



Investment Consultancy and Fiduciary Management Market Investigation

AON RESPONSE TO PROVISIONAL DECISION REPORT

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**INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT MARKET
INVESTIGATION
RESPONSE FROM AON**

EXECUTIVE SUMMARY

- 1.1 Aon welcomes the recognition in the CMA's Provisional Decision Report ("PDR") that the IC and FM markets are competitive and value-enhancing:
- 1.1.1 The CMA has found that the IC and FM services markets are not concentrated; that both markets have grown (and are continuing to expand); and that barriers to entry and expansion are not high.
- 1.1.2 The CMA has found high trustee satisfaction with the services provided; providers can achieve greater discounts from asset managers than schemes could achieve themselves; providers have added value in the areas of manager selection and asset allocation ; FM services have also added additional value with decisions being taken under delegation. Despite CMA concerns schemes are not advised to purchase FM services against their best interests.
- 1.2 We do not agree with the CMA's findings of adverse effects on competition ("AECs") (and the concerns raised in our submission ahead of the CMA's provisional findings remain).¹
- 1.3 Nonetheless, we recognise that while many trustees are well-engaged and highly-skilled, this can vary. We consider the CMA's general approach on remedies to be a valuable means by which trustee engagement can be improved. This will enable trustees to better exploit existing competitive opportunities and secure better outcomes for pension schemes and their members. We welcome the opportunity to work with the CMA, tPR, FCA and the wider industry to achieve this outcome.
- 1.4 We have been developing our approach to transparency of fee and performance information, including active participation in industry bodies, and we have already taken steps to implement aspects of Remedies 4 to 8. We already publish on our website the past performance of our FM services and of our recommended asset management products and funds. We welcome the proposed approach of disclosure of performance be standardised across the market.
- 1.5 However, if not carefully constructed, certain of the proposed remedies run a real risk of distorting the IC and FM markets, which would have a detrimental effect on competition. In particular, rules-based regimes, such as the proposed mandatory tendering, risk creating an uneven playing field or a culture of rule avoidance, particularly if applicable rules are overly complex or uncertain.
- 1.6 It is also important that the CMA does not send the wrong signals to trustees considering the purchase of FM solutions. With the proposed remedies principally

¹ [Submission from Aon ahead of the CMA's provisional findings](#), 26 June 2018.

focused on the purchase of FM, including the proposal to mark FM related documentation with “warnings”, the CMA’s proposals could easily give rise to connotations that FM is an inherently risky decision, or signal that the move to FM is too difficult or burdensome a decision to make. FM services have secured considerable benefits for many schemes, especially smaller schemes, and the CMA must ensure that its remedies do not inadvertently *worsen* scheme outcomes by dissuading trustees from moving to FM where this is the most appropriate solution.

- 1.7 In conducting its investigation, the CMA has shown a more fundamental need to improve and make consistent trustee standards and decision making across the wider pension scheme landscape. This is particularly important given the market move to DC schemes where the CMA has found a greater lack of trustee engagement.
- 1.8 The proposed remedies will impact the DB and DC sectors for many years, so the CMA needs to ensure that it designs measures that improve and focus on trustee *accountability* when using IC and FM services, rather than, or even in addition to, measures that introduce simplistic rules-based requirements. For this reason, we would encourage the CMA to work with tPR to design a model where trustees are more transparent and are held accountable.
- 1.9 We set out below our comments on the findings and proposed remedies in the PDR and look forward to discussing these more fully with the CMA at our scheduled hearing.

PART A – COMMENTS ON SUBSTANTIVE FINDINGS

1. THE CMA MUST DRAW ITS CONCLUSIONS AND STRUCTURE ANY REMEDIES WITHIN THE CONTEXT OF IT FINDING A COMPETITIVE MARKET LANDSCAPE

- 1.1 The CMA's provisional findings establish that the IC and FM markets are competitive and growing:
- 1.1.1 The IC and the FM markets are not highly concentrated and no firm(s) hold market power. More than 37 firms offer IC services; more than 17 firms provide FM services.
 - 1.1.2 The IC market has doubled in size in the last 10 years and the FM market has trebled in size since 2011. New IC and FM firms have entered the market every year since 2008².
 - 1.1.3 There is an absence of material barriers to entry or expansion.
 - 1.1.4 As a result, schemes of all sizes have a choice between making their own investment decisions or using in-house teams, or employing external providers on either an IC or FM basis. Their decision on whether to choose IC or FM will depend on their governance objectives and investment needs and in both sectors the CMA's evidence clearly demonstrates that there are many well-established firms competing. These providers have differentiated service offerings, there is a variety of business models and there are varying levels of integration of IC and FM services, as well as with the provision of other services, such as actuarial or asset management services.
- 1.2 This choice drives competition and it is important that it is preserved.
- 1.3 This competitive and dynamic market structure means that IC and FM providers are obliged to meet their clients' needs and provide excellent client service. This, however, appears to be overlooked by the CMA:
- 1.3.1 The CMA's survey found very high customer satisfaction ratings with 94% of IC customers being satisfied with their provider and similar findings for schemes purchasing FM services.³ The CMA appears to discount this, in part due to trustees having low expectations.⁴ This seems to be an entirely subjective view without any clear analysis of the level of service required or expected by trustees.
 - 1.3.2 Clients are generally provided with clear and regular information on fees⁵ and performance,⁶ which are often expressed in a format that has been requested by the client. The CMA makes no overall finding of inadequate

² PDR, paragraph 9.11.

³ PDR, paragraph 10.94.

⁴ Appendix 6, paragraph 112.

⁵ PDR, paragraph 5.16, 5.91.

⁶ PDR, paragraph 5.51, 5.144.

or misleading information provision. Rather the CMA's focus is on the difficulties experienced as a result of the consistency and comparability of information. This is not surprising where providers or trustees have unilaterally determined how to provide or receive information in the absence of broader industry coordination.

- 1.3.3 Providers achieve greater discounts from asset managers than schemes could achieve themselves, and asset allocation advice is tailored and has added value. Whilst calling it statistically not significant, the CMA has nevertheless also found value added by manager selection. We set out further detail in section 3 below.
 - 1.3.4 The CMA has concluded that potential conflicts of interest do not give rise to a competition problem and that none of the evidence it has reviewed points to IC/FM providers introducing FM contrary to a client's interests.
- 1.4 These findings are significant for the CMA in taking this market investigation forward:
- 1.4.1 This evidence clearly demonstrates the markets have evolved and innovated, market conditions are not deterring entry or expansion, competition has been stimulated, customers have an increasing range of providers from which to purchase services and as such all firms have strong incentives to compete.
 - 1.4.2 We do not agree with the CMA's finding of certain features leading to AECs in the IC and FM markets. However, if there are AECs, any impact is limited. The CMA puts forward no clear or robust evidence of any material customer detriment.
 - 1.4.3 The markets have experienced significant growth and innovation – this will continue and it is critical that this is not jeopardised or inhibited by poorly structured remedies.
 - 1.4.4 Further market entry is likely and it is important that this must not be deterred through over-regulation by the CMA or other regulators.
- 1.5 The CMA therefore needs to structure any remedies flexibly. It also needs to ensure that broader market participants are not excluded from the scope of any remedies – a level playing field is critical to future competition, innovation and market growth. As such, in developing remedies, the CMA needs to involve and seek contributions from all market participants.

2. THE CMA HAS MISCHARACTERISED THE FEATURES WHICH LEADS IT TO FIND AN AEC

2.1 In finding AECs in the provision of each of IC and FM services, the CMA has identified four main features:

2.1.1 Low levels of customer engagement;

2.1.2 Difficulty for customers in accessing and assessing information;

2.1.3 IC firms having an incumbency advantage and steering their clients into FM services; and

2.1.4 High costs in switching provider for FM services.

2.2 We have concerns with how the CMA has approached its analysis of each of these features. The CMA itself has conceded that the evidence for these features is mixed. The inference, therefore, that these contribute to reducing the ability of the broad IC and FM sector to drive competition and to reducing providers' incentives to compete is misguided. These are in fact markets which the CMA characterises as non-concentrated, having low barriers to entry and expansion and which are growing. As such, we consider that the evidence of these features is not sufficient on which to base an AEC.

There is mixed evidence concerning low levels of customer engagement

2.3 The CMA finds that there is 'substantial variation' in trustee bandwidth and capability across both IC and FM, that there is a low level of engagement by only 'some' IC customers and that it is difficult to assess levels of engagement in FM as this is a new and growing market.

2.4 We dispute that this is sufficient to support the finding of an AEC. The implication of this for the CMA's analysis is that any purported detriment from a lack of engagement is, at most, limited in its scope justifying a flexible approach to remedies should the CMA uphold its provisional AEC finding.

The CMA's analysis of engagement is limited in scope

2.5 We operate in a highly competitive market, driven by capable trustees holding us to account. Our market is also heavily influenced by corporate sponsors, professional trustees, third party evaluators and other advisers who complement the skills of lay trustees by evaluating and challenging our services.

2.6 For example, analysis provided by Aon's advisors has found that Aon's FM clients are more engaged than the average FM client. In particular, [X] of Aon FM clients have already held tenders, compared to [X] on average across the industry.⁷ Further, the proportion of Aon's FM clients that have a professional trustee, investment sub-committee or a third-party evaluator are larger relative to the industry average. These values are set out in Table 1 below.

⁷ Source: Aon client data templates.

Table 1: Proportion of schemes of all types exhibiting ‘engagement’, by market and provider(s) (2016)

Market	Provider(s)	Externally acquired (%)	Held a tender (%)	Has a professional trustee (%)	Has used a third-party evaluator (%)	Has an investment sub-committee (%)
FM	Aon only	[>]	[>]	[>]	[>]	[>]
	All parties	[>]	[>]	[>]	[>]	[>]

Source: RBB Economics analysis of the parties' client data. Note: for consistency with the PDR, we have omitted DC schemes from this table; results are not materially changed when DC schemes are included. For the avoidance of doubt, the All parties rows include Aon clients.

- 2.7 Whilst many of our customers are highly skilled, we recognise there are variations in the degree of trustee skill and engagement. We support measures which will assist trustee decision making and hold them accountable. This will benefit trustees and their members.
- 2.8 We have previously acknowledged that improvements can be made to the accessibility, transparency and consistency of information that trustees require to become more engaged when assessing value for money of IC and FM services and when making buying decisions. However, our concern is that the CMA has overstated the impact of low engagement and has failed to consider more broadly low accountability of trustees and of trustee decision making. As a result, the CMA focuses its remedies on simplistic measures to allow trustees to demonstrate engagement, whilst not addressing more fundamentally how trustees can be held accountable in their decision making.
- 2.9 The CMA has opted to continue to measure engagement simply in terms of switching, tendering, formally reviewing fees or quality, or commissioning an external review of fees or quality. While the CMA says “*switching and tendering rates are informative as they indicate the extent to which trustees actively test the market*”,⁸ the CMA has not, in our view, adequately explored the reasoning of trustees who have not switched.
- 2.10 Equally, the CMA does not appear to have fully considered any other indicators of engagement and “*deeper analysis of the switching process*” despite acknowledging their relevance.⁹ In our view, this leads to a significant under-estimate of the degree of engagement of trustees who purchase IC services.
- 2.11 Even to the extent that tendering is used as a measure of engagement, increased use of professional trustees, third-party evaluators (“TPEs”) and the influence of other professionals on schemes means that tendering is becoming increasingly the norm for the appointment of IC and FM providers.

