemes surveyed received some form of third-party support (in the form of advice or running a tender) when buying FM services for the first time.[21] We further refer to KPMG's 2016 and 2017 surveys which indicate that the proportion of new FM appointments in a given year that were advised by an independent third-party has grown from 23% in 2015, to 33% in 2016, and 60% in 2017.[22] Most importantly, we refer to the fact that the CMA's survey had found that, when appointing their first FM provider, 53% of all pension schemes did not appoint their existing investment consultant.[23] We urge the CMA to take into account these crucial findings of the relevant surveys when measuring customer engagement at the point of first moving to FM. In WTW's view, a holistic assessment of customer engagement at the point of first moving into FM reveals healthy levels of engagement.

3.40 Notwithstanding these considerations, WTW recognises that there can be benefits to making competitive tendering mandatory when a pension scheme first moves into a full FM solution as it will guarantee that alternative options will be considered. WTW however cautions that any such mandatory tendering regime must be carefully designed with due consideration given to small schemes. In particular, the CMA should recognise that the cost of running a formal tender can be significant and that care must be taken to avoid inadvertently creating a barrier to switching for smaller schemes with limited time and resources. This would be to the detriment of customers. We note that the CMA has separately identified barriers to switching one's FM provider as a separate AEC and – while we would dispute this assessment for the reasons outlined below – we strongly believe that steps should be taken to avoid unnecessarily creating new barriers. We provide more information on our thoughts on Remedy 1 in section 5.

The incumbency advantage of IC-FM firms: lack of clear and comparable information for customers to assess the value for money of alternative fiduciary managers

3.41 With regard to the lack of clear and comparable information for customers to assess the value for money of alternative fiduciary managers, WTW recognises that customers looking to appoint a fiduciary manager may struggle to compare the offers of different providers. For example, bundling of the FM service fees with third party fees and the use of performance fees are two fee structures that can make it difficult for customers to gauge what the total cost associated with the FM service of each provider is.

3.42 WTW therefore supports measures to improve the comparability of fees for FM services, and will address the relevant Remedies in detail in section 5 below.

The incumbency advantage of IC-FM firms: concluding thoughts

3.43 Whilst disagreeing that there is a detrimental incumbency advantage for the existing IC-FM firms which prevents, restricts or distorts competition at the point of customers moving into FM, WTW remains open to any well-designed measures by the CMA which can create even more competition in the FM market (noting that the CMA has found healthy levels of competition already) and generate better outcomes for customers. In WTW's experience, there is always external pressure from our competitors to ensure that we offer value for money for our clients.

[21] Paragraph 7.44 of the PDR
[22] Paragraph 70 of the Fiduciary Management Working Paper
[23] Paragraph 7.29 of the PDR

Other features of the FM market which prevent, restrict or distort competition after customers have bought FM services: lack of clear information for customers to assess the value for money of their existing fiduciary manager

3.44 With regard to the lack of clear information for customers to assess the value for money of their existing fiduciary manager, WTW refers to the following positive findings of the CMA's survey:

(a) 86% of trustee boards say they find it very easy or fairly easy to monitor the fees they pay to their fiduciary manager; and

(b) 66% of trustee boards say they find it very easy or fairly easy to monitor third party fees relating to their FM work.

3.45 Nonetheless, WTW agrees that more could be done to provide additional information, in particular with regard to third party fees. WTW recognises the benefits of ensuring that trustees are given an appropriate level of information on fees and strives to provide clients with detailed information on total fees on a regular basis in relation to FM services. WTW believes that the standards for cost disclosure – in particular for the investment arrangements embedded in FM mandates – will ensure transparency of the fiduciary manager's fees and that of the agents they employ on their clients' behalf.

3.46 WTW further agrees that, as highlighted by the CMA in paragraph 5.87 of the PDR, the introduction of MiFID II and the related IDWG templates would enhance pricing transparency in relation to fee reporting for FM significantly. WTW notes the CMA's observation that not all FM activities/providers are governed by the MiFID II regime[24], and welcomes measures to subject all FM activities to the same fee reporting regime. The fee disclosure requirements under the MiFID II regime would likely address the CMA's concerns.

Other features of the FM market which prevent, restrict or distort competition after customers have bought FM services: barriers to switching fiduciary manager

3.47 The CMA has also concluded that there are some barriers to switching fiduciary manager as the process of switching FM provider generally requires substantial time and can incur high costs, which will deter some customers from changing provider.

3.48 WTW notes that, as acknowledged by the CMA at paragraph 6.106 of the PDR, "the process for switching FM varies considerably across schemes". The CMA has further noted in the same paragraph that "there are some cases in which the switching process can be completed quickly and at minimal cost". WTW therefore cautions against making generalisations about the switching process of FM.

3.49 Furthermore, there is no evidence which illustrates that the costs and time associated with switching a FM provider are key factors which will influence a customer's switching decision. As the CMA has acknowledged at paragraphs 6.93 and 6.94 of the PDR, the associated costs are as a result of changing the underlying portfolio and are mostly paid to the banks and brokers that trade the underlying securities (and not to the fiduciary managers themselves). FM contracts in general do not include restrictive exit clauses or penalties. Hence there is no evidence to suggest that the costs and time associated with switching FM constitute in practice a barrier to switching.

3.50 In addition, WTW submits that the fact that a scheme will incur switching costs and time from moving to a new FM arrangement should not detract from the fact that this new FM arrangement is ultimately a better service as set out at paragraph 3.27 above which in the long run provides a number

[24] Paragraph 5.76 of the PDR

of additional benefits. As the CMA itself has noted, even small improvements in the quality of investment decisions can substantially outweigh the cost of migrating to and paying for the service. To the extent that switching costs are an unavoidable cost of migrating to a service, that is capable of delivering substantially higher value for many customers than an advisory-only service, and that there is no evidence that these costs are higher than they need to be, it makes no sense to label these switching costs as an AEC.

Other features of the FM market which prevent, restrict or distort competition after customers have bought FM services: concluding thoughts

3.51 In conclusion, WTW does not think that there is any feature of the FM market which would prevent, restrict or distort competition once customers have bought FM services.

Future trends of the FM market

3.52 With regard to future trends, the CMA has concluded that the FM market could become more concentrated in the future[25] on the basis that:

(a) the three largest IC firms have increased their combined share in the FM market by 40 percentage points since 2007; and

(b) the incumbency advantage of IC-FM firms could contribute to further growth of the three largest IC firms in the FM market.

3.53 WTW submits that none of the evidence listed in (a) and (b) above supports the conclusion that the FM market could become more concentrated in the future. Furthermore, while we agree with (a), as elaborated above, we disagree that there is an incumbency advantage of IC-FM firms which could contribute to the further growth of the three largest IC firms in the FM market.

3.54 Specifically, while we acknowledge that there has been a trend of increasing market shares for the three largest IC firms since 2007, we note that, as stated at page 38 in the Competitive Landscape Working Paper, "Because our [CMA's] data indicates that Russell Investments and River & Mercantile were previously the only two large providers of services in 2007, the entry and subsequent rapid growth of the three largest IC providers actually resulted in a reduction in the HHI over this period from over 4300 in 2007 to 1353 in 2016.". Therefore, it appears that the increased combined market share of the three largest IC firms in FM since 2007 was accompanied by a corresponding fall in market shares of the original incumbent FM firms (Russell Investments and River & Mercantile). We thus urge the CMA to contextualise the identified increase. The increasing combined market share of the three largest (as it currently stands) IC firms in the FM market since 2007 had led to the FM market becoming significantly less concentrated. It is also the case that the rapid growth of the three largest IC firms in the FM market since 2007 could simply be a reflection of the low number of players in the FM market in 2007.

3.55 Furthermore, given the nascent nature of the FM market in 2007 (with only two large providers) and the CMA's finding that the FM market has trebled in size since 2011, we submit that the past trend of rapid growth of the three largest IC firms in the FM market is not indicative of any future trend of their growth in the FM market. As noted on page 69 of the PDR, there has been recent entry into the FM market by a number of large asset management firms. These asset management firms, with highly complementary expertise and the resources to expand rapidly, pose a strong competitive constraint on the existing providers in the FM market. We further refer to the Spence Johnson analysis referenced

[25] Paragraph 11.5 of the PDR

by the CMA at page 67 of the PDR, which forecasts reduced FM market shares for IC-FM firms; they predict that market shares for IC-FM firms in the FM market will decrease from 74% in 2014 to 50% in 2024. Therefore, it remains speculative at best to conclude that the past trend of increasing market shares of the three largest IC firms in the FM market will continue.

4. Market Outcomes

4.1 We welcome the CMA's finding that a number of aspects of the IC and FM markets function well and deliver value for customers. In particular, we note the CMA's conclusions that:

(a) trustees are generally satisfied with their IC and/or FM providers;

(b) FM providers can achieve significant discounts from asset managers for their customers;

(c) the asset allocation advice of IC/FM providers appears to be tailored and has added value in recent years through the hedging of interest rate risks; and

(d) asset manager recommendations on average were found to provide value gross of fees to a statistically significant extent and some firms were found to provide asset manager recommendations that have added value on a net of fees basis to a high degree of statistical significance.

4.2 Nonetheless, the CMA argues that the AECs it has provisionally identified may be expected to result in "material customer detriment" in both the IC and FM markets. Specifically, the CMA contends that:

(a) there are logical reasons to expect that the AECs it has identified are detrimental for schemes using IC and FM services;

(b) there is empirical evidence that these AECs are resulting in some customers paying materially higher prices for IC and FM services than they would in a well-functioning market; and

(c) there is also empirical evidence that these AECs are resulting in some customers receiving a lower quality of IC and FM service than they would in a well-functioning market.

4.3 The CMA further claims that the detriment it has identified is likely to be more significant for FM customers than for IC customers due to the additional AECs that the CMA has identified in relation to "the behaviour of IC-FM firms" and the costs involved in switching from one FM provider to another.

4.4 The CMA's purpose in presenting this analysis appears to be to quantify the scale of the harm caused by the AECs that it has identified with a view to justifying the proportionality of the Remedies it is proposing. We recognise the importance of conducting such a detriment analysis, since – for the reasons we explain in section 5 below – some of the Remedies that the CMA has put forward will impose significant costs not only on suppliers of IC and FM services but also on the customers using these services.

4.5 We are therefore concerned at the brevity and lack of evidence underpinning the CMA's analysis of detriment, which only runs to just eight paragraphs – or less than two pages – of the PDR. We are also concerned that the CMA has overlooked the value risk management has provided clients with, as shown through the lower volatility in funding ratios achieved for FM clients.

4.6 For the reasons explained in section 2 above, we disagree with a number of the CMA's AEC findings and therefore dispute the logic that these are likely to act as sources of "material customer detriment".

(a) **First, the empirical evidence that the CMA has put forward to substantiate its claim that there is "material customer detriment" does not stand up to scrutiny.** In particular, a balanced assessment of the CMA's findings points to the following conclusions:

(i) The CMA presents evidence which, it argues, shows that the failure of some customers to engage is resulting in worse outcomes for those customers. However, this evidence is undermined by material errors of fact and assessment. Once these errors are corrected, the CMA's analysis no longer supports this conclusion.

(ii) The CMA has itself rightly concluded that the remaining "market outcomes" it has considered yield no clear evidence of customer detriment. Specifically:

(A) The CMA has concluded that evidence it has assessed on investment consultants' recommended asset manager products "hasn't clearly demonstrated one way or the other whether providers collectively add value through this service". For the reasons we explain below, there is clear evidence that investment consultants do add value, both through their product recommendations and their wider services. Nonetheless, we agree with the CMA that, at the very least, this evidence cannot be used to substantiate the CMA's AEC and customer detriment concerns.

(B) The CMA has also rightly concluded that it would not be feasible to assess the economic profitability of IC or FM services because of the difficulties associated with calculating the capital bases of the firms involved.

(iii) In the absence of hard evidence, the CMA has put forward "illustrations" to show that modest increases in prices or reductions in service quality could be highly detrimental for customers. However, these illustrations are entirely hypothetical and provide no evidence that such detriment exists.

(b) **Second, the CMA's reasoning that detriment is more likely to be concentrated in FM services than in IC services is flawed.** The CMA identifies additional AECs that it argues are specific to FM, but the mechanism for these AECs is flawed. Even if switching barriers were higher in FM than IC, this would only constitute an AEC if:

(i) those switching costs were artificially high; or

(ii) customers would be better off not taking up FM or switching their FM service provider in the first place (i.e. if the market should not exist).

In WTW's view any costs for switching FM providers are inherent to the service, for example, arising from changes to the investment strategy. The CMA has presented no evidence to suggest that these costs could be reduced. The CMA has not put forward any evidence that switching costs could be lower in FM or that customers who switch to FM do not benefit from doing so even after taking account of these switching costs.

Further, the CMA proposes that IC-FM providers steer customers towards choosing their own FM service. However, there is no evidence that IC-FM providers are giving customers misleading information about the relative quality of their FM service or the availability of competing services. Nor does the CMA explain why such a concern – if it did exist – would be specific to FM services. Indeed:

(i) the CMA's assessment does not take into account the significant benefits that many IC customers would gain from switching to FM services; and

(ii) contrary to the CMA's argument, a balanced assessment of the evidence would suggest that – to the extent that any material customer detriment does exist in the industry – it is likely to be concentrated amongst a subset of customers who would benefit from migrating to a delegated service model such as FM but have not done so. This would suggest that the potential conflict for IC-only firms, which have an incentive to discourage clients from considering a switch to FM, may be a more material concern than those areas that the CMA has focused on.

(c) **Third, a balanced assessment of the other market outcomes that the CMA has considered yields no evidence of customer detriment – and on the contrary demonstrates the significant value that IC and FM firms create for customers.** Specifically:

(i) The CMA itself recognises that a number of aspects of the service that IC and FM firms provide creates significant value for customers – not only do the CMA's survey results reveal high levels of customer satisfaction, but the CMA has itself uncovered evidence that providers can achieve significant discounts from asset managers on behalf of their customers and that they provide tailored advice that has added value in recent years in particular through the hedging of interest rate risks.

(ii) Although the CMA concludes that evidence on the IC industry in aggregate "hasn't clearly demonstrated one way or the other whether providers collectively add value through this service", it acknowledges that some individual firms may do so. WTW has previously submitted a significant body of evidence to the CMA to demonstrate that WTW adds value in this area.

(iii) In WTW's view, the best way to measure the overarching value that WTW, and the IC-FM industry as a whole, can add is to assess the actual performance of fiduciary management clients against their overarching objectives of reducing volatility in funding ratios. WTW has previously submitted detailed evidence on this that the CMA briefly references in the PDR. For the reasons we explain below, the doubts that the CMA has expressed about the strength of this evidence do not stand up to scrutiny. We therefore strongly urge the CMA to reconsider this evidence.

(iv) We submitted a wide range of evidence to demonstrate WTW's own track record in delivering such value in our responses to the CMA's working papers as well as a standalone submission on performance measurement issues in January 2018. The CMA appears to have dismissed this evidence without good justification.

4.7 We explain each of these concerns in more detail below.

I. The empirical evidence that the CMA has put forward to support its finding that there is "material customer detriment" is flawed

4.8 The CMA has relied heavily on its "gains from engagement" analysis to substantiate its conclusions that there is material customer detriment. In its analysis of market outcomes, it cites the following evidence to support its conclusion that low customer engagement is proving detrimental for some customers:[26]

[26] As set out in the first box of Section 10 of the PDR on page 231.

