

## INVESTMENT CONSULTANCY MARKET INVESTIGATION

### GAINS FROM ENGAGEMENT WORKING PAPER

This is the response of Mercer Limited (**Mercer**) to the CMA's working paper on Gains from Engagement (the **WP**).

#### 1 Executive Summary

- 1.1 The CMA's qualitative analysis does not support the provisional findings in this WP. The qualitative analysis focuses on a small set of documents, and the CMA's interpretation of those documents appears to misunderstand the competitive behaviour they exhibit. The evidence suggests vigorous competition where providers need to work hard to retain their clients and respond to their demands. Further, the improvements achieved by engaged customers are enjoyed more widely: we provide examples and evidence of this in our response below.
- 1.2 Our ability to respond to the quantitative analysis in this working paper is limited because the CMA has not disclosed the data underlying its analysis. However, based solely on the information in the WP, we have significant concerns about the CMA's approach.
- 1.3 First, the CMA applies a narrower approach to defining "engagement" in this WP than in earlier papers. The CMA Customer Survey, for example, identified a broader set of ways that schemes monitored and challenged the prices or services from their investment consulting (**IC**) and fiduciary management (**FM**) providers. The CMA's narrower approach to defining engagement in this WP risks understating the actual level of engagement in the market.
- 1.4 Second, there are a number of errors and inconsistent results in the CMA's WP, and we believe the empirical results are not representative or robust to changing model specifications. For example:
- (a) The CMA itself notes that, for IC, its econometric analyses are not robust (and that "*this significantly reduces the confidence we have in these results*"<sup>1</sup>) and that there may be "*no effect*" of the engagement indicators on IC spend per hour.<sup>2</sup>
  - (b) The lack of robustness of the CMA's FM transition analysis – in particular the different results that arise as a result of small changes to the model specification – means the CMA cannot reasonably conclude that "*[o]ur emerging findings from this work are that engaged schemes pay significantly less than disengaged customers when moving into FM with the same provider they have used for IC*".<sup>3</sup>
- 1.5 Figure 4 is a key – and confusing – result:
- (a) The CMA's analysis finds that "internally acquired" clients pay lower FM fees than "externally acquired" clients, even when these externally acquired clients were treated as engaged (as per the CMA's definition).
  - (b) Figure 1 shows that "externally acquired" clients have higher levels for each proxy of engagement, and indeed have demonstrated a further form of engagement through

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<sup>1</sup> WP, paragraph 121.

<sup>2</sup> Paragraph 191 of the WP states that "*an important caveat to these [IC] results is that they are generally not robust to the inclusion of firm fixed effects ... the engagement coefficients become statistically insignificant ... We therefore consider that an equally plausible explanatory factor is that the data we have on IC is of insufficient quality to derive results that are more than indicative of an effect, and therefore cannot rule out with certainty that there is no such effect*". The CMA goes on to note that "*[w]e are unable to place more than indicative weight on the findings for IC*", but in fact this is itself too strong as the results are not robust.

<sup>3</sup> WP, paragraph 123.

switching to a new FM provider. However, the CMA's evidence suggests that internally acquired schemes achieve better prices than these more engaged schemes.

- (c) The CMA's analysis finds that clients benefit directly from remaining with their existing IC provider. If this is correct, it undermines any arguments for remedies targeting mandatory tendering or switching.
- 1.6 Based on the WP analysis, we do not understand how the CMA arrives at the emerging finding that "[t]here is some corroborating evidence that switching providers when moving into FM also reduces prices".<sup>4</sup> This appears factually incorrect based on Figure 4, and we cannot identify any other analysis in the working paper to support this claimed effect of switching.
- 1.7 Without access to the underlying data we reserve our position on the validity of the emerging findings in this WP. However, given the concerns we have with both the qualitative and quantitative analysis undertaken in this WP, our view is that neither should be relied upon by the CMA in its Provisional Decision.

## 2 The CMA's decision not to disclose the data underlying this WP

- 2.1 Our ability to respond to this working paper is limited. This is because the CMA has not disclosed the data underlying its analysis into a confidentiality ring.
- 2.2 We do not believe that the CMA's decision to defer disclosure of the data underlying the quantitative analysis until the time of the Provisional Decision allows for parties to offer a complete analysis of the WP. In addition, the parties will have to undertake their analysis of this data at the same time as considering, and responding to, the Provisional Decision. Should the CMA decide to revise its approach to this analysis following comments from the parties after the Provisional Decision, this will take place at a relatively late stage in the investigation and could have wider implications for the CMA's conclusions.
- 2.3 Notwithstanding our concerns, however, we set out below the comments that we are able to make on the WP in the absence of access to the underlying data.