⁸ PDR, paragraph 6.65.

⁹ PDR, paragraph 6.65.

- 2.12 We disagree with the CMA's findings that because an incumbent IC knows a scheme well, that this creates an "*inherent barrier*"¹⁰ to switching, the insinuation being that this evidences a lack of engagement. The CMA presents as somehow inappropriate that an advisor becomes familiar with their client and their needs over time, and provides a service that meets those needs well, such as to make it more likely they will be re-appointed in the event of a tender. However, to suggest that a trustee would only demonstrate 'engagement' by switching presents a misleading over-simplification of the trustee-advisor relationship.
- 2.13 We endorse the CMA's overall finding that a switching rate of 27% does not raise concerns on a lack of competition in the IC market,¹¹ and that competitive pressure can be exercised in other ways than switching alone. However, we consider the CMA should have explored better these other means of applying competitive pressure throughout a trustee/consultant relationship to give a better understanding of the true nature of trustee engagement.
- 2.14 For example, while the CMA considers survey evidence, such as from Leeds University Business School, that found trustees do not often reject the recommendations of their investment consultants,¹² this statistic is used in a simplistic way to assert that trustees do not have the necessary investment expertise to challenge them.¹³ This is narrowly construed to evidence a lack of trustee engagement.
- 2.15 We have previously submitted this is an incorrect way to view engagement with the advice received.¹⁴ The provision of advice is not a 'one shot' process. In meetings with trustees, consultants will suggest investment strategies which are then discussed as part of an iterative process. By the time formal recommendations are made, clients are very likely to accept these, as they will have been tailored to meet the client's needs and objectives.

The CMA cannot place weight on the levels of engagement in FM

- 2.16 We agree with the CMA that it is difficult to assess levels of engagement in FM as this is a new and growing market.
- 2.17 We welcome the CMA's recognition that switching is not a useful measure of trustee engagement with respect to the provision of FM services.¹⁵ This is because the service is nascent and many clients have not yet reached the point when they would be ready to switch in any event. As such, no conclusions can be drawn from this that existing levels of switching are too low.
- 2.18 In our view, switching rates for FM should never be expected to reach those measured for the provision of IC services. FM can be a complex service and it takes time to identify investment objectives, then implement a strategy to realise these

¹⁰ PDR, paragraph 6.76.

¹¹ PDR, paragraph 6.75.

¹² PDR, paragraph 6.31.

¹³ PDR, paragraphs 6.32-6.34.

¹⁴ Aon's response to the working paper on trustee engagement, paragraph 1.12.

¹⁵ PDR, paragraph 6.80.

objectives over time. In our view, the most important factor is not how frequently a scheme switches, but to ensure that when a scheme appoints an FM (i) it does so having made an informed and market-aware selection and (ii) trustees take responsibility to monitor the performance of the scheme and their appointed FM provider at regular intervals.

The CMA overstates the difficulties for customers in accessing and assessing information

- 2.19 The CMA has not made any finding that information is materially deficient, or confusing. At most, the CMA has found that some information may not be sufficiently detailed or disaggregated and that the scope of information that is provided can differ between providers hindering comparability. We note that the CMA has found that IC clients are generally provided with clear and regular information on fees.¹⁶ This accords with our experience in the market place.
- 2.20 We have previously submitted that whilst we consider that improvements can be made to the consistency of presentation of information, the introduction of the MiFID II and IDWG templates will assist here. We do not believe that there is a general deficiency in information provided to trustees that leads to reduced competitive pressure and in turn reduced incentives to compete, or that a lack of standardisation does not equate to a lack of effective competition.
- 2.21 In addition, Aon's FM clients responding to the CMA's survey indicated that they found it easier to monitor fees than the average respondent. Specifically, the proportion of Aon clients that found it "very easy" to monitor FM fees stands at [X] for Aon, relative to [Y] on average. Only one client indicated that monitoring FM fees was "not very easy" and none said "not at all easy".
- 2.22 We disagree with the suggestion that even though a clear majority of trustees said that they find it easy to compare fees, this is only because they do not know "what good looks like"¹⁷. This is not our experience.

Clients are not 'steered' into purchasing FM services; IC firms do not have an incumbency advantage

Evidence does not support a finding that trustees consider 'steering' to be a problem

- 2.23 The CMA's core evidence used to support the allegation that clients are 'steered' into purchasing FM services is the result of the Trustee Survey. However, the CMA has interpreted the survey results in a misleading fashion.
- 2.24 The CMA notes that 60% of trustees perceived that investment consultants steering clients into FM was 'a problem'.¹⁸ However, the CMA in fact identified that 60% of trustees considered steering to be a *potential* problem, but that 30% (i.e. half of

¹⁶ PDR, summary of findings, page 72.

¹⁷ PDR, paragraph 5.12(c).

¹⁸ PDR, paragraph 7.17.

these respondents) considered the potential problem to be well-managed. In our view, this means that these respondents did not see a problem at all.

2.25 It is inherent in the structure of a market that there will be a ‘potential’ problem of steering when a provider of one service wishes to cross-sell another. In this respect, the more meaningful statistic is that 70% of respondents were comfortable with the effectiveness of the market and that only 30% of respondents considered there to be an actual problem that requires addressing.

2.26 With respect to Aon’s own clients, the CMA’s survey illustrates how a well-devised and rigorously-enforced conflicts management policy, along the lines that Aon already implements, can substantially address the potential problem of conflicts of interest: while 30% of all survey respondents found that steering was “*A problem, and more should be done to address it*”, only [30] of Aon’s FM clients said the same. Further, the CMA did not consider it problematic that 26% of respondents considered ‘steering’ from FM to AM to be a “*problem that more should be done about*”.

Firms’ practices and incentives for selling FM are not problematic as they are well managed

2.27 It is not unusual for an IC-FM firm to have the incentive to cross-sell FM. Cross-selling is a feature of any professional services firm and even if the commercial incentives to do so are ‘particularly strong’ this should not in itself be problematic, so long as adequate safeguards against conflicts of interest are put in place.

2.28 None of the evidence put forward by the CMA to evidence ‘steering’ is empirical. It mostly comprises survey results and internal documents which cannot in themselves evidence that consultants have ‘steered’ trustees to purchase FM. Indeed, the CMA adduces evidence to show that far from being disadvantaged, clients who engage their existing IC provider to deliver FM services may well be better off than those who switch.¹⁹

2.29 The CMA also downplays the fact that many trustees are already sophisticated buyers of IC services, when deciding to purchase FM services.

2.30 We note that the CMA itself concedes that “*none of the evidence implies that firms are seeking to sell FM services that are against clients’ interests*”²⁰.

2.31 The only substantive evidence that the CMA appears to have gathered which supports the CMA’s allegation that clients are ‘steered’ into FM is the observation from internal documents, which pre-date improvements within the industry, that firms instigate strategies to sell FM to existing IC clients. However, this falls some way short of supporting the finding of an AEC.

Conduct of firms when introducing and advising on FM

2.32 The CMA notes²¹ that because a customer’s journey from IC to FM can take several months, the nature and duration of an IC-FM firm’s relationship is stronger

¹⁹ PDR, figure 26.

²⁰ PDR, paragraph 42.

compared to other possible providers without the same degree of interaction. This is true but is also perfectly legitimate.

- 2.33 While, as an IC-FM firm, we have reasonably extensive contact with our clients, we do not leverage this relationship to actively influence trustees to take any course of action that is contrary to their best interests.
- 2.34 We disagree with the CMA's assessment that conflicts of interest policies under which IC firms 'introduce' but do not 'recommend' their own FM service may leave a grey area where a customer is unclear whether a firm is providing impartial advice on FM as a model or if the firm is promoting their own product.
- 2.35 We consider that we are very clear with IC customers that when we make them aware of our FM service, we introduce it, but do not recommend it. Our internal compliance documents (as seen by the CMA) show that:
- 2.35.1 Clients are to make their own decision on whether to move to the FM service. We do not pressurise them to do so.
- 2.35.2 Clients have been directed to a TPE if they would like advice regarding our FM services. On many occasions trustees opt to purchase FM services from a competing provider, even though we will have made them aware that this is a service Aon offers.
- 2.35.3 The vast majority of FM appointments are now made following a competitive review.
- 2.36 We are surprised by the comment from the round table that trustees have purchased a delegated product without realising that this is an FM solution thus 'slipping' into FM.²² There are various documents that must be negotiated and agreed prior to the move to FM services such as the investment management agreement setting out the investment parameters within which the FM provider may operate. The terms of such agreement make it clear that certain investment powers will be delegated to the FM provider.

The CMA has undertaken inadequate analysis of trustee purchasing decisions

- 2.37 In our response to the working paper on the provision of FM services by investment consultants, we made clear that it should not be assumed that a switch to a new FM provider rather than to the existing IC provider's FM solution was in a client's best interests. Where no switch takes place, it is not correct to assume that this is because a customer has been 'steered' to remain with their existing provider. By focussing too much on the act of switching, the CMA has inadequately considered trustees' processes of review.
- 2.38 No conclusions can be drawn from the fact that many existing IC clients opt to purchase FM services from the same provider; or have not used a third-party evaluator to help them to decide whether to switch or not. In our experience, trustees are informed and capable and are aware of other FM providers, especially

²¹ PDR, paragraph 7.107.

²² PDR, paragraph 7.129.

given the increased prevalence of professional trustees, who will be aware of a range of FM providers across their different appointments. They challenge us, and take input from other professional advisors, when moving from IC to FM. This includes the receipt of advice from legal advisers which, in our experience, is always robust.

- 2.39 They are already well-appraised of their IC firm's strategy, operational due diligence capability, manager selection and asset allocation expertise. Since these are core criteria in choosing an FM, just as they will have been when the scheme chose their IC provider, it is natural that many trustees conclude that their existing IC provider would be their best fit to provide FM services. This in itself cannot be taken as evidence of 'steering'.

On the CMA's analysis 'steering' by asset management firms is also problematic

- 2.40 If standard cross-selling by professional services firms is considered to be 'steering' the activities of FM and AM firms who 'steer' customers to their own asset management products are likely to have as significant, or even a more significant, impact on customer outcomes than any alleged 'steering' of IC customers to a firms' FM offering.
- 2.41 The CMA does not appear to be concerned by this issue, noting that only 26% of CMA survey respondents said that FM to AM steering with a problem that more should be done about. However, we would note that respondents exhibited essentially the same level of low concern about steering from IC to FM. Only 30% of respondents to the CMA survey said that IC to FM steering is a problem more should be done about, yet the CMA took this as evidence of there being a potential issue that needs to be rectified. This is clearly an inconsistent and subjective approach, that risks leading to market distortion, if remedies to tackle alleged conflicts of interest are centred only on IC-FM firms. Please also refer to our discussion at paragraph 2.28 above.