(a) in FM, less engaged schemes pay significantly higher prices than more engaged schemes when they remained with their existing investment consultant, and there is some evidence of less engaged schemes paying higher fees for IC services;

(b) less engaged schemes are likely to receive lower discounts from asset managers negotiated by their investment consultant;

(c) less engaged customers in some cases receive a lower quality of service; and

(d) IC firms with above average quality have persistently lower market shares.[27]

However, the analysis underpinning these findings suffers from a number of material errors of fact and assessment, particularly regarding the CMA's definition of engagement. As mentioned previously, the definition is narrow and in WTW's experience not an effective proxy in determining how engaged or otherwise trustees are. There are many instances where highly engaged trustee boards often challenge their advisors on the advice they receive but would not be defined as engaged under the CMA's definition of engagement.

4.9 This is not to say that we disagree with the CMA's proposition that customer engagement is important for a well-functioning market or that that trustees do not stand to gain from actively and carefully considering their choice of IC or FM provider: on the contrary, we fully recognise the challenges facing trustees that have limited bandwidth and in-house capabilities and would support well-designed measures to help them overcome these challenges. However, the CMA should be mindful of the fact that – for the reasons explained below – it has not clearly quantified the scale of any detriment resulting from limited levels of engagement. Such an exercise is inherently challenging, and the CMA should therefore proceed with caution when considering the proportionality of the remedy measures it has put forward.

The CMA's claim that less engaged schemes pay higher prices than more engaged schemes does not stand up to scrutiny

4.10 We raised a number of conceptual concerns in our response to the CMA's working paper on gains from engagement. Our external advisors have now had the opportunity to assess the CMA's analysis using the information that the CMA has made available in the second confidentiality ring. Below we set out the findings from the confidentiality ring, which demonstrate that, as anticipated in our response to the working paper, the evidence of gains from engagement put forward by the CMA is not robust.

4.11 The CMA states that it has carried out three different assessments of the relationship between customer engagement and fees:

(a) a "static" approach for IC services, which compares the level of prices across schemes depending on whether they are engaged or not;

(b) a "static" approach for FM services, which compares the level of prices across schemes depending on whether they are engaged or not; and

(c) a "transition" approach, which assesses the change in prices when schemes moved into FM with their existing provider of IC, depending on whether they are engaged or not.

[27] While the link between this point and the gains from engagement is not completely clear to WTW, we have followed the approach of the CMA within the PDR of grouping this issue within its wider discussion on the gains from engagement.

4.12 The CMA contends that these assessments point to the conclusion that less engaged schemes pay more, and in the case of FM schemes, materially more than more engaged schemes.

4.13 None of these results stand up to close scrutiny.

(a) The CMA's finding that more engaged schemes pay less for IC services relies entirely on making direct comparisons across providers without adequately controlling for the differences in services that different providers may offer to their customers.

(i) Such comparisons are inherently unreliable when dealing with differentiated product markets such as IC services where there are substantial differences in the 'products' that different providers offer to their customers.

(ii) Indeed, the baseline specification of the FM static analysis includes controls for such differences between providers,[28] and the CMA has not provided an explanation for why it would be appropriate to include these controls for FM but not for IC.[29]

(iii) Once these differences in provider characteristics are appropriately controlled for, by including provider fixed effects, the CMA's own analysis finds no meaningful difference – either economically or statistically – in the prices paid between schemes it considers to be engaged and those it considers not to be engaged.[30]

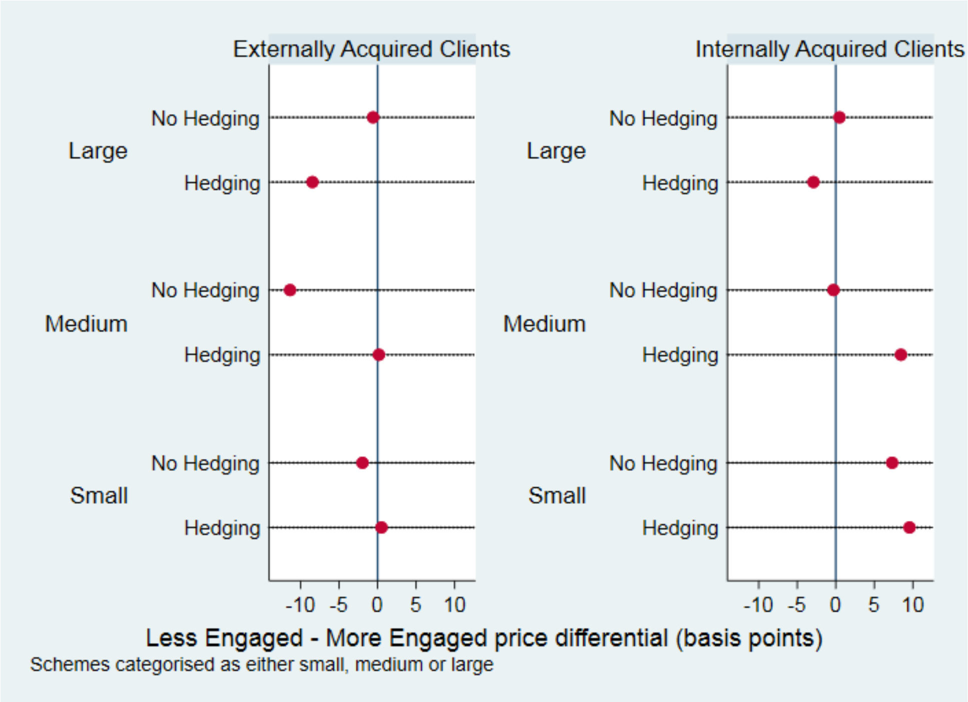
(iv) For this reason WTW considers that the CMA's conclusion that "There is some evidence that less engaged schemes in investment consultancy pay more too."[31] is based on a material error of assessment.

(b) The CMA's FM static analysis suffers from both errors of fact and assessment, and is highly sensitive to small changes in the approach adopted by the CMA. For these reasons WTW considers that it provides no robust evidence that FM schemes classed as engaged by the CMA, whether internally or externally acquired, pay less than those FM schemes that are not classed as engaged by the CMA.

(i) Figure 13 within Appendix A5 of the PDR is incorrect.[32] The correct figure is reproduced below. In contrast to the erroneous Figure 13, the corrected figure shows, that on average externally acquired schemes that the CMA classed as engaged typically paid *higher* amounts for FM services than those the CMA did not class as engaged. Overall, we consider that these results provide no clear evidence as to gains from engagement.

[28] See paragraph 172(f) of the working paper on Gains from Engagement.
[29] It is standard practice for the CMA to include firm fixed effects when conducting analysis that uses data sourced from different firms and/or where products sold by each firm are differentiated.
[30] See Table 25, Appendix 5 of the PDR.
[31] As set out in the first box of Section 10 of the PDR on page 231.
[32] The issue appears to be simply that an old version of the chart has remained in the PDR document. The error was identified by our advisors as the version of figure 13 produced by executing the relevant computer code contained within the second confidentiality ring produces a figure that is different to that contained in the PDR. Our assumption is that the figure 13 produced by the computer code contained within the second confidentiality ring is correct.

<u>'Replication' of Figure 13 from Appendix 5.</u>



(ii) The CMA's finding that engaged schemes (according to its indicators of engagement) pay less than non-engaged schemes is entirely dependent on assessing the gains from engagement separately for internally acquired and externally acquired schemes. As the results of regression analysis carried out by WTW's advisors within the second confidentiality ring below show, if this distinction is not made there is no statistically significant difference in the price paid by engaged and non-engaged schemes (the p-value for "any engagement indicator" in the table is 0.20, indicating that the coefficient is not statistically significantly different from zero at 90% confidence level).

<u>Table 1: Baseline (FM static) specification - no distinction between externally and internally acquired clients</u>

	Coef.	Robust Std. Err.	t	P>t	[95% Conf. Interval]	
Any engagement indicator	-0.11	0.08	-1.28	0.20	-0.27	0.06
Client buys hedging (Dummy)	0.33	0.13	2.49	0.01	0.07	0.59
Performance fee (Dummy)	0.36	0.17	2.17	0.03	0.03	0.70
Number of AM firms (Logs)	0.14	0.05	3.12	0.00	0.05	0.23
AUM (Logs)	-0.40	0.03	-12.33	0.00	-0.46	-0.33
Percentage assets in FM	0.00	0.00	1.02	0.31	0.00	0.01
Firm fixed effects	Yes					
Constant	9.46	0.58	16.19	0.00	8.31	10.61

Observations	198.00
R- squared	0.588
Adjusted R- squared	0.568

(iii) In this context WTW considers that the CMA's finding that internally acquired, engaged FM schemes pay less is likely to be a false positive result that would be unlikely to be replicated if data from a different sample of schemes or an alternative time period was analysed.[33]

(c) The CMA's FM transition analysis suffers from errors of assessment, and is highly sensitive to small changes in the approach adopted by the CMA.

(i) The CMA's findings are entirely dependent on the inclusion of a small number of schemes that are reported to have experienced particularly large (more than tenfold) increases in expenditure when transitioning from IC to FM.[34] Excluding these schemes, or using a statistical approach that is robust to these types of outliers (a median regression) entirely removes the CMA's finding that engaged schemes experience lower increases in their total expenditure when transitioning from IC to FM. This can be seen from Tables 2 and 3 below respectively, where in both cases the coefficient on the engagement indicator is not statistically significantly different from zero at 90% confidence level.

Table 2: Baseline (FM transition) excluding observations with IC-to-FM cost increase multiple greater than 10

	Coef.	**Robust Std. Err.**	**t**	**P>t**	**[95% Conf. Interval]**	
Any engagement indicator	-0.12	0.12	-0.95	0.35	-0.36	0.13
Client buys hedging (Dummy)	0.42	0.11	3.79	0.00	0.20	0.64
AUM (Logs)	0.05	0.04	1.28	0.21	-0.03	0.14
Percentage assets in FM	0.01	0.00	5.93	0.00	0.01	0.01
Constant	-0.69	0.76	-0.91	0.36	-2.20	0.81
Observations	92					
R- squared	0.435					
Adjusted R- squared	0.409					

[33] The underlying issue is that any test of whether an effect is statistically significant is associated with a probability that the effect has arisen purely by chance. For example, for an effect significant at the 5% level, there is a 5% chance that the effect has arisen purely by chance – i.e. that it is a false positive result. As a greater number of comparisons are made – i.e. in this case as the effect of engagement is assessed within a greater number of sub groups – the chance that any particular statistically significant effect is a false positive increases.

[34] Out of the 104 schemes included in the CMA's FM Transition analysis only 12 have a multiple in excess of 10. Of these 10 schemes only 2 are counted as "engaged" under the CMA's definition.

Table 3: Baseline (FM transition) specification median regression

	Coef.	Robust Std. Err.	t	P>t	[95% Conf. Interval]	
Any engagement indicator	-0.21	0.17	-1.25	0.21	-0.54	0.12
Client buys hedging (Dummy)	0.43	0.17	2.45	0.02	0.08	0.78
AUM (Logs)	0.11	0.06	1.89	0.06	-0.01	0.23
Percentage assets in FM	0.01	0.00	5.27	0.00	0.01	0.02
Constant	-1.83	1.12	-1.63	0.11	-4.05	0.39
Observations	104					
Pseudo R- squared	0.256					

Given this, WTW considers that the CMA's results are likely to be driven by a handful of schemes with unusual or anomalous characteristics. Extrapolating the experience of such schemes to all schemes that transitioned from IC to FM would be highly unreliable and amount to an error of assessment on the part of the CMA.

(ii) The CMA's regression analysis is not robust to small changes in approach. In particular, WTW's advisors note that any of the following changes to the control variables used within the analysis removes the CMA's finding that engaged schemes face a statistically significantly smaller change in their expenditure when they transition into FM:

(A) the inclusion of the (log) of the number of assets managers used by a scheme as an additional control variable within the CMA's analysis results in the coefficient on the engagement indicator no longer being statistically significant at the 90% confidence level;

Table 4: Baseline (FM transition) specification including logs of number of asset mangers

	Coef.	Robust Std. Err.	t	P>t	[95% Conf. Interval]	
Any engagement indicator	-0.27	0.20	-1.34	0.18	-0.67	0.13
Client buys hedging (Dummy)	0.60	0.23	2.56	0.01	0.13	1.06
Number of AM firms (Logs)	-0.03	0.06	-0.52	0.61	-0.16	0.09
AUM (Logs)	0.17	0.08	2.08	0.04	0.01	0.33
Percentage assets in FM	0.01	0.00	3.06	0.00	0.00	0.02
Constant	-2.60	1.36	-1.91	0.06	-5.32	0.12
Observations	63					
R- squared	0.516					
Adjusted R- squared	0.473					

(B) the inclusion of the (log) of the number of asset managers used by a scheme and the existence of performance fees as additional control variables within the CMA's analysis results in the coefficient on the engagement indicator no longer being statistically significant at the 90% confidence level;

Table 5: Baseline (FM transition) specification including logs of asset managers, and performance fee

	Coef.	Robust Std. Err.	t	P>t	[95% Conf. Interval]	
Any engagement indicator	-0.27	0.20	-1.37	0.18	-0.67	0.12
Client buys hedging (Dummy)	0.55	0.25	2.15	0.04	0.04	1.05
Performance fee (Dummy)	0.26	0.31	0.83	0.41	-0.36	0.87
Number of AM firms (Logs)	0.01	0.09	0.15	0.88	-0.17	0.19
AUM (Logs)	0.17	0.08	2.08	0.04	0.01	0.33
Percentage assets in FM	0.01	0.00	2.70	0.01	0.00	0.02
Constant	-2.73	1.38	-1.98	0.05	-5.49	0.03
Observations	63					
R- squared	0.522					
Adjusted R- squared	0.471					

(iii) For these reasons WTW considers that the transition analysis for FM services provides no robust evidence that FM schemes classed as engaged by the CMA pay less than those FM schemes that are not classed as engaged by the CMA.

4.14 For the reasons set out above, WTW considers that the CMA's conclusions that engaged schemes pay less than those that are not engaged are based on material errors of fact and assessment.

The CMA's claim that less engaged schemes receive lower fee asset manager discounts negotiated by their investment consultant is not supported by a balanced assessment of the evidence

4.15 The CMA recognises that both IC and FM services can help clients secure discounts on asset management fees, and that this is potentially a very important benefit given that asset management fees are generally much larger than IC fees. However, it also claims that less engaged schemes are less likely than engaged schemes to receive lower discounts from asset managers negotiated by their investment consultant. It suggests that this provides further evidence of detriment resulting from a lack of engagement on the part of scheme trustees.

4.16 A balanced assessment of the evidence that the CMA has considered does not support such a conclusion with regard to detriment. Instead, such an assessment points to the following conclusions.

(a) First, customers are likely to secure lower asset management fees if they follow their IC provider's advice or use FM services.[35]

[35] See paragraphs 10.61 and 10.62 of the PDR.

(b) Second, customers using FM services on average secure materially higher asset management fee discounts than customers using IC services.[36] This is entirely to be expected given that one of the advantages of FM services relative to IC services is that FM providers can use the scale they gain from pooling assets to negotiate better discounts from asset managers than individual clients would be able to secure themselves. This would suggest that – to the extent that there is material detriment arising from a lack of customer engagement – it is most likely to arise from some smaller IC customers failing to appreciate the cost advantages that FM can offer them, and consequently failing to migrate to FM even though they may benefit from doing so.

(c) Third – as the CMA itself recognises – in the case of FM services there is no relationship between the level of customer engagement and the size of the asset management fee discount that the customer secures.[37] This indicates that all customers benefit from the service that FM offers in this regard, irrespective of how engaged they are. This makes perfect sense given that one of the main advantages of FM service is that it allows schemes who struggle to engage because of limited internal resources or capabilities to tap into the expertise and pooled scale of the FM provider, thereby offsetting the disadvantage they would otherwise suffer compared to larger and better resourced schemes.