## 3 Qualitative analysis

- 3.1 The CMA acknowledges that its qualitative analysis is "limited".<sup>5</sup> It appears a small selection of documents from only two providers have formed the basis of the analysis.
- 3.2 The small number of documents considered in the WP shows that providers respond to competitive threats and are willing to negotiate with clients. This is entirely normal commercial behaviour and is not indicative of any competition problem. Indeed, the fact that providers in the market:
- (a) keep a "Clients at Risk" register;<sup>6</sup>
  - (b) actively collate feedback from schemes;<sup>7</sup> and
  - (c) take action to improve their offering to customers,<sup>8</sup>

shows that the competitive threat in the market is real and that, if firms do not offer a quality service at a competitive price, there is a real risk of clients switching away. Indeed, if the CMA had found evidence of the opposite: that firms were not seeking client views, or not acting on

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<sup>4</sup> WP, paragraph 124.

<sup>5</sup> WP, paragraph 18.

<sup>6</sup> WP, paragraph 30.

<sup>7</sup> WP, paragraph 34.

<sup>8</sup> WP, paragraph 35.

their concerns, this might indicate a market that was not working well because firms were not feeling competitive pressure.

- 3.3 The CMA's emerging finding is that more engaged clients may receive improved terms, and that this is "*indicative of mechanisms through which engagement could lead to better client outcomes, and disengagement could lead to worse outcomes*".<sup>9</sup> There is no evidence in the qualitative analysis that "disengaged" clients receive worse outcomes. In addition, the CMA should also consider whether improvements achieved by engaged customers are being passed on to other customers.
- 3.4 In our experience, improvements in fees and quality are shared across our client base to a considerable degree. As the FM market has expanded, fees have reduced in general terms (see, for example, the EY survey<sup>10</sup>). [X<].
- 3.5 In addition, intellectual capital is a core feature of a successful provider of IC and FM services.<sup>11</sup> Engaged customers, and the competitive environment, continuously drive us to improve our intellectual capital which is then deployed across our client base, including to less engaged clients. Similarly, we invest in infrastructure such as, for example, Navigator (Mercer's online portal for FM clients), to allow more engaged customers to review their assets and funding level on a daily basis. Less engaged clients of course benefit from this same infrastructure.
- 3.6 Overall, therefore, we believe that the evidence the CMA has identified, rather than being indicative of any competition concern, is instead consistent with highly competitive markets where providers are forced to make active efforts to retain their clients, and where improvements driven by the most engaged clients are shared by a wider group. Indeed, the indications are that engagement is widespread and increasing: both in IC, where in our experience clients regularly assess and challenge their IC's advice and quality of delivery<sup>12</sup>, and FM, where the use of ongoing external assessment is increasing.<sup>13</sup> This is not consistent with any AEC in these markets.

## 4 Quantitative analysis

- 4.1 Our response to the CMA's quantitative analysis is limited as the CMA has not disclosed the underlying data. However, based on the information in the WP itself, we have concerns in the following areas:
- (a) the CMA's measures of engagement are too narrow;
  - (b) the CMA's approach to assessing market outcomes needs further consideration;
  - (c) potential flaws in dataset construction;
  - (d) the FM static analysis; and
  - (e) the FM transition analysis.
- 4.2 Finally, we attach as an Annex a list of apparent errors and inconsistencies in the WP.

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<sup>9</sup> WP, paragraph 41.

<sup>10</sup> "This year's survey shows that the total of fiduciary management and investment management fees has continued to fall as the industry has grown", 2017 EY Fiduciary Management Fees Survey, February 2018, Figure 4.

<sup>11</sup> See, for example, paragraph 68 of the Profitability working paper: "*In the case of IC and FM businesses, much of the asset base is intangible in the form of clients, reputation, brand, and human and intellectual capital, including staff experience and skills, and internally developed methodologies and know-how.*"

<sup>12</sup> 70% of respondents to the CMA's Customer Survey indicated that they had challenged their IC to improve their terms in the last three years. Trustee Engagement WP, paragraph 67.

<sup>13</sup> As described further in paragraph 4.8 below.