Costs of switching

- 2.42 The CMA is correct to observe that FM has higher on-going and switching costs. There are valid reasons for this based on the need to change investment strategy and these are described in some detail by the CMA at Appendix 3. It is wrong for the CMA to draw simplistic conclusions and especially for it to set the costs and process of switching against those of switching IC provider. This is a misleading comparison, which fails to take account that much of the cost of any FM switch is attributable to the costs charged by the underlying asset manager.
- 2.43 While we acknowledge that the cost and time commitment involved in a switch from IC to FM requires considerable care, this is not a factor that contributes to the finding of an AEC.

3. THE CMA HAS NOT PRESENTED CLEAR EVIDENCE OF ADVERSE MARKET OUTCOMES OR DEMONSTRATED MATERIAL CUSTOMER DETRIMENT

The CMA has failed to adequately quantify any detriment caused by the alleged AECs

3.1 The CMA has failed to quantify the material customer detriment created by the alleged AECs. The CMA appears to suggest that outcomes for clients should be even better and this is the detriment. We have four specific concerns:

3.1.1 The CMA's assertion that 'engaged' clients pay 24% less for FM services gives no clear indication of levels of customer detriment across the market as a whole, and is in any event a flawed statistic.

3.1.2 The CMA offers no basis for the suggestion that fees may be at least 10% higher than they should be in a well-functioning market.

3.1.3 The evidence that the CMA cites on the quality of service received and in turn the quality of schemes' investments, places an excessive weighting on a small number of negative findings. It must not be forgotten that 94% of IC respondents to the trustee survey were satisfied with the service provided, including 56% who were "very satisfied" (with similar figures for FM).²³

3.1.4 The CMA's attempts to use econometric analyses to evidence the impact of any AEC on service quality are either flawed or lack statistical significance.

3.2 Each of these factors mean that the evidence that the CMA has reviewed does not support a theory of harm that service quality, and thus investment performance, is worse than would be expected in a competitive market.

Analysis of pricing gains from engagement does not sufficiently evidence customer detriment

3.3 A central aspect of the CMA's quantification of alleged detriment appears to be the assertion based on its gains from engagement analysis that 'engaged' FM customers could pay around 24% less in fees than 'disengaged' customers.²⁴ This is not sufficient to quantify customer detriment since, for the following reasons, we consider the CMA's analysis of the fees paid by disengaged schemes to be flawed:

3.3.1 First, we do not accept that engagement in itself is a measure of a well-functioning market. Many markets contain certain customers who are less engaged than others. Any difference in pricing attributed to the degree of customer engagement cannot be used as a way of quantifying any perceived issues in pricing in the market as a whole.

3.3.2 Second, the CMA's assertion that 'disengaged' FM schemes pay 24% higher prices than 'engaged' schemes is in large part the result of the gains available to Internally Acquired ("IA") clients – i.e. those clients that use the

²³ PDR, paragraph 10.94.

²⁴ PDR, paragraph 11.15.

same provider for IC and FM services. Put differently, there is no robust evidence to suggest that being an IA scheme is harmful. Indeed, on average (and focusing on statistically significant results), engaged IA schemes pay *less* than EA schemes, while disengaged IA schemes do not pay more.²⁵

3.3.3 Third, the CMA's chosen measures of engagement do not produce consistent results with respect to the gains from engagement conclusions. When the CMA looks at gains from engagement for each of tendering, TPE, and PT separately in its sensitivity checks for the FM static regression, only the tendering measure gives rise to a gain from engagement.²⁶

3.4 Finally, Aon notes that the CMA continues to rely on its 'transition' analysis to measure gains from engagement when moving from IC to FM, despite its spend ratio measure being economically meaningless. As set out in Aon's response to the gains from engagement WP, the spend ratio the CMA uses in its transition analysis may in fact measure *the opposite* of what the CMA seeks to gauge. Moreover, the CMA fails to acknowledge and address this criticism anywhere in the PDR.

No evidence to support suggestion that any market-wide over charge could exceed 10%

3.5 The CMA states that even if fees were on average "*only 10%*" above those in a well-functioning market, a customer detriment of at least £450m would arise across IC and FM.²⁷ Yet the CMA has undertaken no comparison of existing prices to those it would expect to observe in a well-functioning market. It therefore has no basis to infer that any over-charge across the industry could in fact be 10% or higher.

3.6 Further, if 10% is deducted from the mid-point of the CMA's calculated IC-FM profitability percentage of [20-30%] one arrives at an average percentage profit for a 'well-functioning' market of 15%. This would be extremely low for an accepted professional services business model. It is clearly misconceived to suggest that a 10% market-wide over-charge should be a lower bound of any estimate.

The CMA places undue weight on a small number of quality measures

3.7 The CMA's further conclusions on the impact of an AEC on the quality of service received and in turn schemes' investments themselves is one-sided, placing undue weight on a small number of negative findings and largely ignoring a number of positive findings:

3.7.1 A high proportion of survey respondents are happy with their IC providers. In particular, 94% of IC customers responding to the CMA's survey are "*very satisfied*" or "*satisfied*" with their provider.²⁸

²⁵ The CMA states that "*Externally Acquired schemes appear to pay about 14% less than less engaged Internally Acquired schemes, but this effect is not statistically significant*", paragraph 10.39.

²⁶ PDR, Appendix 5, Table 26.

²⁷ PDR, paragraph 11.16.

²⁸ PDR, paragraph 10.94.

3.7.2 The CMA has found that IC and FM providers are able to secure better discounts from asset managers than schemes are able to achieve themselves.

- (a) The CMA notes that schemes using manager product recommendations receive a discount of 17% compared to 11% for those that do not.²⁹
- (b) The CMA notes that discounts are ‘substantially’ higher in FM, which the CMA correctly attributes to economies of scale.³⁰ While the CMA has noted that less ‘engaged’ IC clients may achieve lower discounts, the CMA has not reached any conclusion that achieved asset manager discounts should be higher overall.

3.7.3 IC and FM firms add real value in terms of asset allocation and the CMA has collected no persuasive evidence to the contrary:

- (a) We note that the CMA does not consider it “pragmatic” to conduct a large-scale quantitative analysis³¹ on the effect on returns from asset allocation advice, albeit it conceded that in relation to hedging (a key important scheme decision) asset allocation advice ‘*may have produced*’ value for customers.³²
- (b) The consequence is that the CMA has assembled limited evidence to support any finding that improvements in returns from asset allocation are not as high as expected in a competitive market. Given that this element of service is generally accepted to be responsible for up to 90% of the variation in a scheme’s’ returns,³³ we cannot see how the CMA is able to conclude that it has sufficient evidence of customer detriment to support the finding of an AEC.

The CMA’s econometric analysis leading to the conclusion that AM product recommendations do not lead to statistically significant improvement in returns after fees is misconceived

3.8 The evidence on the outperformance of AM product recommendations that the CMA has assembled remains insufficient to substantiate customer detriment that supports any finding of an AEC. In particular, the CMA has done little to incorporate the necessary changes identified in Aon’s response to the AM product recommendation WP. In this section we address three key aspects of the CMA’s analysis:

²⁹ PDR, paragraph 10.64.

³⁰ PDR, paragraph 10.64.

³¹ PDR, paragraphs A6.64-65

³² PDR, paragraph A6.64.

³³ We note that at paras A6.56-57 the CMA is dismissive of the metric that asset allocation represents 90% of outcomes. We consider that the evidence to support this assertion is weak and unconvincing. It comprises only two academic studies (one 27 years old) plus an unsupported assertion that trustees consider asset allocation and manager selection to be “*equally important*”.

- 3.8.1 The CMA acknowledges that some providers of 'buy-rated' products outperform their benchmark, even after AM fees.
- 3.8.2 The CMA's treatment of backfill bias results in an understatement of performance.
- 3.8.3 The CMA has not addressed criticisms of its methodology that would correct an understatement of the performance of 'buy-rated' products.

Certain providers of buy-rated products outperform their benchmarks net of fees

- 3.9 While we continue to have significant concerns regarding the AM product recommendation analysis, the CMA notes that some providers' 'buy-rated' products outperform their benchmarks net of AM fees to a far greater degree than the average of 4 bps per quarter and that this is statistically significant for two providers. Aon expects to fall into the latter group of high performers. This is because in response to the CMA's AM product recommendation WP, Aon demonstrated that when necessary corrections to the CMA's analysis are made, its buy-rated products outperform their respective benchmarks by a substantial amount and that this is statistically significant.

The CMA's treatment of backfill bias results in an understatement of performance

- 3.10 Aon's practice is to exclude backfilled returns and so take into account returns only once a product has been listed on eVestment. However, instead of dropping the specific backfilled time-period for each product from its analysis, the CMA drops the product from its AM product recommendation analysis *entirely*. As set out in response to the AM product recommendation WP, Aon contests this assumption – there is no reason to expect backfill bias impacts on returns going forward (i.e. once a product is listed on eVestment). Moreover, the CMA's approach has the unintended effect of removing the vast majority of products that were inception since 2007, approximately [X].
- 3.11 The CMA's findings are sensitive to the treatment of the backfill bias. In particular, the CMA concludes that the active returns of recommended products with a period of backfill (i.e. those *omitted* from the analysis) are on average [X] bps per quarter higher than the products without backfilled periods (i.e. those included in the analysis).
- 3.12 The products dropped from the CMA's analysis therefore perform materially better than those included in its analysis. This assessment includes all time periods, whether backfilled or not. Therefore, this difference could be related to performance in the backfilled time periods, but it could also be due to better performance in non-backfilled time periods that do not suffer from a bias. Regardless, it demonstrates that the AM product recommendation conclusions are sensitive (and likely to be understated) due to assumptions the CMA has made that (i) Aon contests and (ii) Aon's advisors have shown to be material in their response to CMA's AM recommendations WP. Finally, we note that the CMA does not report the implications of this alternative (more reasonable) approach to accounting for backfill bias.

The CMA has not addressed criticisms of its methodology which would correct an understatement of the performance of 'buy-rated' products.

- 3.13 The PDR acknowledges, but does not implement, several other criticisms made by Aon in response to the AM product recommendation WP. Specifically:
- 3.13.1 In some cases, the CMA uses benchmarks that are gross of withholding tax despite the net of withholding tax benchmark being the industry standard. This results in the understatement of both the gross and net active returns for these products (because benchmark returns are overstated). Rather than correcting for this issue, the CMA only refers to a previous FCA finding that only 11% of products are affected resulting in a bias of up to 5 bps.
- 3.13.2 The average discount rate on 'buy-rated' products the CMA uses for Aon is understated due to the use of a simple average calculation across clients and the inclusion of passive products.
- 3.13.3 A significant proportion of Aon's 'buy-rated' products are excluded from the CMA's net active return analysis due to the omission of AM's fees reported in GBP.