(d) By contrast, it is unsurprising that "disengaged" schemes on average secure lower discounts than "engaged" schemes if they only use an advisory-only service.[38] This is because:

(i) The schemes that the CMA has classified as "disengaged" are typically smaller in scale and therefore less well placed to secure significant fee discounts from asset managers when negotiating individually. This is illustrated in Table 10 below, which a breakdown of "engaged" and "disengaged" FM clients by size band[39], as specified by the CMA[40].

<u>Table 6: Breakdown of engagement by size band for FM clients (static analysis)</u>

	CMA engagement classification		
Size	Disengaged	Engaged	Total
Small	113	71	184
Medium	45	81	126
Large	8	16	24

(ii) The schemes that the CMA has classified as "disengaged" are also more likely to face constraints in terms of limited bandwidth and capabilities, meaning that they are less likely to consistently follow through on their investment consultant's asset manager product recommendations.

[36] See paragraph 10.62 of the PDR.
[37] See paragraph 10.62 of the PDR.
[38] See paragraph 10.61 of the PDR.
[39] Size bands are classified according to assets under management (AUM). Small clients have AUM less than 10,000,000, medium clients have AUM between 10,000,000 and 100,000,00 and large clients have AUM>100,000,000.
[40] These number are when the data has been cleaned for the FM static analysis.

The CMA's argument that less engaged customers in some cases receive a lower quality of service does not stand up to scrutiny.

4.17 The CMA notes that its analysis of internal documents uncovered evidence that providers monitor engagement and improve or assure their quality of service in response to either client pressure or having identified clients as being "at risk" of switching. On this basis, it concludes that "at least in some cases" less engaged customers receive a lower quality of service.

4.18 We do not agree with the inference that the CMA has drawn from this information. On the contrary, the practices that the CMA has identified are entirely in keeping with the practices one would expect to observe in a well-functioning market where (i) customers are engaged and (ii) providers face strong competitive pressure to provide a high quality of service to all their customers.

4.19 As the CMA has recognised, the IC and FM services that WTW and its competitors offer clients are highly bespoke, with the type of advice, the degree of delegation and the frequency and depth of interaction being tailored to the specific needs of the client. Services are therefore horizontally differentiated, with firms adjusting the way in which they deliver the service to meet each client's particular requirements. This is difficult and may require additional engagement where the two sides have not yet arrived at an optimal way of operating, and it is why firms have processes to monitor customer satisfaction. Such processes allow them to fine-tune the relationship where necessary, in order to deliver the best offering possible to each and every client.

The CMA's finding that investment consultancy firms with above average quality have persistently lower market shares is based on errors of fact and assessment.

4.20 In the Provisional Decision Report, the CMA concludes that "providers with above average quality had persistently lower market shares in investment consultancy". However, we have significant concerns about the robustness of the CMA's analysis of the relationship between overall quality of service and market share, for the following reasons:

(a) The CMA's analysis ignores the varied needs of customers.

(b) The CMA's analysis fails to control for differences in service cost.

(c) The graphical evidence presented in the PDR is misleading.

(d) The statistical tests performed are flawed.

(e) The metric used to proxy quality is unsuitable for the analysis the CMA has undertaken.

4.21 We explain each of these concerns in turn below.

1. The CMA's analysis ignores the varied needs of customers

4.22 The CMA's analysis relies on the presumption that "[w]ithin a well-functioning market, we would expect providers which have a high quality of service (on a reasonably objective and consistent metric) to have high or growing market shares, all else being equal.". We agree with this statement in principle. However, in practice it is extremely difficult to measure quality by a single "reasonably objective and consistent" metric in a highly differentiated market where quality consists of a range of components, with different components mattering more to some customers than to others. In this market, customers with varying preferences will trade off the components of quality and price differently. In such a context, there is no simple, consistent way to aggregate individual customer preferences to arrive at overall quality metric that can be readily compared across firms.

4.23 To make this point concrete it is helpful to set out a stylised example. For illustrative purposes, suppose that:

(a) There are two components of quality in this market (Component 1 and Component 2).

(b) There are two firms – A and B. Firm A specialises in Component 1 and Firm B in Component 2.

(c) Customers choose the firm that offers the best "quality" for the component they care about the most.

4.24 Clearly in such a market, if most customers care more about Component 1 than Component 2, then one would expect the majority of customers to select Firm A ('Type A' firms) and only a minority to select Firm B, other things being equal. In this example, Firm A would therefore have a higher market share than Firm B.

4.25 However, this does not imply that Firm A is somehow a higher quality firm than Firm B. In the example above there is no single "objective and consistent" measure of service quality; rather what counts as better or worse quality varies across customers depending on their preferences. The market shares of A and B therefore reflect their areas of specialisation and the distribution of preferences across customers, rather than the overall "quality" of Firm A and B.

4.26 The CMA's analysis fails to take account of the heterogeneous needs of customers in this way. Instead it uses a single hybrid quality score – based on the Greenwich Quality Index (GQI) – and in doing so imposes the assumption that all customers would benefit to the same degree from a service with features that score more highly on the basis of the precise weightings that the GQI assumes.

2. The CMA's analysis fails to control for differences in service cost

4.27 The CMA's assumption that firms offering a higher quality of service should attract more business in a well-functioning market rests on the caveat of "all else being equal". Customers ultimately care about value for money. If higher quality firms are able to charge higher prices (i.e. these two factors are positively correlated), it does not follow that a simple correlation of quality with market share should necessarily translate into a corresponding relationship between value for money and market share, as customers may favour lower prices over higher quality. Unfortunately, the CMA's analysis does not control adequately for price and other similar factors.

3. The graphical evidence presented in the PDR is potentially misleading

4.28 In the PDR, the CMA states that "for each year from 2010 to 2016, those who provided a higher quality service had persistently lower market shares." However, the graphical evidence used to support this claim is misleading.

4.29 In particular, for Figure 28 of the PDR, the CMA states that "average quality is calculated as firm specific mean relative to the sample mean. Therefore, if a firm has below average quality in any single year but across the sample has above average quality, we treat them as an above average quality firm." The robustness of this analysis relies on the sample mean calculation. The sample mean for quality should be calculated as the mean quality score of all respondents, across the firms. That is:

$$Sample\ mean = \frac{Total\ GQI\ score\ for\ all\ respondents}{Total\ number\ of\ respondents}$$

4.30 However the CMA has calculated the sample mean quality metric is using firms' individual GQI scores, i.e.

$$\textit{Sample mean} = \frac{\text{Total GQI score for all firms}}{\text{Total number of firms}}$$

4.31 In this case, firms with fewer respondents will be overrepresented in the metric, while firms with more respondents will be underrepresented.

4.32 Given that the number of GQI respondents varies significantly across firms, and smaller firms are reported as having higher average score on the basis of this measure, then the sample mean as calculated by the CMA using the approach set out in paragraph 4.30 above, will be upwardly biased. This makes the graphical evidence presented in Figure 28 of the PDR (which splits firms into "*above average quality*" and "*below average quality*" groups relative to this sample mean) misleading.

4. The statistical tests that the CMA has performed are flawed

4.33 The statistical tests performed by the CMA, and reported in Appendix 6 of the PDR, suffer from a number of weaknesses. These include:

(a) **Limited data.** The regressions are based on a sample of just 85 observations spread across 7 years, and the number of observations differs across years.

(b) **Little variation in year-on-year market shares.** Regressions (5) to (7) "*assess whether higher quality is associated with gains in market shares*". WTW considers the results of these regressions unsurprising, and unrelated to quality of the firm for the following reasons:

(i) Contracts in this market are on average 3 to 5 years long, while quality scores are measured on a yearly basis[41]. The frequency with which existing mandates are re-tendered is limited by the fact that it takes time for pension trustees to form a clear view about the quality of the service that their existing investment consultant is providing. The long-term nature of these strategic decisions means that it can take some years for clients to form a clear view about the success of their chosen strategy, the effectiveness of the system for monitoring progress, and therefore the quality of advice and ongoing support that their investment advisor is providing.

(ii) Given this, we would expect to see very little year-on-year change in market shares[42], even if the relative quality of firms (on any measure) changes between two consecutive years. In this particular market, regressions which focus on the year-on-year change in market shares are therefore unlikely to be strongly related to quality. This does not preclude the possibility that customers switch providers over the longer term, but this would not be picked up by these regressions.

(c) **Significantly larger year-on-year change in GQI scores for firms with lower market shares.** There is significantly more year-on-year variation in the GQI scores of firms with below-average market shares, than there is with firms with above average market shares. This is shown below in Figure 1, a box and whisker plot that shows for each year, for firms with above- and below-average market shares, the distribution of the annual change in firms' GQI scores.

[41] See WTW's response to the MIR Q101.

[42] If contracts are 3 years long, and uniformly distributed, just 33% of clients are able to switch in any given year. This drops to 20% if we assume all contracts are 5 years long. That is, the number of clients that have the ability to switch in any given year is extremely low in this market.

(i) Figure 1 should be interpreted as follows:

(A) the boxes on each of these charts show the typical range of the annual change in GQI scores for firms in that year with above- or below-average market shares respectively (formally it shows the interquartile range of annual change in GQI scores);

(B) the line within the box on each chart shows the median change in GQI scores area for firms in that year with above- or below-average market shares respectively;

(C) the "whiskers" show the extremes of "normal" distribution of the annual change in GQI scores for firms in that year with above- or below-average market shares respectively (formally, these are the Tukey adjacent values). Given the number of firms in the sample in some cases the "whiskers" may coincide with the edge of the "box"; and

(D) the dots located beyond the whiskers (if they exist) show whether there are any firms in that year that have experienced unusually large or small changes in their GQI score relative to other firms in that year with above- or below-average market shares respectively.

(ii) Figure 1 clearly shows that across all of the years considered in the CMA's analysis there is substantially more year-on-year variation in the GQI scores of firms with below average market shares than those with above average market shares. As pension schemes typically enter into a relationship with a given investment consulting firm that lasts for a number of years (for the reasons explained above), customers may rationally choose larger firms who have far more stable GQI ratings, than smaller firms who GQI score varies substantially year-on-year.

(d) **Differing number of responses across firms.** The GQI is based on a survey of IC clients, and each observation in the GQI is associated with a specific IC firm. However, the number of respondents is likely to vary significantly across firms.[43] The variation in the sample size underlying each firm's GQI score has significant implications for both the extent to which the CMA has accurately measured the relationship between quality and market share, and the interpretation of any correlation the CMA has found.

(i) For example, suppose Firm A has 5 respondents while Firm B has 50 respondents, and the GQI scores are 600 and 500 respectively. If regressions are conducted at the firm level, Firm A will be judged as a higher quality firm than Firm B. However, this ignores the possibility that engaged customers may rationally opt to use Firm B on the basis of its good overall track record over a substantial customer base compared to Firm A, which has a marginally higher average score, but based on a much more limited track record.

(e) **The CMA's regressions are underspecified and so likely to suffer from bias.** With only one control (quality, proxied by a firm's GQI score) in the CMA's "base case" regression, there is a high possibility that a number of other important factors have been excluded from the specification. To the extent that these factors are correlated with both a firm's GQI score

[43] WTW notes that one possible reason for the large year-on-year changes observed for firms with below average market shares could be that the number of respondents for these firms within the GQI survey is low, and as such the GQI score for these firms is measured with a sizeable margin of error.

and its market share, their exclusion from the CMA's analysis would lead to a biased estimate of the relationship between markets shares and a firm's GQI score.

(i) This is highlighted by the regressions' low explanatory power, with the base case returning a R-squared of 13%. That is, the model explains just 13% of the variation observed in market shares. This low R-squared clearly indicates that there is a wide range of determinants of a firm's market share other than its GQI score. To the extent that these omitted factors are also correlated with a firm's GQI score, their exclusion would lead to a biased estimate of the relationship between market shares and quality (as proxied by GQI scores).

(ii) Regression (5) demonstrates this risk: adding controls firm fixed effects to the base case regression removes the CMA's finding that firms with lower quality (as proxied by GQI scores) have higher market shares.

(iii) There are likely to be other factors which, if controlled for, would have a similar impact on the results of the CMA's analysis. In particular, as noted above, price has not been included in any of the regression models (1) to (7)[44]. In practice clients will trade off the quality of a given service (in terms of its ability to meet their specific mix of needs) against the price of using that service when selecting a supplier. Price may also influence market shares independently, since – for example – larger FM firms may be able to negotiate more significant fee discounts from asset managers, which they are able to pass on to clients (i.e. price and market shares are negatively correlated). If this is the case, then omitting price from the regression equations would create a negative bias on the quality coefficients. This calls into question whether the coefficients in regressions (1) to (3) are in fact accurate or a result of omitted variable bias.

5. The metric used to proxy quality is unsuitable

4.34 Even setting aside the concerns set out above, WTW does not consider the GQI quality metric to be a suitable explanatory variable for the regression presented in Appendix 6 of the PDR. In summary:

(a) The GQI metric is made of a number of components, seeking to capture different elements of the service that clients might value – including:

(i) **Investment counselling** (Communication of Philosophy and Investment Beliefs; Understanding of Client Goals and Objectives; Advice on Long-Term Asset Allocation and Liability Issues; Provision of Proactive Advice & Innovative Ideas; Capability of Consultant Assigned to Your Fund; Credibility with Investment Committee or Trustees);

(ii) **Client service** (Usefulness of Personal Meetings; Usefulness of Written Investment Performance Reviews; Sufficient Professional Resources; Responsiveness and Prompt Follow-up on Requests; Timeliness of Communications);

[44] Some price elements are captured in GQI questions (i.e. "Reasonable Fees (Relative to Value Delivered)" and "Keeping to Budget Estimates for Work Undertaken"), these are aggregated along with a number of other 'quality' metrics. This aggregation will dilute the relative importance of the price elements, and may mean that the true impact of price is not fully captured in the model. Furthermore, respondents might trade off price and quality differently, however, this is no captured by the GQI which assumes all respondents place an equal weight on the relative importance of price in determining quality.

(iii) **Manager Selection & Commercial Arrangement** (Knowledge of Investment Managers; Satisfaction with Managers Recommended; Reasonable Fees (Relative to Value Delivered); Keeping to Budget Estimates for Work Undertaken).

(b) The overall metric is constructed by using the Rasch model to estimate the relationship between each of the components listed above and the unobserved quality of the IC firm, based upon the entire set of responses for all investment consultants. Scores are then aggregated, and re-computed to the GQI scale of 1 to 1,000[45].

(c) While the Greenwich Associates survey can be a helpful tool for comparing how firms score within each component, the overall quality score is not a robust measure of quality and should not be relied upon for statistical testing. This is because:

(i) Item Response Theory (IRT) models are typically used to estimate a common unobserved ability (also called the "latent trait") such as mathematical ability, via a number of questions.

(ii) Greenwich Associates are using an IRT model to estimate the relationship between the probability of agreeing with a statement regarding the service offered by an investment consultant and the unobserved quality of that firm.

(iii) However, unlike mathematical ability, quality cannot be thought as a latent trait, as the components that make up quality might be perceived differently by different individuals. Therefore estimating the item parameters across the entire set of responses for all investment consultants incorrectly imposes the assumption that all respondents give the same relative weights to the different components.

(d) Fitting the IRT model on WTW's 2015, 2016 and 2017 Greenwich Associates survey data shows that the weights placed on questions differ significantly across years. This either indicates that WTW are making large year-on-year changes to various part of their service, or that customers preferences are changing materially between years. However, this instability raises concerns about the metric's suitability for the regression analysis that has been undertaken.

(e) As a result, while GQI can be a helpful metric for other purposes,[46] it is only a partial measure of quality, and is unsuitable for this regression analysis.

6. The worked examples that the CMA has presented to illustrate the detriment associated with excessive prices or impaired service quality do not constitute evidence of detriment

4.35 In its conclusions on detriment, the CMA has presented "illustrations" to show that modest increases in prices or reductions in service quality could be highly detrimental for customers. It observes that:

(a) even if fees were on average only 10% above those in a well-functioning market, this would still lead to IC customers paying around £250 million more and FM customers paying around £200 million more over ten years; and

(b) this impact on prices represents a lower bound for the total detriment, since any accompanying detriment from impairment in quality of service is likely to be much greater in

[45] Source: Greenwich Associates WTW's Individual Account Profile.