**(a) The CMA's measures of engagement are too narrow**

- 4.3 The CMA's proxies for engagement in this WP do not capture the various ways in which trustees monitor and challenge the fees and performance of their IC and FM providers.
- 4.4 The CMA uses only three indicators of trustee engagement: use of a tender; use of a third-party evaluator (**TPE**); and use of a professional trustee. In contrast, the CMA's Customer Survey identified a much wider set of relevant engagement indicators:
- (a) four headline indicators: (i) switching, (ii) tendering, (iii) undertaking a formal review of fees and/or quality, and (iv) undertaking an external review of fees and/or quality;
  - (b) the ability of trustees to scrutinize and challenge the investment advice and fees they received;<sup>14</sup> and
  - (c) the role played by other stakeholders, such as the scheme sponsor or an internal team, in decision-making.<sup>15</sup>
- 4.5 While tendering is clearly a strong indicator of engagement, it is possible for clients to compare and evaluate potential providers without running a formal tender – potentially through a less formal competitive or benchmarking process. The CMA's focus on formal tenders does not capture these other methods of engagement.
- 4.6 Switching provider is also a strong indicator of engagement. In the analyses carried out by the CMA of FM clients, all "externally acquired" customers (i.e. those who have switched between providers when moving into FM) should be treated as "engaged", rather than segmenting this group between engaged and disengaged clients.<sup>16</sup> Indeed, we note that the CMA applies this approach in its static FM regression analyses.<sup>17</sup>
- 4.7 By failing to take account of the much wider set of ways identified in its Customer Survey in which trustees drive better outcomes from their IC or FM provider, the CMA's narrow approach to defining engagement in this WP risks materially overstating the degree of disengagement in the market. Figure 2 in the WP suggests that around 70% of the FM schemes in the CMA's 2016 sample<sup>18</sup> exhibit at least one indicator of engagement, even on a relatively narrow approach (including switching);<sup>19</sup> and this proportion would likely be higher still if weighted by AUM rather than number of clients. As other FM firms in the market (i.e. those without IC offerings) acquire all their clients externally, this suggests that the vast majority of clients across the FM market are engaged.
- 4.8 Further support for this can be found in 2017 data that would point to increasing levels of scheme engagement – the KPMG Fiduciary Management Survey for example found:
- (a) In 2017, 60% of new appointments were advised by an independent third party, up from 33% in 2016.

<sup>14</sup> For example, the CMA Survey found that 57% of schemes had challenged their IC provider to improve terms within the past three years (65% for Large schemes), an indicator of engagement that would not be captured in the CMA's metrics.

<sup>15</sup> For example, the CMA Survey found that around 74% of schemes considered the actions of the Scheme Sponsor as important in providing external scrutiny and challenge to the IC. For those clients that identified the Scheme Sponsor as an important external scrutiny/challenge to the IC, 86% said the scheme sponsor challenged the IC at least once a year. This is evidence of engagement that is not captured in the CMA's metrics.

<sup>16</sup> See for example paragraph 74 describing the mixed picture for externally-acquired schemes in Figure 4.

<sup>17</sup> Footnote 48 notes that "... externally acquired schemes have demonstrated some form of engagement in that they have switched provider when moving into FM. For this reason, and given the limited number of observations in our data, we have not generally distinguished between engaged and disengaged externally acquired schemes in our econometric analysis ...".

<sup>18</sup> Based on five firms providing both IC and FM.

<sup>19</sup> The CMA's three chosen indicators plus switching.

(b) In 2017, 17% of schemes used an independent third party overseer in conjunction with their fiduciary manager, up from 13% in 2016.

4.9 This undermines the CMA's statement in para 3 of the WP that "a significant proportion of pension schemes do not appear to be engaged". We disagree with this not only on the evidence available to the CMA, but also on the basis of our experience interacting with informed and sophisticated purchasers of IC and FM.

**(b) The CMA's approach to assessing market outcomes needs further consideration**

4.10 The CMA's empirical analyses in the WP seek to test how engagement affects "market outcomes", but we do not believe that the CMA's outcome measures are appropriate.

4.11 *First*, with the CMA's focus being only on price / spend, there is no assessment of the quality of service or impact of the advice within the CMA's assessment. The CMA is not assessing value for money. [§<].<sup>20</sup> The focus only on price / spend therefore fails to take account of the full value for money generated for clients.