The CMA's Greenwich Associates analysis is misconceived and lacks statistical significance

- 3.14 The CMA asserts that one indicator that the market is not functioning well is that high quality firms do not gain market share quickly enough. It is important to note that this allegation does not relate to the FM market but to the IC market. Specifically, the CMA concludes, based on data provided by Greenwich Associates ("GA"), that IC providers with above-average quality had persistently lower market shares. The CMA reaches this conclusion based on (i) an econometric analysis of how the quality score can explain variations in market shares, and (ii) a graphical representation of how average market shares have developed over time for above-average quality ICs and below-average quality ICs, according to GA's quality score. We discuss why each of these approaches is misconceived below.

The CMA's analysis of average market shares is misleading

- 3.15 Figure 28 of the PDR shows the *average* market shares over time of above-average quality ICs and below-average quality ICs.³⁴ The CMA concludes from the analysis that those who provided a higher quality service had persistently low market shares.³⁵ However, closer inspection indicates that the CMA's analysis is misleading. In fact, the below-average quality ICs observed a decline in their combined share of approximately [3<] percentage points, which has been captured by the above-average ICs.

³⁴ The CMA defines an above average IC as an IC which has an average quality score over the whole period which is above the average quality across all ICs across the whole period.

³⁵ PDR, paragraph 10.106.

The CMA's econometric analysis of GA data is misconceived

- 3.16 Providers' market shares are a function of many factors in addition to service quality, including returns, IC fees and AM fee discounts. Even if persistent low shares for providers with above average quality were found (which is denied), this could be the result of below average performance in these other dimensions of competition. The CMA does not take this into account. In short, the CMA's regression is not correctly specified.
- 3.17 The CMA's analysis is, in any event, not robust. The CMA's baseline is a pooled OLS regression. However, it is standard when analysing panel data to run Fixed Effects (and Random Effects). The CMA's pooled OLS regressions suggest a negative relationship between the GA quality score and market shares significant only at the 10% level. If instead Fixed Effects or Random Effects regressions are used, no statistically significant relationship emerges between the GA quality score and market shares. This further undermines the validity of the CMA's econometric analysis and any inference drawn from it that the market might not be functioning well.

No evidence of excess profitability

- 3.18 If there were material issues with competition in either the IC or FM segments one might expect to see excessively high profitability among industry participants.
- 3.19 However, the net profit margin that the CMA has calculated of [20-30%] for IC and FM services combined across the leading six providers does not reach this threshold. We also note that the CMA has not calculated a higher individual figure for either IC or FM.³⁶ In our view, these levels of profitability are in line with what one would expect for a typical professional services provider operating in a competitive segment. The CMA finds that IC and FM profitability is lower than that for asset managers, which are in many ways the most appropriate comparator.
- 3.20 We do not believe that calculated levels of ROCE or equivalent industrywide metrics would be excessively high and we agree with the CMA's findings at Annex 7 to the PDR that it is extremely difficult to calculate a consistent capital base across all IC and FM operators. As such, ROCE cannot be meaningfully calculated with respect to either IC or FM services.

³⁶ PDR, paragraph 10.114.

PART B – COMMENTS ON REMEDIES

1. INTRODUCTORY POINTS ON REMEDIES

- 1.1 If the CMA continues to find that there are AECs with respect to the provision of both IC and FM services, Aon supports many of the proposals put forward by the CMA.
- 1.2 Due to the alignment of the proposed remedies with our previous thinking, there are no additional remedies that we wish to see adopted beyond those that the CMA has proposed, although we do suggest some adjustments to the scope of certain of the remedies. We agree with the CMA's decision not to take forward the potential further remedies described from page 307 of the CMA's report. Those that the CMA describes would not have been proportionate to the alleged AECs and, as the CMA identifies, would have had an overall negative effect on the market. We make no further comment on those potential remedies.
- 1.3 We support the CMA's main thrust of driving better trustee engagement. However, we caution against the CMA using blunt tools to achieve this. Instead, we encourage the CMA more broadly to focus on improving wider trustee accountability when selecting IC and FM providers and making related decisions. Such accountability is crucial for the long-term interests of scheme members.
- 1.4 The only remedies that we have specific concerns about are Remedies 1 and 2:
 - 1.4.1 **Remedy 1** – the CMA's proposal to mandate a competitive tender at the time a scheme appoints an FM provider for the first time. Within the context of encouraging greater trustee accountability, a more flexible requirement for trustees to transparently account for their FM appointment decisions would achieve the same objective. However, this would be in a way that would avoid the need to mandate expensive obligations on trustees and service providers.
 - 1.4.2 **Remedy 2** – the requirement to issue a warning is incorrectly targeted at the FM solution itself. A transparency statement should target problematic conduct by service providers, rather than creating the incorrect impression that the FM solution is the cause for concern.
- 1.5 The CMA will appreciate that in these markets the 'devil will be in the detail' in creating effective and workable proposals. Therefore, we have provided reasonably detailed comments with respect to all eight core remedies.
- 1.6 Although the remedies have different objectives, it is important that the package of remedies ensure that less engaged trustees start to be more transparent and accountable, while making available more readily comparable information from providers to support their decision making.
- 1.7 In order to be perfectly clear, we support the drive for increased tendering as this naturally creates healthy competition. We have a proven track record of delivering value and thus do not fear the prospect of greater competition.

- 1.8 However, in saying the above, mandatory tendering may create serious competitive problems in the market rather than address them. This is because if it is only applicable to specific purchases of FM services, it will incentivise trustees to purchase services not covered by the mandatory regime, even in circumstances where such a purchase would not be in members' best interests. It is also critical that the CMA maintains a level competitive playing field in the sector.
- 1.9 We consider that the following design criteria must be adopted by the CMA as a minimum in any remedies imposed:
- 1.9.1 Focussed on the nature of the services provided, rather than the identity of the service provider.
 - 1.9.2 Proportionate. This is particularly important given the risk of adding considerable operating costs to smaller schemes, while not materially improving their scheme outcomes. Remedies also need to consider the fact that evidence on which the CMA has based its AEC findings is at best mixed (and in our view, is in many places weak).
 - 1.9.3 Constructed to keep costs of compliance for trustees and IC or FM providers at a reasonable level. This means avoiding the temptation to impose complex, rigid, expensive requirements in circumstances where there is no proven need. For example, an over-onerous mandatory tendering remedy could prevent small schemes from taking advantage of moving to FM, despite the benefits it brings.
 - 1.9.4 Designed with the benefit of extensive cross-industry engagement. This will ensure that remedies are developed in a fully practical way and are effective from the first day they are imposed.
 - 1.9.5 Built on good initiatives that have already taken place in the industry. For example, this means avoiding duplication of work undertaken by IC Select and the CFA wherever possible.
 - 1.9.6 Constructed in the acknowledgment that the real beneficiaries of our services are the scheme members.
 - 1.9.7 Able to adapt to the evolution of the nascent market that is FM. Any remedy that is too rigid could find itself being frustrated as the FM market continues to evolve.
- 1.10 In the remainder of this Part B we evaluate each of the CMA's proposed remedies individually.

2. REMEDY 1: MANDATORY COMPETITIVE TENDERING ON FIRST ADOPTION OF FM

Aon's views in summary:

- *We are supportive of encouraging better trustee engagement.*
- *We welcome tendering within a range of approaches to support engagement and competition.*
- *However, making tendering mandatory presents serious risks of creating market distortion if not carefully implemented.*
- *Any tendering remedy must not operate to deter schemes from moving to FM where this is the most appropriate solution.*
- *FM providers should not be required to police compliance before accepting instructions.*
- *A trustee accountability regime, founded on tPR guidance and transparent accountability for first FM provider appointments would be more proportionate and effective. It also allows the tPR to adapt its guidance as FM continues to develop.*

2.1 As set out in relation to Part A of this response document, we do not consider that there is an AEC with respect to the provision of either IC or FM services. If that is accepted, no mandatory tendering remedy should be necessary, especially given that the vast majority of new appointments of providers of FM services now involve some form of voluntary tender in any event.

2.2 We do, nonetheless, support the CMA's encouragement of tendering representing best practice, which we consider to be positive for clients and prospective clients. However, we would caution that any tender remedy that focusses on mandating rather than encouraging tendering should be developed with an eye on the potential market distortions this could create. This is a particular risk in view of the CMA's current focus on mandating tendering only within the FM space. The CMA must be mindful of the fact that it has not found the FM market to be uncompetitive nor has it questioned the FM product itself. Singling out FM could create a negative impression of this service and may have the unintended consequence of market stagnation. This is discussed further in our 'mandatory tender on first adoption of FM' section below.

2.3 If the CMA has found any AEC (and we do not consider it has) this relates to the way services are purchased and monitored. The main objective of any remedy should be increased engagement on the part of trustees in the appointment and ongoing review of their FM provider. Tendering is only one means of achieving this. It is therefore important that such a remedy is applied proportionately and considered in the context of the other remedies proposed by the CMA and also the way in which the rest of the market will operate. It must balance the need to drive trustee engagement and encourage competition against the need to ensure that the remedy does not become overly burdensome. It must not operate to deter

schemes from moving to FM where this is the most appropriate solution and securing the benefits that it brings, especially for smaller schemes.

- 2.4 There are two potential approaches that the CMA could adopt to secure increased engagement when trustees appoint an FM provider:
- 2.4.1 a mandatory approach, which will drive engagement by requiring behaviours that are governed by a clearly defined set of rules; or
 - 2.4.2 an accountability approach, which will drive engagement by increasing trustee accountability through requiring tPR best practice guidelines to be considered, complemented by mandating transparent disclosure of the decision making process.
- 2.5 In view of the complexities and risks inherent in adopting a mandatory tendering approach, the CMA should explore a more flexible approach which focusses on increasing trustee accountability for their FM purchasing decisions. This would not only be more proportionate, but would be more effective in ensuring greater trustee engagement in, and transparency of, the decision to first move from IC to FM.

Mandatory tendering on first adoption of FM

- 2.6 If the CMA does decide to implement a mandatory tender regime this will need to be carefully crafted. The implementation of rules that are too definitively targeted on a narrow view of FM would create a significant risk of market distortion:
- 2.6.1 *Creation of uneven playing field:* Applying rules to only one aspect of a market in which substitute services are readily available could unduly influence clients to remain in, or purchase, a service which is not described as FM, where this is not ultimately in the best interests of its members. This could have a significant impact on scheme outcomes.
 - 2.6.2 *Rule avoidance:* Providers may seek to ‘game the system’ to gain a competitive advantage by avoiding an overly complex or burdensome tender regime. This could be achieved, for example, by structuring services to sit outside applicable definitions of FM.
- 2.7 While each of these risks could be mitigated by imposing comprehensive rules and guidance. Such steps would likely increase the cost of a tender process as clients seek to navigate the process in a compliant manner. This will not only incur time costs for clients and providers, but may well result in clients retaining lawyers to manage compliance risk. Ultimately, any additional costs will be borne by scheme members or employers/sponsors.
- 2.8 We discuss below, on a thematic basis, the key issues that the CMA will need to resolve to implement an effective mandatory tender remedy.