[46] As illustrated in WTW's response to the MIR Q30, WTW normally uses GQI as one of the input used by the management to assess quality standards.

magnitude than the detriment from prices paid, given the substantial amount of capital – £1.6 trillion – invested in pension scheme assets, the material impact that investment decisions can have on the value of these scheme assets and the fact that any negative impact on scheme outcomes will compound over time.

We fully agree that – given the widespread use of investment consultants and the substantial volumes of capital invested in UK pension scheme assets – even a small improvement or small deterioration in the performance of these schemes can be highly beneficial or detrimental for scheme sponsors. However the illustrations that the CMA has set out are entirely hypothetical and in themselves provide no evidence that such detriment exists unless coupled with evidence to support the proposition that the AECs that the CMA has identified are leading to materially poorer scheme performance. For the reasons we set out above, the CMA has found no evidence to support this.

II. The CMA's reasoning that the level of detriment in FM services is likely to be greater than that for IC services is flawed

4.36 The CMA cites two AEC concerns that it suggests are specific to FM services –

(a) that barriers to switching are higher for FM than for IC; and

(b) that IC-FM providers may have the ability and incentive to prevent customers from shopping around and considering third party providers when migrating to FM.

4.37 It argues that, on the basis of these additional FM-specific concerns, the detriment is "even greater" in FM than in IC.[47]

4.38 We do not agree with this inference because – for the reasons explained in Section 3 above – neither of the two FM-specific AECs listed above stands up to scrutiny.

4.39 To summarise:

(a) The CMA's first argument – that there are higher barriers to switching FM provider – cannot be cited as a source of detriment for the following reasons:

(i) The high switching costs that the CMA has identified are intrinsic to the FM service. Given this, the only "remedy" would be to prevent customers from switching to FM in the first place.

(ii) However, this would be wholly disproportionate since – as the CMA itself acknowledges – FM delivers significant benefits for many customers that cannot be replicated by an advisory-only service:

- The CMA itself acknowledges in the PDR that one of the most significant challenges facing many trustees is a lack of bandwidth and expertise[48] – and FM is a solution that directly addresses this challenge.

- The CMA itself acknowledges that FM customers in particular have benefitted from the asset allocation and hedging decisions of FM providers.[49]

[47] Paragraph 11.14, PDR.
[48] See "Main findings" box at the beginning of section 6 of the PDR.
[49] See paragraphs 10.75 and 10.76 of the PDR.

- The CMA itself acknowledges that FM providers can secure lower asset management fees than would be available to small trustees using IC only services.[50]

- The performance of FM providers is easier to monitor, meaning that customers can hold FM providers to account more easily than they can IC providers.

(iii) It is in any event too early to tell whether these switching costs will constitute a high barrier to switching FM provider, as the CMA also acknowledges.[51]

(b) The CMA's second argument – that "the behaviour of IC/FM firms" can make it less likely that customers will shop around for their FM provider – is similarly not supported by the evidence.

(i) The CMA points to the customer survey to support its view that FM providers discourage customers from shopping around, but:

- The survey positioned its questions on this in a highly leading way. The way in which questions are framed in a survey can materially affect responses. In the CMA's trustee survey, respondents were asked whether a series of factors were a problem for the market as a whole, including the hypothesis: "Investment consultants using their position to steer clients into their own fiduciary management services". However, the question is framed in a way that presumes a problem exists – a version of the question which started from the premise "Investment consultants provide impartial advice on their own and others' fiduciary management services", or one that asked respondents to mention any problems in the market, unprompted, is likely to have resulted in a lower proportion identifying an issue in this respect.

- A balanced assessment of the survey responses does not support the CMA's views in any event. Despite the leading nature of the question, only a minority (30%) of respondents considered that there is an issue and more should be done about it.

(ii) To the extent that IC-FM firms have an incentive to discourage customers from shopping around for their FM provider, this applies equally to IC providers – it is not clear why the CMA has singled out FM in this regard. In fact this is more likely to be a source of detriment within IC services than FM services since:

- Customers must actively decide to migrate from IC to FM (and indeed must sign a new contract) – this change of service can act as a trigger for thinking about changing one's service provider.

- This is borne out by the fact that competitive tendering has been common practice upon take up of FM services for the first time.

- By contrast, there is no equivalent natural "trigger" for an IC customer to consider changing its IC provider.

[50] See paragraph 10.62 of the PDR.
[51] See paragraph 9.58 of the PDR.

(c) The CMA has unjustifiably downplayed concerns expressed by market participants about the behaviour of advisory-only firms in hindering the take-up of FM services. This is surprising given that:

(i) The CMA acknowledges that a number of industry stakeholders have expressed concern about this issue – and even reports that it was "one of the most widely raised issues."[52]

(ii) This is likely to be a greater source of detriment than any detriment arising from IC-FM firms not encouraging their customers to shop around for their FM provider since:

- advisory-only providers have a clear incentive to prevent their customers from migrating to FM even if it would be highly beneficial for them to do so;
- for the reasons explained above, this could be highly detrimental for many customers;
- by contrast, as the CMA itself acknowledges, there is no reason to think that IC-FM providers would have an incentive to push their IC customers to take up FM when it would not be in their interests to do so (given that the higher revenues associated with FM are offset by commensurately higher costs and operational risks and – furthermore – encouraging a firm to consider FM acts a natural trigger to consider switching one's provider, introducing additional risk for the incumbent IC-FM firm).[53]

(iii) The CMA's decision to focus on the issue of IC/FM firms selling clients their FM service, but not the countervailing issue of advisory-only services not recommending FM is wholly inconsistent and unjustified:

- The CMA appears to rely entirely on the fact that the latter issue was not raised by survey respondents to justify its decision not to pursue it, but this is because the survey didn't ask about this issue.
- This contrasts markedly with the leading questions that the survey asked about IC/FM firms recommending their own FM services.

III. A balanced assessment of the other market outcomes that the CMA has considered demonstrates that providers create significant value for customers

4.40 In section 10 of the PDR, the CMA assesses the evidence on a number of other "market outcomes" focusing on indicators that it has cited in previous market investigations to support findings on customer detriment in other industries. However, with the exception of its assessment of gains from engagement – which we have addressed above – the CMA acknowledges that it has uncovered no clear evidence of customer detriment. On the contrary, a balanced assessment of the evidence that the CMA has considered demonstrates that providers create significant value for customers in a number of ways.

The CMA itself acknowledges that there is an array of evidence indicating that IC and FM firms create value for clients – and that they do so in a number of ways

[52] See paragraphs 8.116 and 8.118 of the PDR.
[53] See paragraph 8.118 of the PDR

4.41 The CMA recognises that "some outcomes indicate that aspects of investment consultancy and fiduciary management markets function well".[54] In support of this conclusion, it cites:

(a) evidence from its customer survey suggesting high overall levels of trustee satisfaction with the service that IC and FM firms are providing;[55]

(b) evidence that IC and FM providers tailor their asset allocation advice to the specific needs and circumstances of their customers;[56]

(c) evidence IC and FM providers have added value for customers in recent years through the hedging of interest rate risks;[57] and

(d) evidence that FM providers in particular have been able to secure significant fee discounts from asset managers in recent years on behalf of their clients.[58]

<u>There is evidence that WTW's asset management product recommendations systematically outperform their benchmarks net of fees</u>

4.42 With regard to the value of IC and FM firms' asset management product recommendations, the CMA concludes that the evidence it has considered "hasn't clearly demonstrated one way or the other whether providers collectively add value through this service", it now acknowledges that some individual firms may do so.

4.43 WTW strongly believes that its recommended asset management products systematically outperform their benchmarks on average, both gross and net of asset manager fees. We have previously submitted a detailed body of statistical evidence to the CMA to support this assessment.

4.44 For the reasons we explained in our response to the CMA's working paper, we continue to have concerns about the methodological approach that the CMA has used to assess the value of investment consultants' recommendations of actively managed products, and consider it unsurprising that the CMA has not been able to draw clear conclusions from its analysis. In summary:

(a) There are significant issues around representativeness of the data used within the CMA's analysis, with the asset class mix of the data sample being biased towards equities and fixed income products, which have the lowest net active returns. These issues are likely to have led to the CMA's analysis understating the value of manager recommendations, as the CMA itself acknowledges.[59]

(b) The majority of CMA's analysis of net returns is not on a like-for-like basis as it does not consider the fees associated with passive products. The CMA contends in paragraph 96 of Appendix A2 of the PDR that it is not appropriate to consider passive fees because the focus of its analysis was "*to test whether investment consultants are able to identify products that outperform their benchmarks on average, rather than compare the average gains from active management with active gains from passive management*". However, this is wholly inconsistent with the CMA's stated justification for focusing on net returns rather than gross returns for the purposes of its analysis, namely that "[…] *these are more representative of the*

[54] "*Our main findings*", Chapter 10, PDR.
[55] See paragraphs 2.5 to 2.9 of WTW's Response to the Evidence to Date (submitted on 13/06/18 for a summary of the key survey evidence.
[56] See paragraphs 10.71 to 10.73 of the PDR.
[57] See paragraphs 10.75 and 10.76 of the PDR.
[58] See paragraph 10.62 of the PDR.
[59] Paragraph 157a, Appendix A2, PDR.

actual gains accruing to investors" (paragraph 152, Appendix A2, PDR). We further note that the CMA has carried out a "sensitivity" test of its analysis that assesses the impact of incorporating passive fees, and that this generates statistically significant evidence that recommended products outperform their benchmarks net of fees for a number of specifications.[60]

4.45 The fact that the CMA has found evidence that some individual investment consultants may add value through manager recommendations despite the limitations of its methodological approach is, in our view, worthy of note.[61]

4.46 In our response to the CMA's asset management product working paper, we submitted further evidence that our own recommended products systematically outperform their benchmarks net of fees on the basis of alternative non-parametric methodological approach based around randomisation inference. As we explained in our response to the working paper, we considered that this approach is likely to be more reliable and informative than the CMA's parametric regression-based approach for two reasons.[62]

(a) First, randomisation inference analysis requires fewer highly technical and ultimately untestable assumptions to hold than is the case for CMA's analysis.

(b) Second, the randomisation inference analysis is a direct and highly intuitive test of the hypothesis that the CMA is looking to explore (i.e. do investment consultants' recommendations outperform their respective benchmarks net of fees?)

4.47 In its PDR assessment, the CMA "acknowledges the appeal" of the approach but argues 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 asset management products with a particular expected return and/or risk profile.

(c) Randomisation inference systematically raises the p-values of otherwise obtained statistically significant results which depend upon outliers – meaning that the CMA's preferred methodology is more likely to yield statistically significant results than a randomisation methodology.[63]

4.48 We do not agree that these are valid reasons to ignore the randomisation approach:

(a) The fact that randomisation inference is typically used in experimental set ups does not preclude its use elsewhere, particularly in instances such where a parametric regression-based approach runs into difficulties of the kind that we explained in our response to the CMA's asset management product recommendations working paper.

(b) The randomisation inference approach we have proposed allows for a direct test of whether the observed degree of out-performance is likely to have arisen purely by chance – the direct question the CMA's analysis is attempting to answer.

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[60] Paragraph 128, Appendix A2, PDR.
[61] Paragraph 155, Appendix A2, PDR.
[62] See paragraph 2.32 of WTW's response to the working paper on Asset manager product recommendations.
[63] Paragraphs 75-76, Appendix A2, PDR.

(c) To the extent that randomisation inference raises the p-values in the way that the CMA suggests, it is a more rigorous and demanding test than regression analysis – as well as generating results that are more intuitive, easier to understand and less assumption heavy.

4.49 We therefore urge the CMA to reconsider the randomisation evidence we have presented in our response to its asset management product working paper.

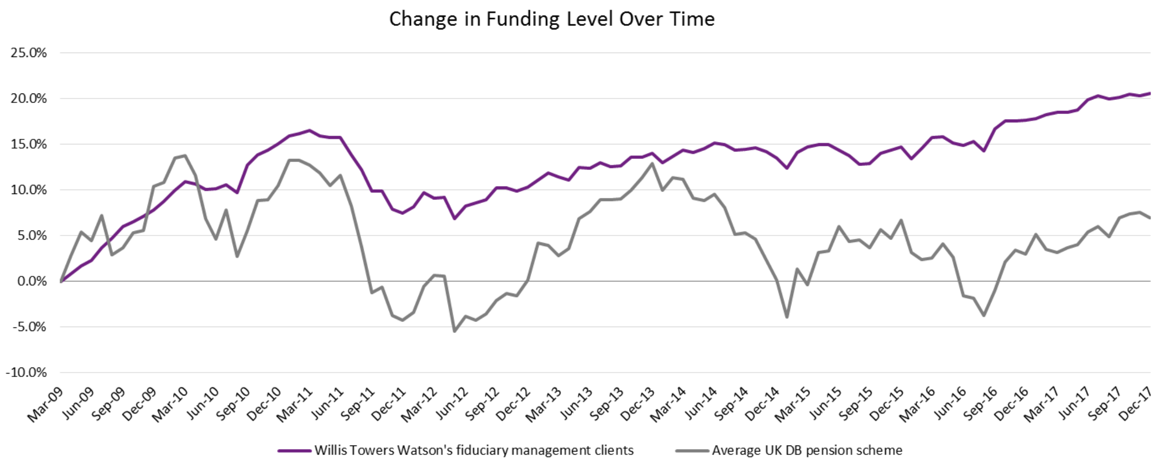
4.50 In WTW's view, the best way to measure the overarching value that WTW, and the IC-FM industry as a whole, can add is to assess the actual performance of fiduciary management clients against their overarching objectives of reducing volatility in funding ratios. WTW has previously submitted detailed evidence on this that the CMA briefly references in the PDR. For the reasons we explain below, the doubts that the CMA has expressed about the strength of this evidence do not stand up to scrutiny. We therefore strongly urge the CMA to reconsider this evidence.

An assessment of the funding ratio performance of WTW's FM customers provides powerful evidence of the overall value of WTW's services

4.51 As we have explained in previous submissions[64], WTW considers that the best way to understand the value that it – and the investment consulting industry as a whole – can add, is to assess the actual performance of fiduciary management clients against their overarching objective – to reach full funding over time in a predictable and low volatility manner. The fiduciary management service is the full expression of the investment consulting firm's capabilities and skill sets, covering all aspects of the service, and therefore monitoring the overall performance of clients provides a good measure of the value added by investment consultants.

4.52 The performance of WTW's FM clients is set out in the chart below. This compares the average funding ratio of WTW's FM clients (shown by the purple line) against the development in the funding ratio of the average UK DB pension scheme (shown by the grey line).

Figure 1 Performance of WTW's fiduciary management clients against benchmark, 2009-17



4.53 We explained this analysis in some depth in our standalone *Submission on Performance Measurement Issues paper*, which we shared with the CMA in January 2018, and so we do not repeat the analysis in full here. However, to summarise, the chart clearly demonstrates strong performance for WTW's fiduciary management clients in two metrics.

[64] WTW *Submission on Performance Measurement Issues*, 16 January 2018, Section 2.

(a) First, it shows that the funding ratio of WTW's fiduciary clients has improved to a greater degree than the average scheme.

(b) Second there is much less volatility in the funding ratio over time for WTW's fiduciary management clients. WTW considers that this reflects its efforts to better identify the sources of potential risk and to put in place actions (such as hedging and diversification) to reduce and mitigate these risks. In the occasions where such risks materialise, WTW's clients' funding ratios should therefore be less affected.[65]

4.54 Furthermore, statistical analysis confirms both of these observed features of the relative performance of WTW's FM clients. As demonstrated in our *Submission on Performance Measurement Issues*:

(a) the funding ratio performance of WTW's FM clients (as measured by monthly changes) are statistically significantly less volatile than the average UK pension scheme; and

(b) the monthly change in funding ratio is statistically significantly greater than zero for WTW's fiduciary management clients, but is not different from zero for the average UK pension scheme.

