INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of response hearing with Mercer Limited (Mercer) held on 28 September 2018

Introduction

1. Mercer said that it does not agree with the finding of an adverse effect on competition (AEC) in the CMA’s Provisional Decision Report. It explained that the Investment Consultancy and Fiduciary Management markets are well functioning with healthy levels of competition and low barriers to entry.

2. Mercer said that while practices in some areas within the markets could be improved, formal remedies did not need to be imposed to achieve these improvements, which can be achieved by the industry, and of which many are already underway.

The CMA’s finding of an AEC

3. Mercer said that it does not understand the CMA’s provisional finding of an AEC.

4. Mercer disagreed that there are widespread problems of low trustee engagement; its view is that the evidence shows trustees are experienced, well qualified and regularly challenge advisers on advice and fees. Mercer also highlighted its concern that the CMA’s definition of engagement[1] was overly narrow and risked not capturing a wider range of engagement. Examples of this may include in-house capabilities, experience from other pension schemes within a group, or experience from the corporate.

[1] Mercer said that CMA’s definition of engagement relied on either (i) trustees running a formal tender for the mandate; (ii) the presence of a TPE, or, (iii) the presence of an independent trustee.

5. Mercer expressed its view that the CMA's analysis of client detriment is not representative, not robust, and not reliable to draw conclusions which may be applied to the whole market. Mercer does not consider the CMA has demonstrated that clients have suffered detriment. Mercer challenged the CMA's findings that engaged clients pay less than disengaged clients.

6. Mercer referred to its submission that outlines what it considers to be fundamental data errors it has uncovered in the CMA's analysis. Among its concerns, Mercer explained that a coding error incorrectly treated certain clients as disengaged, and that its own analysis of the data demonstrated that disengaged clients did not pay more than engaged clients. Mercer is very keen to ensure that the CMA's analysis is updated and to comment on this.

7. Mercer pointed out that engagement is clearly a 'good thing'. However, Mercer cautioned against fees being used as a measure of engagement as the more engaged clients tend to pay more as they tend then to understand more about their options, and the benefit and value of different solutions. In addition, the number of meetings would not necessarily be the right measure of engagement.

Mandatory Tendering

8. Mercer is concerned that unintended consequences may arise from Remedy 1,[2] with unnecessary costs falling on schemes and providers.

9. Mercer explained that it does not accept the CMA's conclusion of low trustee engagement. In Mercer's experience, trustees challenge their advisers on numerous occasions on a wide range of issues and will assess the performance of their advisers. Trustees are also very sensitive to best practice initiatives and will take guidance from the Pensions Regulator (TPR) and others on board.

10. Mercer said that its clients are supportive of competitive processes, and that they should test their advisers at the point of appointment and

[2] **Remedy 1**: Mandatory competitive tendering on first adoption of Fiduciary Management.

on an ongoing basis, but they do not want to be forced to do something in a particular way at a particular time as a tick-box exercise.

11. Mercer said that its clients believe they should be allowed to award a mandate without going through a competitive process in circumstances where that would be inappropriate, so Mercer believes mandating a tendering regime which does not allow for this nuance would be disproportionate.

12. Mercer also reported feedback from some of its clients who are within five years of achieving buy-out status. These clients felt strongly that forcing them to go through a process where they have to consider changing something that they are already happy with would be disproportionate.

13. Mercer also said that it has very material concerns that the cost of mandatory tendering to existing clients was disproportionate as they would incur this for no additional benefit. A large number of existing clients are satisfied with their provider. As such, applying this remedy to existing clients could cause detriment to those clients.

14. Mercer said that the level of market testing by clients was already high and increasing - the vast majority of Fiduciary Management mandates go through a competitive process of some form.

15. Mercer also said that all Fiduciary Management clients gain the same benefits, regardless of level of engagement as they are investing in the same set of funds and receive the same discounts on asset manager fees.

16. Another factor the CMA should consider is that the costs of tendering would fall disproportionally on smaller schemes.

17. Mercer detailed that 90 new mandates came to market last year. If 150 – 160 mandates were required to be retendered over the next two years then this would double the amount of tenders coming to market and providers would struggle to cope with this level of activity. This would have a detrimental effect on clients, with advisers spending less time on each tender. In addition, providers would be selective on those mandates that they would pitch for. It is likely that providers would focus on those mandates that have a higher value attached, which

would hit the smallest clients the hardest and it is likely to lead to less competition for them.

18. Mercer explained that Fiduciary Management is a solution for a client based on that client's needs. The most important decision made by a client when considering a Fiduciary Management solution is their strategic asset allocation. The adviser will need to undertake analysis in terms of what are the liabilities, understanding the client's objectives and then building that strategic analysis. This requires a lot of work, there is a lot of time, data and people looking at that analysis. So, the majority of the cost of preparing a bid for a mandate comes through this part of the process.

19. Mercer stressed that if a client is thinking of moving into Fiduciary Management, then the key consideration will be each firm's proposals on strategic asset allocation. Consideration of fee levels is often secondary.