4.12 *Second*, for the IC analyses, the outcome metric "IC spend per hour" is a weak indicator of value for clients:

(a) Figure 14 shows the wide range of IC spend per hour for clients in 2016, with the majority of IC clients spending less than £300 / hour. There are, however, many limitations to this metric. For example, the total number of hours may well be understated – [§<].<sup>21</sup> More importantly, there is no control for service complexity or quality of service / advice provided to the scheme.

(b) The CMA's hypothesis appears to suggest that more engaged clients – and so a better functioning market – should see lower IC spend per hour. This, however, makes no allowance for differences in the quality of service for each hour or the impact of the advice on the scheme's performance. As in most professional services firms, more experienced team members have higher billing rates than more junior team members. A client may request more senior / experienced involvement (at higher billing rates per hour) when projects are more complex and challenging. Indeed, a more engaged client may insist on a more experienced IC team, which would increase IC spend per hour.

(c) The unintuitive impact of this variable is, for example, illustrated in Table 14, where the coefficient on "Hours spent by consultant (log)" is negative and statistically significant across all specifications i.e. as hours spent by the IC increase, so the IC spend per hour decreases. However, paragraph 172(n) specifically notes that hours spent by the consultant are included as a control as "a proxy for complexity".<sup>22</sup> The regression result, therefore, appears at odds with what might be reasonably expected in showing that increasing project complexity would, in fact, lead to lower IC spend per hour.

4.13 *Third*, for the FM transition analysis, the CMA uses "FM-to-IC spend multiple" (i.e. the average of each scheme's FM spend post-transition divided by the average of their IC spend pre-transition) as the outcome metric. The CMA wants to test whether engagement reduces the FM-to-IC spend ratio for a client transitioning from IC to FM. However:

(a) The CMA's analysis assesses only internally acquired FM clients, while externally acquired clients (who also transition from IC to FM) are not captured in the analysis. This analysis does not inform "market outcomes".

<sup>20</sup> See also [§<].

<sup>21</sup> [§<].

<sup>22</sup> There is no other control for complexity included in the IC regressions.

- (b) For smaller schemes in particular, the move to FM allows access to more complex investment approaches, which may have higher fees but drive better outcomes. The FM-to-IC spend ratio may appear higher for these smaller schemes but this needs to be understood in the context of the benefits they are likely to achieve from FM.
- (c) This FM-to-IC ratio is vulnerable to significant measurement error risks:
- (i) The WP does not explain how the ratio is calculated for clients that transition between IC to FM midway through a year and so incur both IC and FM revenues during that year. How this ratio is computed will clearly have a substantial impact on the analysis.

For illustration, consider - as shown in the table below - a client paying 10 for IC each quarter up until the end of the first quarter of 2016 at which point they transition into FM and pay 30 from that point on. During 2017, the client's FM spend increases to 40 due to AUM growth.

	2015q1	2015q2	2015q3	2015q4	2016q1	2016q2	2016q3	2016q4	2017q1	2017q2	2017q3	2017q4
IC	10	10	10	10	10							
FM						30	30	30	40	40	40	40

The FM-to-IC ratio would be 3 (30/10) at the point of transition, but it could also be 9 (90/10) if measured across spend in 2016; or 3.25 (130/40) if measured as a year of spend each side of transition; or 4 (160/40) if measured across completed calendar years of spend (2015 vs 2017). There is also the confounding impact of changing AUM over time on FM fees (unrelated to engagement). Further, if the transition had instead taken place in 2016q3, most of the above ratios would change.

This illustrative example shows how vulnerable this metric is to measurement approach, timing of the transition, and even market dynamics affecting AUM (and so FM revenues). The FM-to-IC ratio for this client could range from 3 to 9 depending on assumptions and unrelated to engagement. The WP does not explain how it controls for this variation.

- (ii) Similarly, it is unclear how the FM-to-IC ratio could be calculated for “partial” FM clients that will have simultaneous FM and IC revenues. The WP is silent on how partial FM client ratios are calculated, but these are clearly important. For example, as discussed below, the FM transition results are not robust if the sample is restricted to include full FM clients only, meaning that the partial FM clients are materially influencing the results.
- (iii) The IC spend (denominator) for a client may understate what the client is actually spending on IC services – for example, the client may be acquiring some IC-related services from other IC providers or its own resources. In moving to FM, this client may appear to have a large increase in ratio, but this in part reflects measurement error in the denominator unrelated to gains from engagement.
- (iv) The ratio itself is very volatile when scheme size is small and so IC spend is low.<sup>23</sup> Smaller schemes could, therefore, have a disproportionate influence on average

<sup>23</sup> For instance, if a DC scheme spend for IC is £25,000 pre-transition and the scheme spend for FM increases to £75,000 post-transition (i.e. a £50,000 increase), its FM spend to IC spend ratio will be 3. However, if a DB scheme spend increases from £100,000 to £150,000 when transitioning from IC to FM (i.e. a similar £50,000 increase), that ratio will

movements. As noted below, the baseline regression results appear to be strongly influenced by schemes that originally purchased one IC service type of the five available.