Definition of FM

- 2.9 To adopt a mandatory approach, it would be crucial to provide a clear definition of what an FM service is under the relevant rules. For example:

- 2.9.1 For some firms (ourselves included) the intellectual capital underlying the FM and IC offerings are the same. They are simply delivered to clients in differing ways. Any definition of FM would need to avoid distorting the IC market where no AEC has been found requiring a blunt remedy of mandatory tendering.
- 2.9.2 Others carry out FM or FM-equivalent services but do not describe these as FM. For example, within the partial FM segment, there are numerous alternative models which are not marketed as FM because they are offered by firms which do not offer full portfolio FM services. These include:
- (a) Diversified Growth Funds (“**DGFs**”) – the DGF manager will decide asset allocation as well as, in many cases, the underlying investment managers. Trustees using a DGF essentially delegate day-to-day management of a portion of their assets to the DGF manager with the intention of achieving a predetermined objective; and
 - (b) Fund of funds products – a hedge fund strategy, for example, operated by a FM firm will essentially comprise a fund consisting of single strategy hedge funds (i.e. a fund of funds), in respect of which the FM has complete flexibility on the underlying strategies and managers to use and the asset allocation to each strategy. The same structure is adopted by an asset manager or specialist firm which offers fund of hedge funds or multi-manager hedge fund products. In each instance, the trustee will delegate the same amount of its portfolio and the delegation will take effect in the same manner.
- 2.10 Any mandatory tender remedy will therefore need to create a model-neutral operating environment that seeks to capture any potential future models that may be developed specifically to avoid the mandatory tender regime. For example, current providers of partial FM services could restructure their solutions into a DGF wrapper, or could badge a service comprising slightly less than a full or partial FM mandate as a ‘balanced mandate’ to avoid the mandatory tender regime. Other models could be adopted which fall short of absolute delegation because there is, in theory, a trustee right of veto. A failure to take account of these issues could hamper client choice and restrict competition. Clients could be more inclined to move to an ‘FM-like’ model which sits outside of the mandatory tender regime, regardless of whether this is in their members’ best interests.
- 2.11 Capturing solutions such as DGFs and fund of funds would have a significant impact on the market, because these solutions are so heavily used. For example, DGFs alone are estimated to represent around £200bn of assets under management in the UK. For reasons of consistency and avoidance of market distortion outlined above, these cannot be excluded from the regime unless all partial FM solutions are also excluded.

- 2.12 However, excluding partial FM solutions brings its own difficulties since it is difficult to avoid gaming in a scenario where a tender is required for delegating responsibility for 100% of assets, but not 99%.

Risk of FM market stagnation

- 2.13 Even if an appropriate definition of FM can be constructed, the fact that the remedy is only applied to the purchase of FM services could have a negative impact on the market. It would create a negative perception of FM, suggesting that it is potentially risky and requires more detailed consideration than is the case when selecting an IC provider. That is not the case.
- 2.14 The CMA states that a mandated tender on first adoption of FM would address the issue of incumbency advantage, but the CMA has not adduced sufficient evidence that any such advantage exists. The CMA has found a competitive market and has evidence that trustees are already testing the market in ways that they see fit given the circumstances of their scheme. The CMA risks stagnating this market by removing the trustee's flexibility and adding additional cost and burden of a mandatory tendering regime. This will inhibit some schemes from purchasing FM services.

Defining a competitive tender

- 2.15 Any mandatory tendering regime will need to clearly set out what constitutes an adequate tender. A fully open tender process is not appropriate.
- 2.16 An open tender is typically understood to involve issuing a public request for a proposal to which the whole market may respond. Such an approach may not promote competition in the way intended. In a competitive market like FM, providers may become selective and only respond to opportunities where they think they have the best chance of winning. This behaviour is driven by the fact that the cost of responding to numerous open tenders is high. This cost could also impact the quality of the responses and see superficial and untailored proposals given to trustees which would only make their job more onerous.
- 2.17 Further, it would be more likely to result in trustee disengagement as they would be likely to either:
- 2.17.1 outsource the review of the tender documents to a third party as it may not be able to conduct the exercise itself due to time and resource constraints; or
 - 2.17.2 not give detailed consideration to each response provided, or adopt an overly simplified approach to selecting the winner based on past relationship, brand recognition, or cost.
- 2.18 However, we note that the CMA has indicated informally that by 'open' tendering it does not mean every potential provider needs to be invited.³⁷ In our view, a tender

³⁷ Comments made at the Transparency Task Force Symposium 'Time for Transparency – the CMA's investigation into investment consulting and fiduciary management, Thursday 26 July.

process may still be highly effective if three providers were invited to submit a proposal for a mandate.

- 2.19 In addition, providers may seek to address the same client challenge by adopting differing types of solutions. So long as each is responding to the same scope and mandate provided by the trustee, this should be deemed competitive, regardless of whether the other proposals involve FM or not.
- 2.20 For example, a trustee may send the same request for proposals to (i) an IC firm, which proposes an advisory approach with trustee implementation, (ii) an FM firm, which proposes a full FM solution, and (iii) an IC-FM firm, which proposes an advisory approach alongside partial FM for certain elements of the portfolio. All three respond to the same request and so this should constitute a competitive process.

Flexibility for small schemes or partial mandates from larger schemes

- 2.21 Carrying out a mandated tender process may not suit smaller resource-constrained schemes, who would be at greater risk of not purchasing FM because of associated tendering costs. While the importance of trustee engagement and the need to deliver good member outcomes is not scheme-size dependent, small schemes do need to have flexibility on tendering (as they have today), which is difficult under mandatory rules that are designed to apply to a very diverse market.
- 2.22 This would equally apply to larger schemes where it would not be viewed as economic to carry out a detailed tender for a small mandate.
- 2.23 Overall, we strongly believe that FM has improved outcomes for both clients and their beneficiaries. It is necessary to ensure that a mandatory tendering regime does not dissuade trustees from considering FM where this would be a better approach than IC to meet their needs.

Schemes that have already moved to FM

- 2.24 We do not support mandatory retrospective tendering for schemes that already purchase FM:
- 2.24.1 Clients who already receive FM services are not 'locked in' so it is not appropriate to require them to go through the additional cost involved in a mandated tendering regime. If trustees are unhappy with their current provider, the CMA has found there to be no significant barriers to switching to another. Following the implementation of Remedy 7 (duty on trustees to set their investment consultants strategic objectives) and the transparency remedies,³⁸ trustees will be better placed to judge the adequacy of their current provider; and
- 2.24.2 Given the industry's movement to regular review and tendering, within a reasonable period it is highly likely that trustees will retender in any event.

³⁸ Remedies 4 (requirement on firms to report disaggregated fiduciary management fees to existing customers), 5 (minimum requirements on firms for fee disclosure when selling fiduciary management) and 6 (standardised methodology and template for reporting past performance of fiduciary management services to prospective clients).

They do not need to be obliged to follow a compulsory timetable that may not suit their scheme's best financial interests, and will incur significant additional time and expense in circumstances where they may well re-appoint the same FM provider.

- 2.25 As an alternative, tPR guidance issued pursuant to Remedy 3 should simply include a recommendation that existing recipients of non-tendered FM services consider whether their current provider continues to satisfy their requirements.

Best practice with accountability approach

- 2.26 The CMA notes that the core aim of introducing a mandatory tendering regime for FM is to ensure that trustees make an active, informed choice when they move into this service. Good trustee engagement can be achieved in a straightforward manner by enhancing trustee accountability and transparency for their FM purchasing decisions.
- 2.27 We do not consider that a mandatory tendering regime is required to achieve this aim. The tPR could very effectively develop a set of principles which would set out best practice on making the first appointment of an FM provider. It could detail when a tender process ought to be carried out, the minimum standards to which tPR would expect trustees to adhere, and best practice notes on what a good tender process might look like in various scenarios. The tPR would also be able to adapt such standards and guidance as the market evolved.
- 2.28 Accountability would come from a mandatory requirement on trustees to explain, in the recently proposed³⁹ DB Chair's statement or DC Chair's statement, how the move from IC to FM came about and the steps taken to implement that move. The trustees could explain whether an FM appointment has been made in compliance with all of the relevant tPR guidance or, if not, to explain why this was not considered to be in members' best interests. In our view, adding this layer of accountability and transparency will naturally oblige trustees to consider carefully their approach to appointing an FM provider and the best process to adopt, resulting in enhanced engagement in the process. This approach has already been shown to be effective in driving better accountability in the DC space through the use of a DC Chair's statement.
- 2.29 This accountability would be closely interlinked with Remedy 3 (enhanced trustee guidance on competitive tender processes) and Remedy 7 (duty on trustees to set their investment consultants strategic objectives), each of which similarly look to enhance trustee engagement and, ultimately, accountability to be overseen by tPR. It should also be viewed in the context of the enhanced transparency measures detailed in Remedies 4 (requirement on firms to report disaggregated fiduciary management fees to existing customers), 5 (minimum requirements on firms for fee disclosure when selling fiduciary management) and 6 (standardised methodology and template for reporting past performance of fiduciary management services to

³⁹ This was announced in the Department for Work & Pensions white paper '[Protecting Defined Benefit Pension Schemes](#)', March 2018.

prospective clients) which will together enhance comparability across providers and further facilitate an effective tender process.

2.30 This approach would effectively mandate the engagement rather than the form of engagement. In our view, it would achieve the same objective as a mandatory tender approach in a more proportionate manner and would bring a number of additional advantages:

2.30.1 Since the CMA commenced this investigation there has been a decisive shift in the market towards increased tendering. Indeed, the major part of our current pipeline of potential FM clients is being tendered in some way shape or form. In our view, it is disproportionate to mandate tendering in a market which is already evolving rapidly, particularly in view of the fact that, to the extent that any relevant AEC is found, it is based on inconclusive evidence;

2.30.2 With the support of guidance, trustees are best placed to judge whether a tender would lead to the most beneficial outcome for their members and, if so, the approach that should be adopted. This is especially so with transparent accountability for their decision. Trustees should be afforded the flexibility to effect this judgement; and

2.30.3 Adherence to guidance avoids the complexities of defining the scope of the services covered by the remedy or the tendering process. It reduces the risk of firms 'gaming' the system by developing products that fall outside static technical definitions. Ultimately, trustees would determine whether the service proposed requires a tender, based on principles and guidance that can react to developments in the market, and should be prepared to defend this decision when it reports on the appointment.

Prohibition on FM firms accepting a new mandate if no competitive tender process has taken place

2.31 A prohibition on the acceptance of a new mandate by FM firms where no competitive tender has taken place would put FM providers in the position of policing the mandatory tendering regime. This is not a role that FM providers can fulfil and Aon disagrees with this aspect of the proposed remedy.

2.32 Our principal concern is that no FM provider can have full visibility over the process that has been adopted by trustees. They are not public authorities with the power to compel the provision of information, or the power to impose sanctions if the information provided is incomplete or misleading. For this reason, we would be concerned if, for example, the possibility was open for FMs to be fined, or disciplined in some other way, for not undertaking what the CMA regards as sufficient checks.