The fact that the CMA has failed to engage with this evidence on the overarching value of FM services constitutes a material oversight

4.55 In light of the detailed quantitative evidence that we have submitted on the overarching value of FM services, it is highly concerning that the CMA hardly considers this evidence in its PDR. In fact, the only reference that the CMA appears to make at all to this body of evidence is in paragraphs 10.35-10.36 of the PDR, where it notes that WTW and others "submitted statistics and analysis" regarding the historical performance of their FM clients. It then appears to dismiss this evidence on the basis that "it is not clear that the comparators selected by the parties approximate the returns schemes would have achieved, if they were not using these services." The CMA does not elaborate on this or explain what its concerns are with regard to using the funding ratio performance of the average UK DB scheme as a benchmark against which to assess the funding ratio performance of WTW's FM clients[66].

4.56 We are concerned that in failing to engage with this evidence on the substantial value that FM services create for clients, the CMA will not be able to reach informed conclusions about the proportionality of the remedies it is considering to address the AECs it has identified. This is particularly important because – for the reasons we explain in Section 5 – a number of the potential remedies that the CMA is considering risk inadvertently creating higher barriers to switching to FM.

4.57 For these reasons we urge the CMA to consider and engage with the evidence on the overarching value of FM services in our previous submissions on the topic.

5. Remedies

5.1 WTW is broadly supportive of the Remedies proposed by the CMA and believes that – if designed and implemented correctly – they have the potential to increase transparency and consistency within

[65] This is borne out (for instance) in the relative movements of the funding ratio from late-2011 to 2013. Whereas the funding ratio of the average UK scheme dropped by almost 20 percentage points in this period, WTW's clients' funding ratios fell by significantly less. Moreover, later shocks in 2014 and during 2016 saw no material impact on WTW's clients' funding ratio, in contrast to substantial decreases for the average UK pension scheme. WTW considers that this difference in performance in terms of risk management is profoundly important to the future of pension schemes.
[66] And we note that, to the extent that it is an issue that the benchmark used does not accurately reflect the true counterfactual, this would apply even more strongly to the case of the asset manager recommendations analysis carried out by the CMA.

the industry and encourage engagement from trustee boards. However, the effectiveness and proportionality of these Remedies critically relies on the detail of their design and the implementation approach adopted. Furthermore, for the reasons we explain below, some of the Remedies that the CMA has outlined could give rise to unintended consequences that would be actively detrimental for pension schemes unless due care is taken in their design and implementation.

5.2 We have set out our detailed comments on each of the Remedy proposals in turn below. However, it is also important to consider the combined impact of this package of Remedies. In this regard we note that a number of the Remedies that the CMA has proposed will apply specifically to fiduciary management services or create costs and requirements that fall disproportionately on trustees who opt to use such services. We are concerned that the cumulative impact of these measures will be to deter further pension schemes from taking up these services - and hence constitute a barrier to switching. This matters because:

(a) Fiduciary management is a governance solution that can alleviate the resource and expertise constraints on trustee boards. It also provides clearer accountability on outcomes. As we have summarised above and explained in detail in previous submissions, to date, fiduciary management has been very successful for the trustee boards that have adopted it. The CMA has itself recognised a number of these benefits in the PDR.

(b) In our experience, the take-up of such services has been relatively slow (considering the benefits it can potentially confer), especially amongst smaller and less well-resourced pension schemes who would be particularly well-placed to benefit from the service. In part, take-up may be slow due to the conflict faced by IC-only providers, which have an incentive to discourage their clients from considering and switching to FM.

5.3 As we explain below, the risk that the CMA's proposed measures could further unduly deter the take-up of fiduciary management services is most acute in relation to Remedies 1 and 2. However, Remedies 3 - 6 could exacerbate this problem if they are not implemented with due care and attention to the risks that we describe below.

5.4 To address – or at least partially offset – this concern, the CMA should consider whether there is an additional remedy that could be implemented to encourage trustee boards to assess (a) the governance of their scheme and (b) whether there are sufficient resources and expertise in place to deal with the number of decisions that need to take place on a day to day basis. This additional remedy could be as simple as introducing some additional disclosure requirements for trustees on a triennial basis to the Pensions Regulator confirming that the trustees have considered its governance arrangements. This remedy could also be extended to ensure that trustees have been through a process of assessing accountability of outcomes and defined these appropriately. This would at least provide a prompt for trustees to consider the relative merits of the advisory and fiduciary management service models that are available to them, and to weigh the short-term costs and barriers that they would face in migrating to a fiduciary management model against the potential long term benefits.

5.5 By way of a further overarching comment, the CMA should also clarify the definition of "fiduciary management" that it is using for the purposes of its Remedy package. For the avoidance of doubt, the CMA should confirm that it does not intend the Remedies to cover "delegated advisory" or "implemented consulting" models. Under these models clients that ask for directive advice (rather than a range of suitable options to consider) which typically covers the majority of assets. However, an important difference between the fiduciary service and implemented consulting is that the client ultimately makes the decision to implement a specific recommendation and the client organises operational aspects relating to new investments (albeit often with WTW providing some assistance). In these respects, this is fundamentally an advisory model and indeed these relationships use advisory contracts. Including delegated advisory arrangements within the remit the Remedies that are specific to fiduciary management (such as compulsory tendering) would introduce a disproportionate level of complexity since – in contrast with fiduciary management – there is no contractual distinction between a traditional advisory service and a delegated advisory service.

5.6 To ensure that there is complete clarity of what is considered a fiduciary management arrangement, we would therefore encourage the CMA to define this as those circumstances in which a client has delegated its investment decision making powers along with the execution of those decisions. For clarity, we would not expect fiduciary management services to include any execution only services that are carried out for clients.

Proposed additional remedy - requirement for trustees to consider scheme governance

5.7 We would like to discuss with the CMA a potential additional remedy to encourage trustee boards to assess the governance of their scheme and whether there are sufficient resources and expertise in place to deal with the number of investment decisions that need to take place on a day to day basis. A mandatory competitive tendering regime in isolation may discourage clients from considering fiduciary management as a solution.

5.8 As set out at paragraph 5.4 above, this additional remedy could involve introducing some additional disclosure requirements for trustees on a triennial basis to the Pensions Regulator confirming that the trustees have considered its governance arrangements. We propose that this would be on a "comply or explain" basis: i.e. the trustees would be required to explain how they considered appropriate governance arrangements for the scheme, and justify any decision ultimately taken (whether to maintain or change governance arrangements).

5.9 As the CMA is aware, scheme governance is of crucial importance to trustees and (in particular) to members. We think that it would be very beneficial for trustees to have an explicit obligation to seriously consider scheme governance. We do not consider that this would impose a material additional burden on trustees or on schemes. Such a remedy could also, in conjunction with the Pensions Regulator, be combined with the provision of appropriate training/guidance materials to trustees to ensure that they have sufficient knowledge and expertise to consider the appropriate governance arrangements for their particular scheme.

5.10 WTW would be happy to discuss this proposed additional remedy in further detail with the CMA if helpful.

5.11 In addition to these overarching comments, we have a number of detailed comments and recommendations on each of the specific Remedies set out in the PDR.

Remedy 1 – Mandatory competitive tendering on first adoption of fiduciary management

5.12 Overall, WTW is broadly supportive of Remedy 1, but careful consideration must be given to its scope, as well as the practicalities of how mandating competitive tendering will work. Failure to do this could result in a disproportionate and ineffective requirement on pension schemes that reduces, rather than increases, trustee engagement.

5.13 In this regard, we agree that trustees should actively consider their choice of service provider when migrating to fiduciary management for the first time. However, it is critical that any remedy designed to promote this recognises the different circumstances within which different trustees operate and the different levels of resource constraint they face. The CMA has itself recognised that there is substantial variation in the bandwidth and capabilities of trustees to monitor and assess their investment advisors. As a result of this, the scope and complexity of a tendering process that is appropriate for one pension scheme may be inappropriate – and indeed unachievable – for another, less well-resourced scheme.

5.14 In particular, care needs to be given to the following features when designing the Remedy:

(a) the scope of services that will be covered by the mandatory tendering requirement; and

(b) the steps that pension scheme trustees will need to take to comply with the Remedy.

5.15 For the reasons we explain below, failing to take account of these issues could result in a Remedy that is disproportionate in the sense that it would impose an unnecessarily high cost burden on less well-resourced pension schemes. This in turn would have the unintended consequence of creating a significant barrier to the take-up of fiduciary management. Furthermore, any such barrier would be highest for smaller pension schemes that would, in many cases, stand to gain most from the services that the CMA has recognised that fiduciary management can offer – including greater bandwidth to focus on strategic decisions facing the scheme by delegating day-to-day investment decisions and operations and enhanced bargaining power when negotiating fees with asset managers.

Competitive tendering should be mandated only for whole fund rather than partial fiduciary mandates and only at the first point of switching

5.16 The CMA has focused much of its investigation on IC-FM providers where the FM has the ability to offer pension schemes a whole fund fiduciary management service. Given that this is the scenario where investment decisions on the whole portfolio are delegated to the provider, mandating a competitive tender at the point of choosing a whole fund fiduciary management service would be the most effective way to address the engagement concerns that the CMA has identified.

5.17 Even setting aside the specific AECs that the CMA has identified, it would still make sense to mandate competitive tendering only for whole fund rather than partial fiduciary mandates and only at the first point of switching. This is because:

(a) The most important decision point for a pension scheme in terms of the nature and cost of the service it procures arises when it makes the decision to migrate from an advisory only or partial FM service to a whole fund FM service. It is therefore more effective to mandate a competitive tender at this point in the process rather than when the scheme first moves to a partial fiduciary mandate, when only a limited – and in some cases very limited – portfolio is being delegated.

(b) By contrast, mandating competitive tendering at the point that a pension scheme moves to a partial mandate would risk imposing a disproportionate burden on pension schemes and – in the process – creating a more significant barrier to the take up of fiduciary management services. This because the cost of running the tender process would be largely the same as the cost of running a tender for a full fiduciary mandate, but the potential benefit of the service would be proportionally lower given its more limited scope of the service. This would be particularly severe for partial fiduciary mandates that only cover a small fraction of the investment decisions that the pension trust must take.

(c) In addition to this, the Remedy in its current format will – without any justification – put IC-FM firms at a material competitive disadvantage if it extends to cover partial fiduciary mandates. This is because the Remedy as currently proposed would not extend to a diverse array of firms and products in the market offering solutions designed to do a similar job to partial fiduciary management – and that are in fact often the most common competitors for WTW's partial fiduciary appointments. These competing products and services include:

(i) **Multi-manager mandates offered by non IC-FM firms** – There is a large number of fund of fund products in the market offered by asset management firms. These should be included in the Remedy and not just those that are offered by IC-FM firms. For example, [✂].

(ii) **Multi-asset products** – many of WTW's products compete with asset management products that cover a wide range of asset classes. For example, [✂].

5.18 Whilst in theory Remedy 1 could be extended to cover all multi-manager mandates and multi-asset products which compete with partial fiduciary mandates, it is important to note that this would significantly extend the scope of Remedy 1 (on eVestment Alliance alone, there are around 3000 products that are either multi-manager products or products that cover a number of asset classes).

5.19 Furthermore, and more importantly, the CMA has not investigated these multi-manager mandates and multi-asset products in any depth, and therefore lacks the evidence base to justify any extension of Remedy 1 to cover these products and services.

5.20 Therefore, a compulsory tendering remedy should be restricted to full fiduciary mandates and not extend to either partial mandates or the array of products that compete with such mandates.

5.21 For the avoidance of doubt, it should be noted that a trustee's choice of provider for a partial fiduciary mandate in no way restricts or limits its subsequent choice of provider for a full mandate. [✂]

5.22 There should be no minimum threshold for full fiduciary appointments assuming the proposed tendering approach is proportionate – unless the remedy is extended to include partial mandates.

5.23 We believe that there should be no minimum threshold for pension schemes undergoing a competitive tender for a full fiduciary mandate as long as the process for competitive tendering is not overly burdensome and does not create disproportionate costs for less well-resourced schemes. As we explain further below, guidance on minimum standards for competitive tendering from the Pensions Regulator should take into account the size of the mandate so that tender exercises are not prohibitively expensive for small schemes.

5.24 This, however, assumes that compulsory tendering will not be extended to partial fiduciary mandates, which we think would be disproportionate for the reasons explained above. If the CMA were to extend the scope of the Remedy to include partial fiduciary mandates, then a *de minimis* threshold should be applied in these instances to take into account the level of influence the fiduciary manager has on the scheme's total assets. In our view, a minimum threshold of at least 20% of assets would be required in such a scenario in order to avoid deterring a substantial number of smaller schemes from considering partial fiduciary solutions.

Appointments for internal schemes should be excluded

5.25 We propose that appointments for the internal pension schemes of IC-FM firms would be excluded from the scope of the mandatory tendering regime for the following reasons:

(a) Compulsory tendering in this context would be disproportionate because it would impose an additional burden on these internal pension schemes without realistically having any impact on outcomes. This is because it would be highly unusual for an IC-FM firm to hire a competitor for IC or FM services. It may also give rise to competition law concerns, as IC-FM firms would be providing explicit information on the workings of their business to their competitors. WTW would not be comfortable with such an arrangement.

(b) Similarly, we would expect internal pension schemes in this context to include master trust schemes where the FM firm fulfils the role of a Funder and/or Scheme Strategist role as defined under the relevant legislation (such as Towers Watson Limited for LifeSight). Imposing such a requirement on the IC-FM appointment would affect the stability of a master trust as a Funder would be unlikely to want to continue to financially support the Master Trust if the FM products provided to it were provided by a competitor. The decision to stop financially supporting the master trust would cause a trigger event under the terms of the trust deed and this would significantly impact the master trust, potentially causing it to wind up.[67]

A closed tendering process will be more effective and proportionate

5.26 The CMA is provisionally proposing an "open" tender process similar to the process used by local government schemes. WTW considers that this would not be proportionate and it would impose unnecessary costs on less well-resourced pension schemes. Generally, the buyers in the industry have a good knowledge of the services they require and the type of provider they prefer. As noted by the CMA, there are currently 17 providers of fiduciary management. It would be disproportionate to require that pension scheme trustees consider all 17 providers. WTW considers that it would be more effective and proportionate for the CMA to mandate a closed tender process with minimum standards along with guidance from the Pensions Regulator as described in our response to Remedy 3. To ensure that pension scheme trustees are able to consider the entire market, the Pensions Regulator could maintain a list of available providers for pension scheme trustees to approach.

Answers to the specific questions raised in section 12:

Should trustees be required to hold a competitive tender process when first choosing fiduciary management?

5.27 Yes, but – for the reasons explained above – only at the point of moving to a full fiduciary mandate and not at the point of moving to a partial fiduciary approach.

Should the tender process be open? In what circumstances would a closed tender process be an effective alternative and how should we define the minimum standard for a tender process?

5.28 As described above, WTW believes that an open tendering regime is unnecessary and disproportionate. We discuss in more detail what type of guidance would be helpful for the Pensions Regulator to consider when defining a minimum standard under our response to Remedy 3. We note that the minimum standards should be appropriate for different sizes of schemes.

Should firms be prohibited from accepting new mandates if no such competitive tender process has taken place?

5.29 No – it should be the responsibility of the pension scheme to identify whether it needs to run a competitive tender (and whether/how it wishes to run such a tender if the service in question sits outside the scope of the CMA's compulsory tendering Remedy). However, as we discuss further below, we would support steps to create more guidance and advice to help trustees meet this responsibility. We would in practice remind the scheme of its responsibilities (as indeed will be mandated anyway under Remedy 2).