20. Mercer said that investment consultants do not steer their clients into Fiduciary Management. Advisers will introduce Fiduciary Management to clients only when it is appropriate. Mercer noted that the CMA found no evidence of inappropriate introduction.

21. Mercer explained that firms should not be responsible for assessing whether any mandatory tendering requirement has been complied with as they do not have sight of the processes the client has followed, and cannot assess whether these may be compliant with the CMA's requirements.

22. Mercer also said that the cut-off point for any mandatory system should be schemes with assets of £100m. The cost of a mandatory tender could put off smaller schemes from adopting Fiduciary Management.

23. Mercer said that the definition of Fiduciary Management should cover only those mandates where the benchmark for performance measurement is the scheme-specific liabilities, as opposed to a market benchmark. Mercer gave the example of multi-manager global equity products which would form part of the scope of this remedy as currently drafted, and which would therefore capture over 100 investment managers. It added that the definition should not cover multi-asset funds for the same reasons.

Alternative approach

24. Rather than a mandatory tendering regime, Mercer said that clients should be able to make the decision on tendering themselves as they are better placed to understand their current situation, and the resources and input required. It proposed an alternative, best practice "comply or explain" regime. Mercer said this would be effective, and would be backed up by trustees' fiduciary responsibilities and TPR guidance.

Remedy 8: Standardised reporting of asset management products

25. Mercer pointed out that while it is open to this remedy in principle, the solution must be proportionate, structured in a useful way, and must not impose excessive costs.

26. Mercer highlighted its concerns that:

(a) Mercer uses a different database from other Investment Consultants. [✂].

(b) The headline analysis should be presented gross of fees as a 'standard' net of fees report would be misleading. Mercer proposes that advisers should explain the net of fees figures to clients separately as clients pay different levels of fees.

(c) The CMA should set out how the benchmark is to be set to prevent gaming of the system; and

(d) Asset allocation is the most important decision the client can make and, whilst performance reporting is important, its role should not be overly emphasised.

27. Mercer added that in terms of design features, principles would be better than a highly prescriptive approach.

Comments on other proposed remedies

28. Mercer said that while it agrees with Remedy 2 in principle,[3] it was concerned that the CMA should avoid imposing standard risk warnings which may be ignored. It said that it is important that a client understands what the specific risks are.

29. On Remedy 3,[4] Mercer said that it supports TPR guidance in principle. TPR regularly updates its guidance and trustees take steps to keep themselves up-to-date. Trustees respond to TPR's guidance and take it seriously. One example of evidence of this is that levels of tendering have increased generally in response to TPR guidance.

30. On Remedy 6,[5] Mercer said that discussions with IC Select are advanced, although there are a small number of outstanding issues that remain under discussion. Mercer believes that the industry can get the IC Select proposals agreed in the near future and that a committee of relevant market participants would be helpful to clarify and agree those few points. Mercer said that responsibility for the standards should transfer to CFA in 2020 as proposed.

31. On Remedy 7,[6] Mercer said that this needs to be proportionate, workable and add value to clients. Mercer suggested that this remedy may achieve a better outcome if implemented by way of TPR guidance rather than the imposition of a prescriptive solution. Mercer also set out its concerns with the workability of a more prescriptive remedy, given there will be occasions where a client follows advice which is not readily measurable (such as advice around risk reduction), and occasions where clients do not follow advice or take time in implementing it. Measuring these areas is very difficult and at best partially useful.

32. Mercer said that it is important that this remedy should encourage good conversations between the adviser and the client on what the client's

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[3] **Remedy 2**: Mandatory warnings when selling Fiduciary Management services.
[4] **Remedy 3**: Enhanced trustee guidance on competitive tender processes.
[5] **Remedy 6:** Standardised methodology and template for reporting past performance of Fiduciary Management services to perspective clients.
[6] **Remedy 7**: Duty on trustees to set their Investment Consultants' strategic objectives.

objectives are. Such objectives should be expressed in financial terms, and will differ from client to client.

Regulation

33. Mercer had no objection, in principle to the extension of the FCA's regulatory perimeter, but was concerned that it was unclear what products the FCA remit would eventually cover. The extension of the perimeter in respect of asset allocation should apply both for Investment Consultancy and Fiduciary Management services.

34. Mercer would expect the FCA to carry out a full cost-benefit analysis before making any changes. The impact on Mercer would include the implementation of additional processes and training, which is likely to have a greater impact on smaller firms with fewer resources.

35. Mercer also explained that it would expect its fees payable to the FCA to increase by a material amount.

Defined Contribution (DC) Schemes

36. Mercer explained that the comments it has made relate to DB schemes as DC schemes are different and are trying to achieve very different goals than DB schemes.

37. Fiduciary Management is not commonly used by DC schemes, other than through a master trust. A decision to invest in a master trust is made by the employer rather than by trustees, and as a result DC Fiduciary Management (master trust) should be outside the scope of Remedy 1.