2.33 Even if these significant concerns were set aside, FM providers would need to seek to carry out due diligence to assess the nature of the process conducted by the trustee and whether this was compliant with applicable rules. This could be complex and time-consuming, which ultimately incurs costs, for both the FM

provider and the trustee, in addition to the expense already incurred in carrying out the tender process. This additional cost, together with the necessary intrusion into the scheme's actions by a third party (with the attendant risk that this brings of inadvertently sharing market-sensitive information) would be likely to further inhibit trustees from opting to choose FM services, even where that might otherwise have been beneficial to their members. As such, this aspect of the CMA's proposed remedy is likely to increase, rather than reduce, the risks of market distortion.

- 2.34 In our view, mandating a trustee to tender should be sufficient to prompt engagement with the FM selection process without any need for the FM service provider to be subject to an additional obligation. However, if a duty must be created to oversee trustees' compliance, this rests much more naturally with tPR.
- 2.35 If a prohibition on accepting non-tendered mandates were to be introduced, there would need to be clear guidance setting out exactly what steps an FM must take to satisfy itself that the trustee has carried out a compliant tender process. In our view, this should be kept as simple as possible.
- 2.36 The only requirement placed on the FM should be to ask trustees to confirm that they have undertaken a compliant tender process before accepting a new FM mandate. If our alternative approach were to be adopted, the FM should ask the trustees to confirm that they understand their obligations under the accountability approach before accepting a new FM mandate.

Regulatory oversight

- 2.37 Compliance with a mandatory tender regime should be overseen principally by tPR. However, if the CMA opts to introduce a prohibition on FM firms accepting non-tendered business, this would need to be subject to FCA oversight. The two regulators would need to be closely aligned on implementation, enforcement and guidance.

Application to DC

- 2.38 The points above for the most part apply equally to DB and DC schemes.

3. REMEDY 2: MANDATORY WARNINGS WHEN SELLING FM

Aon's views in summary:

- ***We support the CMA's aims of increasing transparency and driving greater trustee engagement.***
- ***A 'cigarette packet' style warning is ineffective to do this as it targets the FM solution itself and makes FM look like a negative option when it in fact nearly always drives better scheme outcomes.***
- ***Principles-based transparency statements focussed on conduct rather than product would be more effective and appropriate.***
- ***Our views below apply equally to DB and DC schemes.***

- 3.1 The core objective of this remedy is to ensure that trustees understand whether information provided by their IC constitutes advice or marketing. The intention appears to be that this additional clarity, particularly where conflicts may exist, should reduce the alleged “incumbency” advantage of IC-FM firms.
- 3.2 Whilst we support the aim of increasing transparency and promoting greater trustee engagement, we do not believe that the proposed mandatory warnings are an appropriate way of achieving this:
- 3.2.1 First, a reference to a ‘warning’ is wholly inappropriate. It has strong negative connotations and suggests there are extensive risks involved in adopting FM, which is not the case. This could have the unintended consequence of dissuading trustees from considering FM, even where it is suitable for their needs and beneficial for their members.
- 3.2.2 Second, the application of the remedy only to IC-FM firms cannot be justified. As set out in Part A paragraphs 2.23 – 2.41, the CMA has not adduced sufficient evidence to show any incumbency advantage. Also, there is a similar need for FM-only firms and, even more so, AM-FM firms to be transparent about the fact that they are providing potential clients with FM material and any conflicts that may exist. IC only firms should similarly be open about their potential conflict against FM services. All providers of IC and/or FM services should prompt trustees to engage when making a buying decision, remind them of any obligations and flag available tPR guidance.
- 3.2.3 Third, the implementation of the proposed remedy would require a clear definition of FM services so that providers could be certain about the circumstances in which they are under an obligation to provide a warning. We discuss the difficulties in doing this in relation to Remedy 1 above.
- 3.3 We do not consider that any warning or disclaimer style remedy is necessary. The main objectives underlying the mandatory warning proposal are all achieved by the other proposed remedies:
- 3.3.1 The implementation of Remedy 1, whether comprising a mandatory tender regime or enhanced trustee accountability, will increase trustee engagement and ensure that they do not ‘slip’ into FM without testing the market.⁴⁰ Each option also negates the potential risk of incumbency advantage;
- 3.3.2 Enhanced tPR guidance under Remedy 3 will encourage and assist with the engagement of trustees during the appointment process; and
- 3.3.3 The extension of the regulatory perimeter to capture IC services will mean that documentation that is produced in relation to activities that are currently unregulated will, going forward, need to be presented in a manner

⁴⁰ PDR, paragraph 7.129.

that is clear, fair and not misleading.⁴¹ This will significantly enhance the transparency of information provided to trustees.

- 3.4 If the CMA proceeds with this remedy, then in our view a simplified approach would be more effective. All IC and FM service providers (including IC only, FM only, IC-FM and AM-FM firms) should be required to include transparency statements in their marketing and advisory documentation, which would explain:
 - 3.4.1 The limitations on any advice provided. This should explain whether the advice considered alternative solutions that may be suitable for the client;
 - 3.4.2 Any potential conflicts of interest that may exist. This should cover not only potential IC-FM and AM-FM firm conflicts, but also the fact that FM-only and IC-only firms have an interest in recommending the services that they provide to the exclusion of alternate solutions which may be appropriate; and
 - 3.4.3 That trustees are recommended to consider conducting a tender exercise prior to the appointment of a service provider in accordance with tPR guidance.
 - 3.5 We do not consider it necessary for the CMA, FCA, tPR or indeed any other body to prescribe the wording or format to be adopted in such statements. They need to be flexible according to the precise circumstances of the provider.
 - 3.6 We also support a requirement for FM providers to explain clearly when they introduce FM, that they cannot give recommendations for their own services. We included this proposal in the undertakings that we offered to the FCA.
 - 3.7 FM content need not be contained in a separate document, but it should be in a separate section of any document.
 - 3.8 We agree that oral statements are not likely to be effective and would be difficult to enforce and monitor.
 - 3.9 Oversight of the provision of a compliant transparency statement should reside with the FCA, with internal compliance monitoring processes in place.
 - 3.10 The costs of incorporating the proposed statements into all new material would be minimal. The remedy would not involve any additional costs for clients.
- Application to DC**
- 3.11 All the points made in Section 3 apply equally to DB and DC schemes.

⁴¹ FCA Handbook, PRIN 2.1.1.

4. REMEDY 3: ENHANCED TRUSTEE GUIDANCE ON COMPETITIVE TENDER PROCESSES

Aon's views in summary:

- ***We support the encouragement of engagement and trustee accountability via tPR guidance.***
- ***tPR guidance should be extended to cover the whole tender process including the full breadth of FM including partial FM, DGFs and fund-of-funds.***
- ***This will be more effective in driving positive behaviours than prescriptive rules.***

4.1 We support increased trustee engagement and accountability to deliver better outcomes on behalf of scheme members via enhanced guidance from tPR. We suggested this within the undertakings we proposed to the FCA.

4.2 TPR has already made available a range of helpful guidance.⁴² However, this does not guide trustees through the whole tender and appointment process and does not address FM tenders.

4.3 More comprehensive guidance, if carefully drafted, will better help trustees to articulate their specifications and objectives in tender exercises, as well as driving higher-quality tender responses from providers. Greater consistency of quality is likely to reduce providers' costs, which can be passed on to members. This is likely to cut costs, particularly for smaller schemes.

4.4 In addition to the topics outlined by the CMA at para 12.63 of the PDR, this guidance should also:

4.4.1 Go beyond the procurement of services described as either IC or FM. Given the difficulty in defining the services by name (as discussed in relation to FM in response to Remedy 1 above), the CMA/tPR should work with a range of providers of IC and FM services to ensure that the guidance makes sense whatever services are being purchased.

4.4.2 Cover how trustees should interact with any TPE or in-house function which is assisting with the procurement process (and who will often lead the trustees through tPR guidance). Trustees should be encouraged to engage personally in the process, even if it is not being run directly by them. Trustees are key to setting the scheme objectives and articulating them to potential providers, so this should be reflected in the guidance.

4.4.3 Include best practice examples, which can add significant support to trustees, e.g.:

⁴² For example, as part of its 21st Century Trusteeship campaign it has published guidance on '[advisers and service providers](#)', the supporting guides to the TPR 2016 DC code of practice included '[scheme management skills](#)', which comprises a checklist for reviewing contracts, and '[investment governance](#)', which includes some general issues on manager monitoring.

- (a) tender timetables;
- (b) the number of firms to invite to tender;
- (c) how TPEs should be used in the tender process; and
- (d) how to assess the true value of the services proposed by providers and not to focus on cost alone.

4.4.4 Encourage trustees to focus on asking concise, open, questions that will yield the most helpful information to assist them in selecting the appropriate provider. The guidance could also suggest some due diligence questions to make final checks when a preferred bidder emerges. Any supporting templates published should clearly indicate the differences between strategic selection questions to address with all bidders, and due diligence issues to address only with a preferred bidder.

Application to DC

4.5 In many ways we believe that this remedy would not make a significant difference to the competitive process for the award of DC mandates, since all meaningful business is already tending to be awarded via TPEs.

4.6 Nevertheless, we consider that additional guidance for trustees can only be a good thing, albeit that in the DC space guidance needs to be targeted at the employer, as well as the trustee. This is because the employer will, for example, decide on any Master Trust or Group Personal Pension Plan provider. That said, if any assets are to move in bulk from an existing Trust-based plan to a new Trust-based plan, this will need trustee agreement, so they need to be properly informed.

5. REMEDY 4: REQUIREMENT TO REPORT DISAGGREGATED FIDUCIARY MANAGEMENT FEES TO EXISTING CUSTOMERS

Aon's views in summary:

- ***We support the principle of existing customers receiving disaggregated information on FM fees.***
- ***Since it would be difficult to agree consistency of presentation of fees by industry consensus we see CMA intervention as a positive step.***
- ***Disclosure should be required from the broad scope of FM providers including partial FM, DGFs and fund-of-funds.***
- ***The CMA should follow the work of the IDWG to the extent possible.***

5.1 We note that the CMA has found that FM fees are currently disclosed to existing customers reasonably well, but not in a sufficiently consistent manner to allow comparison. We agree that FM providers should move to provide disaggregated fee information. Further, the consistency of implementation that is required to allow comparability is difficult to achieve by industry consensus. We therefore see CMA intervention as a positive step.

Disaggregated FM fees

- 5.2 To be effective, it is essential that FM fee information is provided in a consistent and practical format to ensure comparability. This should be accompanied by clear guidance on how to present the relevant information, categorise fees into the three components of the overall fee information (i.e. those relating to the FM service, the asset management fees and all other investment fees) and the level of disaggregation within each category. This guidance should also seek to ensure that the annual fee statement is presented in a manner that does not overburden trustees with excessive information.
- 5.3 However, the information will also need to be developed in a manner which recognises the differing models that are available in the marketplace. This should ensure that these fee disclosures are required of providers of all variants of FM services. In our view, with careful thought, this can be done in a way that allows slightly different information to be presented by, for example, a provider of DGFs, while still making the different components of fees clear to aid comparisons. This will avoid creating an uneven playing field that would prevent trustees from being able to compare fees across similar services.
- 5.4 We also recommend that the fees are further disaggregated to show which of the asset management fees and other investment fees were incurred by entities affiliated to the FM provider. This will provide trustees with more clarity as to who is the ultimate beneficiary of the fees. Further, it would reduce the potential incentive for FM providers to offer an artificially low FM service fee in the knowledge that this is effectively subsidised by income to the FM firm, or its affiliates, via asset management charges.