Should there be a minimum threshold either for size of schemes or scope or scale of the mandate?

[67] The CMA should be aware of potential inconsistencies in the treatment across Master Trusts and Group Personal Pensions (GPPs). Both Master Trust and GPPs are designed with similar objectives (providing suitable ranges of investment options, engaging members and providing administration) but operate under different regulatory frameworks.

5.30 For the reasons explained above:

(a) We do not believe that a minimum threshold for the size of schemes should apply for movements into a full fiduciary approach, assuming that the competitive tender process is not overly burdensome for small schemes as discussed under the response to Remedy 3.

(b) We do not believe a competitive tender process for partial fiduciary mandates will be effective or proportionate for the reasons explained above. Should the CMA nonetheless extend the scope of the Remedy to include partial fiduciary mandates, we propose a minimum threshold of 20% of scheme assets.

Should trustees be required to hold an additional tender process for any expansion in the scope of fiduciary management?

5.31 As articulated above, WTW believes that competitive tendering should only be compulsory when pension schemes first decide to move to a full fiduciary mandate from either an advisory only mandate or a partial mandate. There is, by definition, no way to expand the scope of the service further beyond this full fiduciary mandate. For the reasons explained above, mandating a competitive tender irrespective of the scope of the fiduciary service would in and of itself create a significant barrier to adopting fiduciary management for less well-resourced schemes, and mandating further tenders for any subsequent expansions in the scope of the service would simply exacerbate this.

5.32 If the CMA were to impose the requirement for a competitive tender process when taking up partial fiduciary service for the first time, then it would be disproportionate to mandate a further competitive tender for any subsequent expansions in the scope of this service (e.g. for moving from a partial to a full fiduciary mandate).

How should trustee compliance be monitored?

5.33 We believe that compliance should be monitored by the Pensions Regulator as the decision (or obligation) to hold a competitive tender for a new fiduciary management appointment should rest entirely on the trustees. In many cases, providers will not be notified on whether the trustee has carried out a competitive tender.

Backdating the Remedy for existing mandates

5.34 The PDR provides that this Remedy will be backdated for existing fiduciary appointments that were not competitively tendered. Generally, WTW would have no material concerns with this assuming:

(a) The requirement applies to full fiduciary mandates only – for the reasons explained above, WTW believes that a mandatory competitive tendering regime for partial fiduciary appointments would be disproportionate and distortionary.

(b) The definition of competitive tendering is proportionate and not-overly prescriptive – it would be disproportionate and unreasonable for trustees that can show they actively considered their choice of service provider when they first migrated to a fiduciary management arrangement to be required to re-run the tender process on the basis of a new set of best practice guidelines or requirements that did not exist at the time (and that indeed have yet to be agreed even now). The CMA should ensure that past tenders are not subject to any forward looking definition of a competitive tender in this regard.

Answers to the specific questions raised in section 12:

Should trustees be required to hold a competitive tender process if they did not previously do so?

5.35 WTW believes that this is appropriate subject to our comments above.

Should the nature of the competitive tender process be the same as for those schemes adopting fiduciary management for the first time (eg should this be an open or closed tender process)?

5.36 Per our comments above:

(a) We believe that it would be ineffective and disproportionate to mandate an open tender process. Trustees should be given the choice of running either an open or closed tender depending on their specific circumstances and needs.

(b) It would be disproportionate and unreasonable for schemes to be made to tender again if they have not met "best practice" guidelines or requirements for competitive tenders that have yet to be agreed. Therefore, competitive tender processes for existing mandates should be less prescriptive – provided that trustees can demonstrate that they actively considered their choice of service provider at the point at which they first migrated to a full fiduciary mandate this should be deemed as sufficient.

What should be the qualifying criteria of a previous competitive tender process, such that trustees are not required to hold an additional tender process?

5.37 Our view is that a scheme should not be required to hold an additional tender process as long as it can demonstrate that it actively considered its choice of provider at the time that it first migrated to a full fiduciary management services. Either of the following situations would qualify in this regard:

(a) Any open or closed tender process in which at least two firms were invited to submit a proposal for the fiduciary management service would be suitable.

(b) Any process where a TPE was employed to assess the FM provider regardless of whether there was actually a competitive process. The intermediary would have ensured reasonable quality and price as they have visibility over a number of FM providers.

What should the maximum permissible tenure without holding a competitive tender process be?

5.38 We would propose that 7 years in total would be a sensible approach, where existing mandates are tendered over 5 years with a 2 year grace period. As currently proposed in the PDR, the timeframes look ambitious.

What should the grace period for schemes which have already reached the maximum permissible tenure be?

5.39 WTW is satisfied with the timeframe suggested in the PDR.

<u>*Remedy 2 – Mandatory warning that alerts trustees to the nature of the information being provided*</u>

5.40 WTW is generally supportive of Remedy 2 and believes that it is important that firms are transparent with regard to when they are advising clients and when they are selling additional services. That said, there are some specific considerations that we would like the CMA to take into account when setting the scope and requirements of this Remedy.

(a) **Choice of language** – currently, as drafted by the CMA, the framing of the disclosure is unnecessarily negative. The use of the word "WARNING" and presentation in a red box is likely to be associated by trustees with a high level of risk and may discourage them from giving due consideration to the benefits of FM. Any deterrence effect that the warning has on trustees openly considering switching to FM would introduce a high cost to the Remedy since, as recognised by the CMA, FM offers significant benefits for some schemes in terms of improved investment performance. In short, it would be a disproportionate barrier to switching. It would be more proportionate to make trustees aware of the distinction between advice and marketing but to avoid any negative associations with the FM service as a whole, which is unrelated to the AEC the CMA is addressing. A way to frame the disclosure neutrally would be to introduce it with the words “PLEASE NOTE”, not “WARNING”, and replicate the presentation style (fonts and colour scheme) of other disclosures made by the firm.

(b) **Placement of the warning** – If a warning is required to be placed at the start of any report that contains some marketing material, it may encourage clients to dismiss the entirety of a report which provides suitable content for them. Some reports contain a combination of impartial information about the FM service and marketing content about the merits of the firm’s service in particular. Since this Remedy is intended to address the AEC that investment consultants may steer clients towards in-house FM solutions, it would be more proportionate for the disclosure to be included at the point where marketing material on providers’ own fiduciary management solutions are introduced. This would make it more likely that trustees understand that any advice on the relative benefits of FM as a governance model is impartial, and that the marketing element is limited to the marketing of the firm’s own FM service. If the disclosure were to be required at the beginning of any report which contains marketing material, then the wording should be made more precise to acknowledge this distinction, for example, to say “This document contains marketing material about our fiduciary management service. References to our own services should not be considered to be impartial advice.”.

(c) **Different disclosures for full fiduciary management and partial fiduciary management** – As described under our response to Remedy 1, WTW considers that different tendering requirements are appropriate for full and partial FM services. To the extent that our recommendations are adopted by the CMA, it would follow that different disclosures on references to in-house full FM and partial FM services should be introduced. We set out some proposed wording below to illustrate the different scenarios:

Full Fiduciary Management	Partial Fiduciary Management
Please Note: This material includes information about our fiduciary management service. References to our own services should not be considered to be impartial advice. You are required to conduct a tender process prior to appointing a full fiduciary manager if you have not already done so. Guidance on running a tender processes is available from the Pensions Regulator.	**Please Note**: This material includes information about our partial fiduciary management services. References to our own services should not be considered to be impartial advice. Guidance on running a tender processes is available from the Pensions Regulator.

(d) **Timing and frequency of disclosures** – Currently, under paragraph 12.43 of the PDR, the CMA is proposing that warnings are provided in a number of different scenarios (a-d). We consider it disproportionate to require the provider to include this disclosure at the point of contracting (d) given the clients would have been through at least one of the previous three scenarios (a-c). Subject to the above points and the Remedy being unambiguous, WTW is satisfied with the timing of implementation as set out in section 13 of the PDR.

(e) **Interplay with other disclaimers** – We note that most firms will already place disclaimers on their reports to make clients aware of various limitations to the advice provided. To the extent that this new "warning" is presented separately from and differently to other disclaimers, it may influence the way clients interpret it. This needs to be considered by the CMA. As mentioned above, WTW would favour a more balanced approach that treated this disclosure symmetrically to its other disclaimers in terms of the style in which it is presented, although we would suggest that the positioning of the disclosure should be closest to the relevant sections of material in a report.

Answers to the specific questions raised in section 12:

Should this remedy apply only to IC-FM firms, or to other investment consultancy and fiduciary management provider?

5.41 We believe that these transparent disclosures should apply to the entire industry including FM only firms and any firms offering their services where they are the incumbent provider. In particular, the mandatory warnings required under Remedy 2 should be extended to apply to IC providers when selling additional IC services. While it is acknowledged that some IC mandates are wide in scope, in WTW's experience, there are often circumstances where trustees (existing IC clients) require additional services which are not included in the scope of an existing IC mandate. These undoubtedly represent new business opportunities for the incumbent IC providers. It is thus important to ensure that in such circumstances, trustees are not steered into using the incumbent IC provider's IC services without paying due consideration to similar services provided by alternative IC providers. Such disclosures would create significant transparency and encourage trustee engagement, both of which are essential to good trustee decision making.

What should the structure and form of the warning be?

5.42 As described above, there should be flexibility in where the disclosure is placed in written materials, allowing for firms to include the disclosure where most pertinent (i.e. close to the marketing material itself). We support the use of consistent language throughout the industry but would encourage more proportionate language is considered, for example, using the language "PLEASE NOTE" rather than "WARNING".

5.43 We also support different disclosures for the use of full fiduciary management and partial fiduciary management given the different tendering regimes which may be required for each.

Should there be any separation of content?

5.44 As long as written material clearly discloses where advice is provided and where marketing information is provided, WTW does not believe that separating content is necessary.

Should there be any requirement to give a warning on oral advice and marketing?

5.45 It is highly unlikely that a client will not receive written materials when discussing the use of fiduciary management. Therefore, we consider this is unnecessary to provide a warning on oral advice and marketing. In any case, such a requirement would be very difficult to enforce and is likely to be relatively ineffective.

Should firms have flexibility in changing the description of the service in the warning to a term other than 'fiduciary management' to reflect the description of the service being proposed?

5.46 WTW supports the use of mandatory disclosures throughout the industry and not just for raising fiduciary management. As indicated above, IC providers should be required, as appropriate, to indicate clearly to their client whether the nature of the information included in a client-facing document is advice, marketing or both. Therefore, there should be flexibility in the terms used so that the warning describes the service being proposed. For instance, in the context of IC, the warning could read "*Please Note: This includes advice which if taken may result in activities that we undertake which are not already included within our agreement with you and will require additional fees to be paid.*"

Are any additional safeguards necessary?

5.47 WTW does not believe that further safeguards are required.

Remedy 3 – Enhanced trustee guidance on competitive tender processes

5.48 WTW is supportive of providing effective guidance to trustees on running competitive tender processes. The purpose of competitive tendering is for trustees to engage with the market to ensure that before buying services, clients assess whether these suit their requirements and represent value for money. However, for the guidance to be effective it should avoid proposing overly burdensome and prohibitively expensive processes, especially for smaller pension schemes. In addition, the guidance materials themselves should be written in a way that is easily digestible for trustees. If the guidance itself or the proposed tendering processes are too complex, there is a risk that trustees are less likely to fully engage with the guidance and may dismiss it altogether.

5.49 We agree that guidance should be developed by the Pensions Regulator. WTW is happy to assist in this.

5.50 In WTW's experience, there are a number of different types of competitive process which have been adapted to suit different budgets, available resources and scheme sizes. Therefore, it would be beneficial for the Pensions Regulator to set out guidance that recognises the need for flexibility in the tendering regime and presents various models which are suitable and proportionate for different types of scheme. For example, for the smallest schemes, receiving three written bids from alternative advisers (with some minimum standards on the fee and quality information to be included in the submissions) and attending a presentation from one provider should provide sufficient information for them to assess the market without imposing too high a tendering cost. However, for the largest pension schemes, with multiple billions of assets under management, a more thorough tender process with intermediation is likely to be best practice.

5.51 In answer to the points raised in 12.63 of the PDR, our suggestions for guidance on future competitive tender processes are as follows:

Factors trustees should consider as part of fiduciary management strategy implementation and appointment

5.52 In principle, WTW is supportive of making tender templates available for trustees to consider when running tender processes. However, these templates should be designed in such a way that they provide as much information on how to assess the quality of the provider as possible so as to avoid decisions being made based on past performance. Processes should also encourage trustees to engage with potential providers so that the providers understand the client's context and requirements prior to submitting proposals. This will ensure that the service proposed is the most suitable for the client's needs.

5.53 Potential information for clients to request could include the following:

(a) Investment beliefs of the provider;

(b) The services provided under the bid – including on-boarding, strategic investment advice etc;

(c) The range of solutions offered by the provider;

(d) The proposed way of working with the trustees;

(e) The level of resources available to the provider;

(f) The fiduciary management track record following the industry standard;

(g) Information on prospective fees (as discussed in Remedy 5).

The number and types of firms to be invited to participate

5.54 WTW considers it to be appropriate to assess three bids as a minimum.

The possible use of third party advisers and evaluators

5.55 The use of TPEs/advisers should not be mandatory. For many smaller schemes, this would result in large additional costs. However, we support the use of TPEs for schemes at the larger end of the spectrum.

5.56 Alternatively, WTW considers that where schemes have engaged a TPE to select a FM provider, even in the absence of them requesting bids for the specific mandate, the appointment has been carried out through a competitive process as TPEs have sufficient information to be able to benchmark providers and test the market on their behalf.

Factors to consider in interpreting providers' fees and performance track records

5.57 This should be addressed through Remedies 5 and 6.

Remedy 4 – Requirement on firms to report disaggregated fiduciary management fees to existing customers

5.58 WTW is broadly supportive of Remedy 4 subject to requirements not unnecessarily duplicating work required for other regulatory bodies:

(a) *Overlap with MiFID II* – There is significant overlap between the objective of this Remedy and the disclosures that are required under MiFID II for those services it applies to. We attach an example of a MiFID II fiduciary management annual statement to assist the CMA in considering this.

(b) *Consistency with templates from IDWG* – It is important that any proposal made is consistent with the templates that are proposed by the IDWG. Currently, we have no visibility of the IDWG proposals and so would need to consider the detail before opining. That said, we would hope that any proposals from the IDWG will reflect the requirements of MiFID II and avoid unnecessary duplication.

5.59 We have two concerns on the detail of the proposals as written:

(a) **Fees** for in-house asset management products – It is proposed that the fiduciary manager discloses the "asset management fees" including those associated with products provided by the fiduciary manager. For some firms, requiring this may make sense: in particular, where fiduciary managers are charging a fee for the FM service and then additional fees are charged through their own funds that are employed. However, for other parties, such as ourselves, the overall fee is agreed with the client and any fees received from in house fund of funds products used to implement the portfolio are offset against the overall agreed fee. We think, therefore, that it would be more appropriate to have any in-house fees included as a separate line item. This line item can be grouped with the third party asset management fees in the former case, and with the core fiduciary management fees in the latter case (in order to reflect the structure of negotiated fees with the client). The separation of in-house asset management fees from third party fees will also make it more transparent to clients what the total fees being paid to the FM firm are, and what the fees being charged by third parties are.

(b) **Transaction costs** – transaction costs should be split out from asset management fees rather than bundled together, to be consistent with MiFID II disclosures.

Answers to the specific questions raised in section 12:

Should fiduciary management firms be required to provide disaggregated fee information and how should they do this?

5.60 Yes, subject to the templates from the IDWG not duplicating the work required under MiFID II, this is the best place to start. WTW has not yet seen the proposed templated from IDWG.