Service transparency

- 5.5 Alongside the numerical fee information, there should also be transparency over the range of services included within the fee information, in particular non-asset management services. This could be provided by way of a completed checklist of included services, as per our remedies package that we proposed to the FCA.⁴³ This additional transparency would ensure that the services offered are consistent across providers and, if not, will allow trustees to easily identify areas to challenge. Again, this checklist would be accompanied by guidance to assist with consistent interpretation of the relevant services.

Industry body

- 5.6 We would support the establishment of an industry body to develop the format in which these fees should be calculated and presented, as well as the guidance notes. The body should be provided with a long stop date, and an independent expert brought in to complete the project if agreement has not been reached by that date.

⁴³ See Proposed UILs, Annex 3 for an example of the FM services checklist.

Disaggregated AM fees

- 5.7 For the provision of disaggregated AM fee information, we are fully engaged in the work of the IDWG, with a member of Aon's senior management team contributing as a working group member, and are supportive of its template being used as standard, including the disclosure of asset manager fees in the annual fee statement.

Implementation

- 5.8 Reporting should be carried out once per calendar year. This is because the assessment of costs and value added is typically part of the annual governance work that trustees carry out. Further, some asset management costs are cyclical and require a full year to calculate the fees. Variations across asset managers in the timing of cyclical costs will make a clear assessment of these fees more challenging if reporting is carried out on a more frequent basis. All underlying funds will have differing accounting year ends, meaning that adopting a calendar year end for all schemes may result in an increase in clients requesting a bridge letter for audit purposes.
- 5.9 Finally, fees must be considered in the context of broader objectives. Trustees should be encouraged to focus on understanding ultimate net-of-fees outcomes rather than focussing on who charges the lowest prices.

Application to DC

- 5.10 This remedy applies equally to DB and DC and should make life simpler for combined mandates. It should be noted that transparency is already an important disclosure principle through the "Value for Members" statements required to be given as part of the annual Chair's statement under The Occupational Pension Schemes (Scheme Administration) Regulations 1996. These require trustees to assess all charges, which includes transaction costs, borne by DC members and explain the extent to which they represent good value for members.

6. REMEDY 5: MINIMUM REQUIREMENTS ON FIRMS FOR FEE DISCLOSURE WHEN SELLING FIDUCIARY MANAGEMENT

Aon's views in summary:

- ***We support new customers receiving disaggregated fee information.***
- ***The break-down of fee categories should be the same as for Remedy 4 plus entry/exit fees.***
- ***Transaction costs can be estimated differently depending on the assumptions used so can be difficult to present and assess – care is needed.***
- ***Nature of the different provider models needs to be drawn out to allow effective competition.***

- ***The CMA should follow the work of the IDWG to the extent possible.***

6.1 We support any remedy which sets out minimum requirements for fee disclosures to prospective clients. This additional transparency will be very helpful to trustees when conducting a tender process, although it will be critical to adopt a consistent approach across all FM providers.

Disaggregated FM and AM fees

6.2 Except for one-off fees and charges and potential exit fees, the disclosures proposed by the CMA are the same as those proposed for inclusion in the annual fee statement for existing clients under Remedy 4. We therefore urge the CMA to prescribe the same format and guidance for prospective and existing clients. This will enable existing FM clients to assess their actual fees against the proposed fees, allowing the trustees to challenge their existing provider, or the prospective provider, as necessary. This means that our comments in respect of these aspects of Remedy 4 are equally applicable in respect of Remedy 5.

6.3 There is, however, an added complication in estimating performance-related payments, to be included as part of the AM fees category of disaggregation. It will therefore be necessary to implement guidance on the standard position to adopt when estimating performance fees.

One-off fees and exit costs

6.4 There are complexities inherent in the additional information disclosures that would need to be addressed, ideally by way of guidance, to ensure consistency of approach. For example:

6.4.1 ***Estimated transaction costs:*** These are open to a degree of subjectivity. Even following a transition of assets, it is not straightforward to assess transaction costs. Two different parties may calculate these on differing, and yet equally valid, bases. For example:

- (a) The costs of entering an FM provider's fund on any particular day may be impacted by the level and direction of other trades happening at the same time and by the size of the fund itself. Whether these factors trigger an anti-dilution levy will not be known until the trade occurs;
- (b) The trustee will likely incur costs from exiting their existing investments, but there is a degree of subjectivity as to how these costs could be estimated;
- (c) Transition management costs are treated differently across FM firms. Some include this cost within the fiduciary management fee, others may use a transition manager, or the trustee may, in conjunction with their adviser, simply transfer the assets themselves. In many cases the approach to be taken will not be decided until the FM has been appointed and a full assessment of the client's existing arrangements has been made; and

(d) Illiquid asset portfolios will typically be built over time which can stretch into several years. Additionally, the FM provider may use the secondary market to reduce the cost of certain investments. The availability of such secondary market funds cannot be known in advance. This gives rise to several challenges concerning the assumptions that should be adopted in respect of the period over which the cost estimate should be produced or the costs of secondary market trades.

6.4.2 **Legal fees:** We support the inclusion of these fees within the 'one-off fees and charges' to be disclosed to prospective clients. Their size will be partially influenced by the FM provider as they will be impacted by the structure and documentation requirements of the fiduciary arrangement.

6.4.3 **Potential exit fees:** Much of the CMA's discussion in relation to exit fees is not linked with exiting FM services. Rather it relates to a strategy change and will apply whether that change results from a change in FM provider or a standard change in approach by an IC. Further, many of the fees involved will be driven by the potential future replacement provider and the strategic approach it takes. Disclosure should therefore be limited to explicit exit fees or unavoidable transaction fees that would be incurred even if a similar strategy is retained.

6.5 The IDWG has considered how to produce consistent and comparable information for prospective FM clients and will be providing guidance for asset managers on this topic. Additional guidance, using the IDWG work as a starting point, should be developed to provide specific assistance for FM services.

6.6 The nature of the different provider models will need to be accommodated to allow for effective comparison, without damaging the choice that differing structures can offer. We would strongly support industry-wide involvement by representatives of these different types of provider model in the development of these required disclosures. This could be the same body involved in Remedy 4.

Application to DC

6.7 This remedy should apply equally to DB and DC schemes.

7. REMEDY 6: STANDARDISED METHODOLOGY AND TEMPLATE FOR REPORTING PAST PERFORMANCE OF FIDUCIARY MANAGEMENT SERVICES TO PROSPECTIVE CLIENTS

Aon's views in summary:

- ***We support a standard methodology and template for reporting past performance of FM services to prospective clients.***
- ***This accords with our decision to publish our own past performance on the Aon website.***

- *Whatever standardisation is carried out should accord with the global GIPS fiduciary performance standard (likely to launch in 2020).*
- *As there is already an established industry working group (the IC Select Performance Standards Steering Group) we do not support a separate UK industry group (even if implementing measures only from 2018 – 2020) as that could lead to divergence from GIPS.*

- 7.1 We are supportive of this remedy due to the additional transparency that it offers. It will facilitate better decision making for trustees, leading to better member outcomes. We already report on our past performance, which we publish on our website, using the methodology set out in the IC Select Performance Standards (“ICSPS”).
- 7.2 The ICSPS has achieved broad industry support and widespread engagement, including from TPEs and professional trustees. We are pleased to see that IC Select is working with the CFA and that the ICSPS will be handed over to the CFA in 2020. From here it is hoped that it will become a GIPS global standard for reporting the past performance of FM services.
- 7.3 In view of the considerable work industry participants have invested in the development of the ICSPS already, we do not consider that a separate industry group needs to be formed to develop a common standard for FM past performance reporting. This has, effectively, already been achieved. The separate development of an alternative market standard in 2020 could result in a GIPS global standard and a competing UK market standard. This will not aid clarity for trustees, particularly if UK FMs are permitted a choice as to which to adopt.
- 7.4 We therefore encourage the CMA to reconsider its approach to this remedy. The CMA Order should require that FM providers prepare the relevant performance data when the GIPS standard becomes available. In addition, although GIPS standards are ordinarily voluntary, we support the mandatory use of the GIPS standards to present FM past performance.
- 7.5 As a backstop, the CMA should also provide that, if the GIPS standards are not available by a reasonable date, then industry should work together to produce a market-standard methodology in the manner currently proposed by the CMA.
- 7.6 In any event, it is important to address the way in which schemes should report on performance, regardless of how this is achieved. If trustees do not adopt a full FM service then they will not receive any past performance data that is calculated according to an agreed standard.
- 7.7 The importance of transparency is not limited to FM services, but should be expanded to the performance of the scheme, irrespective of the service model adopted. As mentioned above, we understand that IC Select is currently working on a methodology for such scheme reporting.

Application to DC

- 7.8 This remedy should apply equally to DB and DC schemes.

8. REMEDY 7: TRUSTEES TO MONITOR THE PERFORMANCE OF THEIR IC BY MEASURING IT AGAINST AN APPROPRIATE SET OF STRATEGIC OBJECTIVES

Aon's views in summary:

- *This remedy represents best practice and we are supportive.*
- *It should apply in full to DC and well as DB schemes, regardless of whether they retain an IC and/or FM service provider.*
- *Strategic objectives should be set and reviewed every 3-5 years:*
 - *Overriding objectives against which the scheme can measure its overall performance.*
 - *Provider objectives to measure how each provider, to the extent appropriate, is assisting the scheme in meeting its overall objectives.*
- *Performance against objectives to be monitored by tPR – gathering information via the annual scheme return or as part of the Chair's statement.*

8.1 In our view, any measure that helps and guides trustees to become better-engaged and to take responsibility and accountability for better scheme outcomes is to be welcomed. This can only be beneficial to scheme members.

8.2 We therefore support this proposed remedy. We also wish to be explicit that in our view it should apply in full to DC, as well as DB schemes, given the CMA's conclusions that there is a particular need to drive trustee engagement in DC. This is particularly important for DC where member benefits are directly impacted by trustee decisions, and there is no requirement on an employer to fund shortfalls.

Scope of appointments to be subject to strategic objectives

8.3 Since this remedy is designed to foster an enhanced sense of accountability from trustees for their decisions to appoint advisors, it is important that it is designed to cover a wide scope of providers to mitigate against trustee avoidance.

8.4 The remedy should start with the trustees defining their own objectives. They should then consider which parts are shared with ICs or in-house teams and which should be delegated to FMs or AMs. This would ensure a level playing field and should help foster competition. If trustees are required to set objectives and take responsibility for both internal and external objectives, or if their in-house teams lack the necessary capacity or expertise to drive good results for their members, trustees are more likely to purchase the expertise that they need from a third party, to the significant benefit of their members.