Should asset manager fee information be based on the IDWG templates?

5.61 As per the above, subject to no unnecessary duplication with MiFID II, and the content of the proposed templates from IDWG, this approach seems sensible.

What should the frequency of reporting such fee information to customers be?

5.62 The Remedy should align with MiFID II disclosures and so an annual frequency seems sufficient. Provided the final Remedy aligns with MiFID II, this Remedy could be implemented immediately.

Remedy 5 – Minimum requirements on firms for fee disclosures when selling fiduciary management

5.63 Similar to the discussion on Remedy 4, WTW is broadly supportive of Remedy 5 subject to the specific comments made below.

5.64 To be effective, the requirements under this Remedy should – as far as possible – be consistent with those set out under Remedy 4 as this will allow clients to assess actual costs versus estimated costs and thereby hold their fiduciary management service provider to account. Also, similar to the comments made around Remedy 4, standards set out for this Remedy should be as consistent as possible with IDWG proposed templates and MiFID II to avoid unnecessary costs and confusion.

5.65 We do, however, have some concerns on the detail set out in the PDR that arise from the forward-looking nature of Remedy 5 (in contrast with Remedy 4). These are as follows:

(a) **Risk that different providers make different assumptions** – Remedy 5 will require providers to forecast transaction costs and performance fees, and in the absence of clear guidance there is a risk that some providers will be less conservative than others in calculating these estimates. The CMA should consider how it can address this challenge.

(i) **Transaction costs** – In principle, when assessing the costs from moving from a current portfolio to a proposed portfolio, assumptions on one off transaction costs should be similar across providers. However, transaction costs continually change and can vary considerably depending on a number of factors. To minimise this problem, there should be an agreed approach to make the estimates of different providers as comparable as possible.

(ii) **Level of performance assumed in expected performance fees** – To provide an estimate of the performance fees associated with a portfolio, assumptions will be required on the level of performance expected for those managers that have performance fee structures. In most cases, a proposed portfolio will be provided alongside fee disclosures in tender documentation. It is likely that an expected level of performance and risk will be disclosed. The assumptions used within tender documentation for expected performance should be consistent with assumptions on the performance of underlying managers when estimating performance fees.

(iii) **Structure of performance fees** – Differing performance fee structures pose difficulties in estimating what performance fees could be, as some structures will not realise performance fees until after a certain time period e.g. three years, or some could have differing high water marks[68] and investors could be at different points relative to those high water marks.

(b) **Current transparency of transaction costs** – We have no major concerns on providing one off transaction costs at the point of tender. However, there is a risk that this requirement could bring about detrimental unintended consequence unless it is carefully designed and positioned. In particular, many underlying pooled funds are single priced and so investments in and out of these funds will not have any transaction costs associated with them (as these are absorbed via the underlying vehicle). However, segregated mandates that require building a portfolio from scratch will have more transparent costs associated with buying and selling. It is important that the Remedy does not unduly incentivise providers to propose single-priced only funds at the expense of segregated mandates purely as a result of the apparent lack of initial transaction costs.

5.66 In addition to this, we have the following comments on the detail proposed in the PDR:

(a) **Scope of the services provided under the proposed FM solution** – Providers may have differing services included within the quotes provided (for example, strategic advice, meeting attendance, training, reporting, settlement activity etc.). Clarity on what services are provided in the FM fees is important for this Remedy to be effective. Transparency on fees alone – and not on the services that these fees will “buy” – could lead to an excessive focus on price at the expense of service quality, to the detriment of many pension schemes.

(b) **Core fiduciary management fees** – The total amount due to the FM provider should be made clear as per our comments made under Remedy 4. Should the FM provider have performance related fees in place, these should be estimated based on the overall return target.

(c) **Asset management fees** – Disclosures on asset management fees should be broken into base and performance related fees. Again, performance related fees should assume levels of performance that are consistent with the providers’ marketing material. We have concerns around the proportionality and effectiveness of including assumed ongoing transaction costs incurred by asset managers within individual vehicles. Retrieving this level of information would be onerous as it is outside of the FM’s control and subject to many assumptions.

[68] A high water mark is the highest peak in value that a fund has reached. Subsequent performance fees can only be incurred if the value of the fund exceeds the previous high water mark.

(d) **Exit fees** – For WTW, we believe that this is not required and will not provide any meaningful information to customers, meaning that it would be neither a proportionate nor an effective measure. The reasons are as follows:

(i) The change in FM provider will incur minimal fees as it will only include the change of contract.

(ii) In terms of the portfolio, the likelihood of incoming FM providers liquidating all assets to cash is relatively low and is completely dependent on transaction costs at the time of liquidating. There is also no way of knowing what portfolio it would be transitioned into. There are many factors that could determine the level of transaction costs including the target asset allocation, the use of a transition manager and the timing of the transition. For this reason, the cost estimate would be highly unreliable and require heavily caveating. At worst, it could deter clients from terminating a fiduciary manager as it is too expensive and affect the selection criteria for fiduciary managers.

(iii) There are some investments such as secure income assets that provide pension schemes with characteristics that are very beneficial to them, but that can also be illiquid. In practice it is very unlikely that these investments are unwound. While trustees should be made aware of this, it would be extremely difficult to estimate the costs of unwinding the investments to a high degree of accuracy. It would be highly detrimental to pension schemes if the difficulty in satisfying such a requirement effectively barred providers from proposing these less liquid investments in the first place. In our view, a requirement to provide information on the liquidity of the portfolio could provide customers with the information they require to compare the offers of competing providers.

Answers to the specific questions raised in section 12:

Should firms be required to provide a fee breakdown to prospective customers?

5.67 Yes – but care will be required to ensure that the level of detail is proportionate and effective. Please see above for our comments on what information should be provided in this regard.

Should any other fees or costs be disclosed in addition to those mentioned in this Remedy?

5.68 Similar to TERs, there should be disclosure of all third party expenses relating to underlying vehicles used including those incurred through in-house vehicles and those being charged through third party asset managers.

Remedy 6 – Standardised methodology and template to report past performance

5.69 WTW is supportive of Remedy 6 as it allows prospective clients to compare and assess FM providers for full fiduciary mandates and to have more confidence in the information provided to them. That said, it would be detrimental for clients to select their FM provider based purely on past performance for the following reasons:

(a) as with all investments, past performance is no indicator of future performance; and

(b) it is important that clients consider the wider characteristics of fiduciary management providers when selecting their provider.

5.70 In our view, it would be beneficial for providers to include a disclosure reminding clients of these points when presenting such evidence.

5.71 Much of the initial work on this standardised methodology has already been undertaken by the industry and it would be wasteful to start again from scratch. Instead, it would be sensible to build on the progress that the industry has made so far through the IC Select and CFA Institute process.

5.72 That said, we are very supportive of the entire standard moving to the CFA Institute as soon as practical so that it can be governed in the same way as the Global Investment Performance Standards (GIPs) for the asset management industry. Should this be agreed, this will resolve most of the governance questions raised by the CMA in the PDR.

5.73 To be effective in allowing trustees to compare the performance of different providers, the performance standard will need to evolve so that consistent composites are used throughout the industry. However, flexibility for FMs to include "umbrella composites" (i.e. aggregating a number of different return streams) for prospective clients (over and above these standard industry composites) should remain. This will allow providers to provide tailored information that may be of specific interest to specific schemes (and that indeed may be requested by the scheme trustees themselves) while at the same time providing the standardised "base line" information that ensures that the performance of different providers can be directly compared.

5.74 WTW in principle supports an implementation group with fiduciary management representatives to finalise the remaining details with the CFA Institute should the current standard not reach this staging post by the time the CMA order is made. However, we do not believe that an implementation group is required on an ongoing basis should the performance standard be owned and controlled by the CFA Institute with regular consultation with fiduciary management industry stakeholders.

5.75 In the PDR, the CMA has explained that the current standard would not suffice as it stands because this is voluntary rather than mandatory. WTW assumes that mandatory disclosure would only be required at the point of presenting results. Assuming this is the case, we do not see mandatory disclosure as a major hurdle to overcome and it could be regulated in the UK by the FCA in line with the supporting Remedy proposed by the CMA.

Answers to the specific questions raised in section 12:

Should there be a fiduciary management performance standard?

5.76 Yes – subject to the detailed comments above.

Who would be best placed to develop and implement a fiduciary management performance standard?

5.77 We believe that the CFA Institute are well equipped to develop, implement and maintain the standard.

How do you envisage the implementation group working: how should it be funded, who should be part of it, etc?

5.78 As per our comments above, should the CFA Institute be responsible overall, then there is no need for an explicit implementation group over the long-term.

What backstop would be appropriate in the event that the group is unable to agree on the standard in the required period?

5.79 The CFA Institute is an independent party and should be the backstop.

Remedy 7 - Duty on trustees to set their investment consultants strategic objectives

5.80 WTW welcomes Remedy 7 as greater clarity and emphasis on strategic objectives should assist trustees in making decisions, setting objectives for their investment consultants, and evaluating the performance of their investment consultants against objectives.

5.81 In line with the Pension Regulator's Integrated Risk Management voluntary framework, trustees need to be mindful of the level of reliance that they are placing on the investment strategy relative to other contributions to meet their overall goals. As such in addition to these objectives being measurable, they must be appropriate (in view of current funding levels and covenant considerations) and not promote undue risk taking.

More guidance should be provided to trustees to assist them in setting effective investment objectives for investment consultants

5.82 In our experience, the majority of clients have some form of strategic objective in place. As such, we believe that the effectiveness of this Remedy would not simply be in the mandatory introduction of objectives themselves but also some greater guidance on what the investment specific objectives for their investment consultants could include. The CMA should also consider whether or not it is appropriate to provide differing prescriptive guidance depending on the size and resources of schemes. Some proposed items to consider under guidance could be as follows:

(a) **Areas that these objectives should cover** – For investment, this could cover the targeted return and risk tolerance.

(b) **Basis on which these objectives should be set** – For UK pension schemes, objectives are commonly stated relative to liabilities. However, more guidance could be useful on how these liabilities are measured in practice (e.g. a full liability proxy, a reference government bond, discount rates etc.).

(c) **Timescales associated with monitoring performance** – Given the high levels of "noise" over shorter periods, a longer time horizon may be more appropriate in some cases.

(d) **Guidelines and restrictions** – These could include specific constraints and boundaries within which trustees wish to operate when considering and making decisions, so that the investment consultant is able to structure advice accordingly. These guidelines and restrictions will help when considering performance against the objectives set as well as when considering the performance of other investment consultants (so that more of a like for like comparison is achieved). Examples of typical guidelines or restrictions could include:

(i) Asset class restrictions

(ii) Exclusions on types of mandate (e.g. active management in certain asset classes)

(iii) Cost limitations (at underlying manager level and/or investment consultancy fees).

(e) **Accountability –** It should also be made clear which parties are accountable for the outcomes of objectives. Performance against certain overall objectives may be heavily influenced by other advisers and stakeholders such as the Scheme Actuary, or the company and its advisers. Incorporating these objectives into the performance assessment of the investment consultant may not always be appropriate. This review of accountability could be considered as part of a review of governance arrangements.

5.83 While we support clarity on strategic objectives where possible, this does not mean that strategic objectives should be stripped back to outcomes that can be easily measured and quantified. There is a danger that important qualitative objectives and requirements get ignored and behaviours change so that it is just quantitative measurable activities that get attention. There is a potential consequence that performance – rather than sound process – drives decision making on the part of trustees when, as noted above, there is always a possibility that any observed investment outperformance or underperformance, particularly in the short run, could be down to chance. As such, it is important that objectives are used as part of understanding the assessment, rather than being the sole determinant of success.

5.84 For similar reasons, setting objectives for investment consultants should only apply when there is an ongoing relationship with the trustees and where the overall objectives of the trustees can feed directly into the investment consultant objectives. It seems disproportionate for trustees to set prescriptive, measurable objectives where the nature of the relationship is solely for ad hoc project work and where there is no opportunity to review outcomes versus objectives (e.g. one-off manager selection only exercises).

Answers to the specific questions raised in section 12:

Should pension trustees be responsible for setting objectives for their investment consultant?

5.85 This is fundamentally the responsibility of the trustees. There should be a clear link between these objectives and the statement of investment principles (SIP), which are all trustee responsibilities.

Is review and agreement of objectives every three years a suitable timeframe?

5.86 We agree that this should co-ordinate with the triennial valuation process, which provides a natural time to revisit objectives. However, in the event there are material scheme developments, the review of investment strategy – and therefore investment consultant objectives – may need to be brought forward.

Should there be a minimum threshold based on pension scheme size or the scale of the consultancy contract?

5.87 No – subject to the above comments around the scope of the contract and the ongoing relationship.

When do you consider that the formal review of an investment consultant against the scheme's strategic objectives should take place?

5.88 On an annual basis. The point in the year is less important and can perhaps be arranged on a scheme by scheme basis so that it can avoid any unnecessary duplication of data by co-ordinating with (perhaps) valuation dates, or reports & accounts, or MiFID II data and reporting.

5.89 We note that a formal review against the objectives is not the same as a formal review of the appointment. A review against objectives is about understanding what is driving the performance and identifying what changes should be made. Those changes might be to portfolio construction, manager structure, and strategy or scheme governance. They could also result in a review of the appointed investment adviser, though this should be at the trustee's discretion.

Remedy 8 – Establish basic standards for how investment consultants and fiduciary managers report performance of recommended asset management 'products' and 'funds'

5.90 We agree that differences in the ways that IC and FM providers calculate and report performance of recommended asset management products make it difficult for customers to assess and compare the quality of these recommendations. We therefore firmly support the CMA's proposal to establish basic standards for how IC and FM providers report performance of recommended asset management 'products'. However, in order to be proportionate and effective, care will be needed to ensure that these standards are well-designed and are not overly restrictive. By way of general principles:

(a) **The standards should specify a "base line" level of information** that IC and FM providers should make available to pension scheme trustees when presenting evidence on the quality of their product recommendations, but they should not prevent providers from presenting additional information over and above this base line which may be of specific relevance to the trustee in question (and which in many cases trustees may themselves request).

(b) **The standards should work with, and not cut across, existing regulatory requirements and industry standards.** Similar to the CMA's observations, we would like to emphasise that there are already a number of regulatory requirements and principles regulating the presentation of investment performance, such as MiFID II, COBS 4 of the FCA Handbook, the CFA Institute's Global Investment Performance Standards (GIPS), PRIIPs, UCITS, all of which emphasise the requirement to present performance information in a fair, clear and not misleading way. Any new standards would need to work with the grain of these existing requirements and principles.

(c) **The standards should encourage trustees to take a balanced view of IC and FM performance.** One of the key challenges in the industry is the excessive focus on historical performance results which are not indicators of future performance. Much wider assessment beyond past performance is critical in selecting investment consultants and fiduciary managers. There is a risk that – if implemented in isolation – the new standards lead to even greater weight being placed on past performance of asset management product recommendations which may give customers false confidence in this evidence as a measurement tool. There should be mechanisms put in place which control for overreliance on past results and ensure that trustees continue to assess performance overall. As we have explained in previous submissions to the CMA (and have summarised in section 4 above) there are a number of other indicators that can be used to gauge the overall value that IC-FM providers have created for their clients. Trustees should be encouraged to consider this holistic evidence rather than relying exclusively on evidence on the performance of recommended asset management products.

5.91 The proportionality and effectiveness of Remedy 8 will therefore fully depend on its scope and the way it is implemented. Establishing some basic standards for investment consultants to report on their recommended asset management 'products' should helpful to trustees, but only if these additional standards are kept at a relatively basic level and they do not become too granular.

(a) If implemented in line with the principles set out above, the cost of this Remedy should not be disproportionate.