8.5 The importance of the accountability of trustees for their decisions to appoint advisors is not dependent on scheme size. We do not consider that it would be appropriate to set a minimum scheme size threshold for this remedy. However, objective setting and monitoring should be proportionate to the size of the scheme

and the scale of any consultancy contract. This should also be clearly covered in the tPR guidance.

Nature of strategic objectives

8.6 To effectively set strategic objectives for IC and FM service providers, trustees must have a clear understanding of their overriding scheme objective. We therefore consider that Remedy 7 should require the setting of two tiers of objectives, as applicable:

8.6.1 Overriding objectives; and

8.6.2 Provider objectives.

Overriding objectives

8.7 The overriding objectives would start from a clear understanding of what funding target the trustees are trying to achieve and how investment performance is expected to contribute to this. This could derive from areas such the statutory valuation process, an investment strategy review or some other longer term funding plan. The overriding objectives should be reviewed every 3-5 years.

Provider objectives

8.8 Trustees should set specific 'provider objectives' for each of its IC and/or FM providers that fall within the scope outlined above. These provider objectives should seek to measure how the particular provider supports the scheme in meeting its overriding objectives. The provider objectives should therefore be aligned to the rationale behind that provider's appointment.

8.9 As such, the use of an exclusively quantitative metric to assess may not be appropriate as IC providers are more likely to be measured against qualitative metrics.

8.10 In this respect, the CMA is right to say that "*[i]t is not necessarily the case that scheme performance is a proxy for the performance of the investment consultant*".⁴⁴ We agree since what each IC is engaged to achieve can vary significantly from appointment to appointment. There is also a danger that, if scheme performance becomes a proxy for IC performance, advice may become more focussed on targeting higher returns to the detriment of risk considerations. It is also important to note that:

8.10.1 Trustees are not required to accept the advice provided by their investment consultant. Indeed, Aon has produced guidance for trustees to challenge the advice they receive and to ensure that it is appropriate, such as for example a list of 'top 10' questions for trustees to ask of their consultants.⁴⁵

⁴⁴ Para 12.119 of the PDR.

⁴⁵ http://images.respond.aonhewitt.com/Web/AonHewitt/%7B90ec29ed-67b1-4cef-b950-76f5c56fc8d7%7D_10QuestionsForTrustee-TrusteeEffectiveness.pdf

8.10.2 Even where trustees do follow IC advice, implementation delays caused by the nature of trustee decision making may affect actual investment performance.

8.11 A key element of provider objective setting is that the trustees should share any proposed objectives with the relevant provider and check that they are supportive and willing to share accountability for the stated objectives.

8.12 We agree that responsibility for setting objectives should sit with trustees. Therefore, compliance should be monitored by tPR. This could be achieved by including reference to performance against the overriding and provider strategic objectives being included in the annual scheme return or as part of the Chair of Trustees' Statement.

Timing for implementation of the remedy

8.13 A formal review against and agreement of the various objectives makes sense every three to five years. However, this should not take place to the exclusion of ongoing monitoring of the IC and/or FM by the trustees and *ad hoc* reviews where there is a change of stakeholders.

8.14 While we agree that it should be possible for tPR to develop sufficient guidance for trustees on how to set objectives within 6 months of any CMA order, we agree that implementation should be contingent on the tPR guidance being published.

8.15 In terms of when trustees themselves should be required to start setting objectives, trustees could incur unnecessary time and expense if they set fresh objectives outside of the scope of their existing investment arrangements. A more effective and proportionate approach would be to mandate that schemes set fresh strategic objectives within 15 months of the effective date of a scheme's first actuarial valuation following the date of any CMA order. This period is consistent with the timeline to sign off a valuation.

Application to DC

8.16 This remedy should apply equally to DB and DC schemes.

9. REMEDY 8: BASIC STANDARDS FOR REPORTING PERFORMANCE OF RECOMMENDED ASSET MANAGEMENT 'PRODUCTS' AND 'FUNDS'

Aon's views in summary:

- ***We support this remedy and we already publish this information on our website.***
- ***The metrics disclosed need to balance transparency and proportionality. We suggest they are limited to (i) active; (ii) liquid; (iii) UK strategically relevant; and (iv) buy-rated products.***
- ***We recommend that the CMA convenes an implementation committee made of industry experts to address difficulties in comparing strategies.***

Our existing performance reporting provides a useful model

- 9.1 We support this remedy and we included a similar proposal in the undertakings that we proposed to the FCA in February 2017. We have already implemented this practice and the relevant reporting information is published on our website.
- 9.2 How we present this information, together with information on the methodology used to prepare it can be found on our website.⁴⁶ The CMA will see that the published information addresses some key practical and implementation issues relevant to this proposed remedy. For example, while the CMA's proposal does not express a view on the most appropriate intervals over which to report performance, we publish performance data quarterly.

Scope of reporting data to be published

- 9.3 For this remedy to be effectively implemented by trustees and to ensure that it is proportionate, the scope of the proposed reporting disclosure needs to be narrowed to the most useful information. In our view, the best balance between transparency and proportionality for trustees would mean reporting the following metrics:
- 9.3.1 **Active products** - which have an objective to outperform a given benchmark as this is measurable and can be easily presented in a manner which is clear to trustees;
- 9.3.2 **Liquid products** - as the performance of illiquid strategies is more difficult to benchmark because of their idiosyncratic nature;
- 9.3.3 **Strategies relevant for UK clients** - and represent meaningful UK client exposure; and
- 9.3.4 **Buy-rated (or 'highly-rated') strategies** – these are the only strategies that should be included in composites. At Aon, we do not actively seek out non-favourably rated strategies.

Difficulties to consider and resolve during the development of the remedy

- 9.4 Benchmarking is difficult for non-homogenous asset classes such as absolute return strategies and target date funds, so a common approach will need to be determined. Strategies within each asset class will have different performance targets, which will make it difficult to compare the performance of composites across consultants. Comparability may also be hampered by the fact that strategies may not be consistently categorised across consultants. Further, some strategies are explicitly more defensive/aggressive than their benchmark.
- 9.5 There is a risk that reporting these metrics could prompt changes in IC/FM behaviours, including:
- 9.5.1 A focus on short term performance that could result in higher turnover in ratings and, as a result, a higher churn of strategies in client portfolios resulting in higher transaction costs;

⁴⁶ www.aon.com/unitedkingdom/retirement-investment/investment/investment-transparency-disclosure-in-the-uk.jsp

- 9.5.2 Consultants being incentivised to pick strategies that outperform the benchmark with higher risk, rather than those suitable for client needs;
- 9.5.3 Service providers assigning a buy rating to more strategies to lower the probability of significant underperformance; or
- 9.5.4 The development of 'herding' in consultant recommendations, as consultants seek to avoid underperformance against their peers.
- 9.6 In our view, these potential issues could be significantly mitigated by following an approach to comparison that follows the proposed industry standards that we set out in Annex 1 to the undertakings that we offered to the FCA in February 2017.
- 9.7 It may also be necessary to agree appropriate definitions to ensure that strategies are consistently categorised across consultants. While it is helpful that the CMA is addressing this issue, it may be better covered by GIPS rather than by CMA order, given the ability that GIPS offers to align the UK approach with global best practice.
- 9.8 The precise nature of reporting is complex. In our view, the CMA should establish an implementation committee comprising industry representatives. For example, the fee question relating to reporting net of fees must relate to the fees that a particular client would be able to access. A committee is well placed to consider a question of this nature.
- 9.9 This committee should work to a long-stop date, preferably of at least six months, following which an independent expert would be appointed to complete the work if it cannot reach agreed conclusions. Once finalised, it may take longer than the 6 months envisaged by the CMA to fully implement this remedy and in our view one year would be much more appropriate, considering the variety of depth of resource in the industry.

10. SUPPORTING REMEDY A: EXTENSION OF FCA REGULATORY PERIMETER

Aon's views in summary:

- ***We support this remedy.***
 - ***The new perimeter should be defined by activity, but should avoid capturing unintended participants, such as actuaries.***
 - ***Requirements of DPB regime need to be aligned with extended FCA regime.***
- 10.1 The FCA will need to define the relevant regulated activities rather than focussing on the providers. It will also need to be appropriate to the types of advisory services currently provided by ICs and FMs. It will be necessary to ensure that it does not have an unintended effect on competition in other areas of professional advice such as auditors and actuaries who often comment on the appropriateness of a client's investment strategy. It will also be necessary to consider carefully whether in-house teams should be covered.

11. SUPPORTING REMEDY B: ENHANCED TPR TRUSTEE GUIDANCE AND OVERSIGHT OF REMEDY 1

Aon's views in summary:

- ***We support this remedy.***
- ***tPR guidance will help to set more consistent expectations of trustee accountability and responsibility across the market.***
- ***Guidance should be principles-based so it is sufficiently flexible and does not hamper innovation.***

11.1 Aon broadly agrees with this remedy. As mentioned above, tPR guidance will help to set expectations and facilitate consistency across the market. It should also help to contain costs, particularly for smaller schemes.

11.2 Care should be taken to ensure that the guidance is principles-based so that it does not result in (i) excessive burden on providers and/or trustees, or (ii) hamper innovation. With respect to the required guidance proposed at para 12.152 of the PDR, we suggest that:

11.2.1 The scope of the guidance relating to Remedy 7 should go beyond what is required. In addition to the strategic objectives against which ICs will be reporting, it would be helpful to provide trustees other factors to consider when judging their IC's performance, such as the following:

- (a) Has the content and delivery of advice provided clarity and understanding of the decision to be taken?
- (b) Does the advice reflect the circumstances of the scheme and is it to a sufficient level of detail?
- (c) Has the work been completed on time and within budget?
- (d) Have the trustees evaluated the robustness of the analysis behind the advice?
- (e) Has the consultant been clear with regards to the scope of work and associated costs?
- (f) Did the consultant properly follow their instructions?

11.2.2 The guidance should include a high-level description of different approaches to tendering, as well as issues to consider, which would not focus solely on FM and IC services but would also cover the appointment of other advisers or third-party service providers that a pension scheme needs.⁴⁷ This would overlay the FM and IC-specific tendering guidance discussed above.

11.2.3 Tender checklists and templates should similarly cover FM, IC and other service providers. However, separate documents are likely to be needed

⁴⁷ By way of example, we refer the CMA to [guidance note on tendering strategies](#) published by the Royal Institute of Chartered Surveyors.

for each type of provider. These could build on the existing tPR checklist for reviewing contracts.

- 11.3 tPR is best placed to develop the enhanced trustee guidance. Since we understand that tPR is already working on additional guidance for trustees in a number of areas, adding its oversight of the guidance proposed in para 12.152 of the PDR should avoid duplication. However, any recommendations that the CMA makes to tPR will need to consider all feedback provided by stakeholders in their responses to the PDR.

12. SUPPORTING REMEDY C: IMPROVING INFORMATION ON UNDERLYING ASSET MANAGER FEES AND PERFORMANCE

- 12.1 As a founding member and continuing contributor to the IDWG we strongly support the work being done in this area and the recommendations proposed by the CMA in this regard.