(b) However, too much granularity could significantly increase costs for industry stakeholders and create the risk of inconsistencies with other regulatory frameworks. It may also potentially lead to some unintended consequences in terms of behaviours, such as that observed in the asset management industry where strict adherence to benchmarks has led to "index hugging" behaviours.

5.92 We also have a number of comments about the proposed coverage and timing of the proposed Remedy.

(a) With regard to coverage, we do not agree that in-house investment 'funds' run by investment consultants should be included in this Remedy. This would be disproportionate because the performance of in-house funds is already transparent and reported in a largely consistent way across different providers. In particular:

(i) There is no ambiguity as to which underlying asset management products should be included or excluded and the level of fees which has been paid.

(ii) Performance track records of in-house investment funds are based on actual results achieved by these funds and are regulated by MiFID II and other relevant regulations.

Furthermore, in many respects in-house funds run by investment consultants are similar to multi-managers funds or funds of funds run by asset managers. We do not think it would be appropriate to apply additional rules to in-house asset management funds run by investment consultants that do not apply to these competing products.

(b) The timing of the Remedy implementation should take into account the annual reporting cycle when the vast majority of asset managers report year-end results to their customers. Updating performance results for all recommended products is a significant undertaking. We recommend introducing this Remedy on a forward looking basis with grandfather rights until the start of a new calendar year. For example, if the CMA's Remedy comes into force in September 2019, the firms can still be allowed to report their 2018 year-end results in the old way but will be required to produce performance in full compliance with the new standard starting from the 2019 year-end results which typically become available a few months after a calendar year end.

5.93 In the PDR, the CMA has set out five methodological and data issues that have can have an effect on reported performance. We support the CMA's proposal to include all of these areas into the reporting standards and provide our commentary below:

(a) Excess return vs. benchmark

(i) Products in different asset classes will have different benchmarks so we agree that returns should be measured against appropriate benchmarks where available. It is also important to match the reporting currency of the product's return to the reporting currency of the benchmark return.

(ii) For private investments we recommend using a Public Market Equivalent method which compares performance to available public indices and takes into account the timing of cash flows (i.e. aligns the private markets money weighted approach to performance measurement with the public market time weighted approach).

(b) Net of fees vs gross of fees

(i) We would argue that customers should consider both gross and net returns given that the level of asset management fees varies by client. For the purposes of comparison across investment consultants, gross return figures will be the most consistent.

(ii) Net return figures are also very important for customers as they demonstrate what trustees may see as a real investment outcomes but need to be treated with caution because of the fee assumptions used. We would argue, for example, that where performance is reported on a net of fees basis, a disclosure should be included saying "Note that the passive benchmark is not free".

(iii) In practice:

(A) fees paid to asset managers often differ widely by customers and simply focusing on the average or median fee level could be highly misleading, either positively or negatively, for any given customer; and

(B) it is also important that trustees consider whether an investment consultant may be able to negotiate lower fees, either through a fiduciary management execution model where assets are aggregated, or on a standalone basis, compared to those which could be achieved by the trustee on its own.

(c) The inclusion of all relevant products and funds

We believe this may be the most challenging area from a performance measurement consistency perspective. Different investment consultants have different approaches to covering and rating asset managers so determining a consistent minimum reporting standard is not a trivial exercise.

(i) First, the definition of "recommended asset management products" needs to be clarified. There will be examples where an investment consultant rates an asset management product positively but it takes a very long time before an actual recommendation to a client could be made. Some products may be positively rated but never actually "recommended" if there was no relevant client interest at the time. There will also be examples where a client has certain regulatory or governance constraints and may ask for specific implementation options which an investment consultant would not recommend from a pure investment perspective, but for a particular customer in its specific situation a certain product may make sense as a "recommendation" even if it is not expected to outperform its benchmark. Also, different consultants have different rating systems. With all of these factors in mind, we think that a more neutral definition, such as for example "buy rated products", could achieve more consistency than "recommended products".

(ii) Second, there is currently a wide range of product category definitions among investment consultants which tends to add to the lack of consistency in performance comparison. Our suggested categories for reporting on highly rated products are set out in the table below. We believe this range provides a good balance between being sufficiently granular to give a clear picture and capture difference in risk return profiles of various investment strategies; and not having so many categories as to confuse customers. The categories will provide trustees with more comparable mandates to assess performance across different consultants. Investment consultants should include all recommended products in each category but they should retain the flexibility to include only relevant categories rather than all products in all categories every time. For example, if a customer wants to invest in UK bonds, they are unlikely to benefit and may potentially get confused with the information on how the consultant has performed in private equity or hedge funds. We would also recommend some flexibility to show a more granular break-down of performance within each category, as some categories include very wide ranges (for example hedge funds or real estate strategies span a wide range of risk-return targets).

Table 8: Categories for reporting on highly rated products

Category	**Notes**

Investment Grade Bonds	Includes Government, Credit and Aggregate mandates
Sub Investment Grade Credit	Includes Loans and High yield across all geographies
Structured/Securitised Credit	Covers all geographies
Absolute Return Bonds	Includes Absolute return bonds and Unconstrained bond funds across all geographies
Equities	Covers all market capitalisations (e.g. Small cap, Large cap) and styles (e.g. Value and Growth)
Private equity	Includes direct funds and secondaries
Private debt	Includes Distressed, Real Estate Debt and Corporate Direct Lending
Hedge funds	Only direct hedge funds. Includes Reinsurance and alternative smart beta mandates
Infrastructure	Includes direct/unlisted and listed
Real Estate	Includes direct/unlisted and listed (i.e. REITs)
Multi Asset	Includes Diversified growth, Real return and Balanced funds

(iii) We also recommend that the standards fully exclude certain categories, such as passive indexation, mainstream smart beta/factor investing, cash/liquidity/stable value, target date funds, service providers (e.g. custody and transition managers), funds of funds, secondary funds, multi managers and very niche investments (e.g. agriculture, natural resources, convertible bonds).

(iv) Lastly, a significant number of historical recommended products do not have performance information, so we propose that the standard requires investment consultants to include all relevant ratings where performance information is available. Going forward, it would make sense to require investment consultants to apply their best efforts to sourcing performance on as many recommended or buy-rated products as possible, but it should be noted that there still may be instances where it will not be possible (for example, where a customer prefers its investment performance to remain confidential and there is no other way for the investment consultant to source information on the performance of the recommended products in which the customer has invested).

(d) Survivorship bias

We agree that this area should be addressed in the reporting standards. It should be noted that definitions of survivorship bias may vary, but providing more detail on the methodology being used in calculating returns would be useful for customers.

(e) Data issues, including simulated returns and backfill bias

We agree that these areas should be addressed in the reporting standards in principle, but would like to note the following issues.

(i) Regarding backfill bias, we suggest that performance prior to a rating being assigned on a product should be excluded and consultants should apply their best efforts in sourcing past performance for as many legacy buy rated products as possible. Going forward, it may make sense to require investment consultants to apply their best efforts to sourcing performance on as many recommended or buy-rated products as possible but it is worth acknowledging that there still may be instances where it will not be possible, for example, where a customer prefers its investment performance to remain confidential.

Sourcing of data on buy rated products can either be done directly from the managers or via an intermediary such as Morningstar, eVestment or other database providers (we would not support compulsory consultant use of a particular commercial database). Disclosing the percentage of buy ratings with missing performance data over time would seem sensible in order to provide transparency over potential missing data. We do not support other approaches taken by the CMA in order to address the issue of data not being on eVestment prior to the rating date given that this, unfairly in our opinion, led to a significant loss of data on rated products being considered - please refer to our previous submissions for the detailed rationale.

(ii) Simulated returns should be naturally excluded when looking at the performance of buy rated products as a whole. However there may be instances when simulated returns are valid to help an asset owner better understand the characteristics of particular approach as long as it is clearly stated what is a simulated versus live performance data.

Answers to the specific questions raised in section 12:

Should basic standards apply to the reporting of recommended asset management 'products' and 'funds'?

5.94 We believe that basic standards should apply to the reporting of recommended asset management 'products' but not to in-house 'funds' for the reasons described above.

Are there any other areas that we should include in the reporting standards?

5.95 No.

Should standards be developed and agreed by an implementation committee similar to Remedy 6?

5.96 We do not believe that there is a need to establish an implementation committee to develop and agree the basic standards for how investment consultants report performance of recommended asset management products. While we recognise that there is scope to improve the consistency and comparability of this evidence, we believe that this can be achieved with the introduction of relatively basic rules and guidelines, which the CMA has outlined in its proposal. For the reasons explained above, going further and developing a highly granular set of rules would be disproportionately costly and complex, would bring no clear incremental benefit to pension schemes and would in fact potentially give rise to detrimental unintended consequences. In addition and as the CMA correctly notes in its report, parts of this Remedy also fall within the scope of regulatory requirements under current financial regulation, in particular, MiFID II and the FCA's IDWG. In this respect, it is important to avoid both overlapping requirements and also achieve consistent reporting standards.

5.97 That said, if based on its further analysis and consultation the CMA decides that there is a need for more detailed standards than we believe, it would then be necessary to establish an implementation committee to consider the different proposals and agree a solution.

What fees should be used to make the gross to net conversion?

5.98 A sensible approach would be to use the asset managers' standard fees expected to be paid by a typical customer on a certain amount, for example, a $100 million mandate in a pooled vehicle. In addition to this, investment consultants should have flexibility to include information on fee discounts they have been able to achieve on relevant products for mandates of similar size and type. As explained above, there should also be a requirement for a consultant to state that the actual fees will be client specific and may be higher or lower than the ones used in their examples. It should also be stated clearly that customers will see other costs and charges in addition to asset managers' fees as covered under MiFID II.

6. Supporting Remedies

Recommendation A – Extension of FCA regulatory perimeter

6.1 WTW is supportive of the Remedy to extend the FCA's regulatory perimeter but note that this will increase hurdles for new entrants into the market. WTW does not believe that this will have a material impact on WTW as we do not currently distinguish between our regulated and unregulated work when setting our policies and procedures, and monitoring compliance. Consequently, we do not think that this will have a large impact on the way in which WTW conducts its currently unregulated business. There will naturally be an additional compliance burden to the firm more generally, and there are some other consequences which are discussed in further detail below.

6.2 As set out in our response to the CMA's specific questions, more work would be required to define the regulated activities that would be included within the regulator perimeter. The CMA (and FCA) should also consider other professional advisers (not explicitly part of the market investigation) that may provide or input to some of these activities, for example, in-house teams. In WTW's view, anyone giving advice on asset allocation or manager selection should be regulated by FCA. Anyone exercising discretion should be regulated by FCA or the Pensions Regulator. The requirement on trustees to take advice from someone they believe to be knowledgeable should also be upgraded to require them to take advice from a regulated person.

6.3 In WTW's view, it is important that regulation is on an activity basis, not a firm basis. Otherwise there is a risk that the activity will be undertaken outside of regulated firm which would be wholly counterproductive.

6.4 That said, we consider that two of the Remedies may be better monitored by the Pensions Regulator, in particular Remedies 1, 3 and 7, and it is also necessary to further consider the dividing line between the types of advice/work which would be inside or outside of the perimeter.

6.5 We note that part of the CMA's rationale for extending the regulatory perimeter is to allow the FCA to monitor its Remedies over the long-term. We agree with this to an extent, but believe a number of Remedies are the responsibility of the trustees and not the IC or FM provider and so should be regulated by the Pensions Regulator. The FCA may wish to enact rules which support such trustee obligations but we do not think we should be precluded from acting for a client, for example, if we do not have evidence that the tender meets certain standards, or that they fail to set their strategic objectives. In this regard, it is appropriate that the trustees would be responsible for compliance with their obligations. It would not be appropriate or desirable for IC/FM providers to be required to police trustee compliance.

6.6 We envisage that the finalisation of the FCA rules of conduct will take time. It would therefore clearly be preferable for the IC activities to be regulated from such time as the FCA rules are finalised, and not 6 months from the date of a CMA order as currently proposed. Otherwise, there may be two different implementation methods necessary and this will result in increased costs and regulatory uncertainty.

Answers to the specific questions raised in section 12:

Should the FCA regulatory perimeter be extended? What activities should be included? [or excluded]

6.7 WTW would support this Remedy but note that there is a lot of detail to be worked through in terms of how the FCA could practically regulate the industry – for instance would such regulation be activities based or based on firm services. As noted above, WTW strongly supports an activity-based regulatory regime. Assuming the proposal is based on regulated activities, there are a number of services that could come under the perimeter depending on how the regulated activity is defined:

(a) **Strategic investment advice** – Target levels of risk, return, timeframe etc. This is one of the harder activities to define given the number of stakeholders that provide input to the discussion and decision.

(b) **Asset Allocation advice** – We believe that this should be included.

(c) **Manager selection** – We note that under the current environment, only advice relating to specific asset manager recommendations is regulated and this does not include appointments of segregated asset managers. Potentially, this regulatory perimeter could be expanded to include any delegation of investment decision making including FM selection.

(d) **Settlement activity advice** – Advice relating to whether trustees should consider buy-ins, buy-outs etc. These are arrangements relevant to situations where pensions are moved to an insurer. Advisers (from all areas including investment) often assist trustees in determining whether such a move, as well as any related arrangements, is suitable for their situation. We note that having the FCA regulate this would be very difficult in practice given the cross over with the insurance industry which is subject to its own regulations. Therefore, we would propose that settlement activity advice be excluded.

(e) **Advice relating to DB and DC schemes –** Different types of advice apply to DB and DC schemes which will need more definition.

6.8 We assume that the precise scope of the regulatory perimeter will be subject to additional consideration and consultation by the FCA/HM Treasury. We consider that such consultation is vital given the importance of the correct delineation of the regulatory perimeter.

Should specific rules or principles related to Remedies 1-2 and 4-8 be included within the FCA's overall conduct requirements? If not how should those Remedies be best implemented in the regulatory regime?

6.9 WTW's preference is that specific rules and principles be included within the FCA's overall conduct principles, this would give more certainty on the application.

What is the anticipated cost of an extension of the regulatory perimeter to firms? What is the marginal cost to firms already subject to FCA or designated professional body regulation?

6.10 [✂]

How should any changes be implemented to ensure consistency between regulators (including designated professional bodies) and reduce costs to firms?

6.11 There will still be multiple relevant regulators for this industry, the Remedy should aim for one regulator covering one type of work as much as possible and for regulators to work together for consistency of principles and application where there are multiple regulators.

Recommendation B – Enhanced trustee guidance and oversight of Remedy 1

6.12 WTW is supportive of Remedy 1. We have provided more detailed thoughts within our response to Remedy 3. In answer to the explicit questions raised:

Would trustees benefit from enhanced guidance?

6.13 Yes – however, guidance should take into account the size of schemes and provide trustees with the flexibility to undertake tenders that do not require excessive resources or expenses.

What should the scope of any guidance include?

6.14 Processes should encourage trustees to engage with potential providers so they understand the client's context and requirements prior to submitting proposals. This will ensure that the service proposed is the most suitable for the client's needs. Potential information for clients to request could include the following:

(a) Investment beliefs of the provider

(b) The services provided under the bid – including on-boarding, strategic investment advice etc.

(c) The range of solutions offered by the provider

(d) The proposed way of working with the trustees

(e) The level of resources available at the provider

(f) Information proposed as part of Remedy 5, 6 and potentially 8.

How detailed should guidance be and what form should it take?

6.15 In principle, WTW is supportive of making tender templates available for trustees to consider when running tender processes but these should be designed in such a way that provides as much qualitative information to assess the quality of the provider so that decisions are not made on measurable outcomes alone.

Recommendation C – Improving information on underlying asset management fees and performance

6.16 WTW is supportive of this Remedy and encourages the CMA to ensure that Remedies 4 and 5 are consistent with MiFID II disclosures and work ongoing with the IDWG.

WILLIS TOWERS WATSON

29 August 2018