4.14 *Fourth*, we agree that the basis points fee is an important metric for FM schemes and Mercer works to drive down the costs faced by its FM clients.<sup>24</sup> However, we are concerned with the accuracy of the CMA's calculation of implied basis points fees in the WP.

- (a) The summary statistics in Table 5, the FM 2016 dataset, appear incorrect with respect to revenues and implied basis point fees. The columns in grey below – in particular columns (a) and (b) – are taken directly from Table 5 of the WP.

	Observations (a)	Mean (b)	Total Spend (£)	Total AUM (£)	Implied revenues (b)/10,000 x Total AUM (£)
Scheme Spend (£ thousands)	333	306	101,898,000		
Scheme AUM (£ millions)	329	416		136,864,000,000	
Implied basis points	318	23.87			326,694,368

- (b) The WP includes 333 FM schemes (from five firms which provide both IC and FM) with an average scheme spend of £306,000. Total scheme spend, columns (a) multiplied by (b), would therefore be around £102 million.
- (c) The WP on Competitive Landscape notes that the total revenues of FM providers across the market was around £210 million in 2016.<sup>25</sup> The scheme spend in Table 5, therefore, is less than 50% of the total market. This is at odds with the earlier statement in the WP that *“Our analysis in the Competitive Landscape Working Paper shows that these five firms collective [sic] make up the majority of the FM market in revenue terms”*.<sup>26</sup>
- (d) Table 5 then shows average scheme AUM among 329 schemes. Total AUM covered, columns (a) multiplied by (b), would therefore be over £136 billion. This appears high relative to other market sources. KPMG, for example, found that across a wider set of providers surveyed, rather than the five in the CMA analysis, total AUM for FM was £114 billion in 2016.<sup>27</sup>
- (e) Table 5 states that the average implied basis points fee is 23.87. Applying this average to the total AUM in the row above would lead to implied revenues of over £326 million, which is clearly out of line with the total spend in the same table of £102 million (or the FM market as a whole).

The CMA may have made various assumptions in calculating the implied basis points for FM, but it is not clear on the face of the information in the WP that the values are correct. If these figures are not correct, the conclusions drawn from CMA's FM static analysis will need to be revisited.

### (c) **Potential flaws in dataset construction**

only be 1.5 for the same price increase. The spend increase measure used by the CMA is therefore very sensitive to the inclusion of smaller schemes.

<sup>24</sup> For example, we achieve additional discounts on AM and custodian fees for our pool of FM clients that these individual (smaller) clients would not be able to achieve on their own. These fee savings to clients would not be captured in the CMA's implied basis point analysis which appears to be based only on the spend with the FM.

<sup>25</sup> Competitive Landscape WP, paragraph 134.

<sup>26</sup> WP, paragraph 51.

<sup>27</sup> KPMG 2017 Fiduciary Management Survey.

- 4.15 The CMA has not allowed Mercer or its advisors to examine the underlying datasets or the coding scripts and assumptions used to construct the datasets and undertake the analyses. This restricts our ability to comment on the WP findings.
- 4.16 For example, the WP suggests a large number of assumptions and data manipulations were used to arrive at the underlying samples.<sup>28</sup>
- 4.17 Notably, we explain below that Mercer’s data does not appear to have been captured correctly in the FM analyses in the WP. Given that the CMA has not explained which of our FM mandates/clients have been removed from, or reclassified in, the analysis, it is challenging to comment meaningfully on the findings.

**(d) Concerns with the FM static analysis**

- 4.18 As noted above, we have concerns about the implied basis point fees calculated for this analysis and how engagement was defined. There are, however, two further material issues with the CMA’s approach: (i) how Mercer data is captured in the FM analyses; and (ii) the very mixed findings on the effects of engagement.
- 4.19 [REDACTED].
- 4.20 [REDACTED].
- 4.21 We are further concerned about how the CMA then classifies engagement within this data. Figure 3 shows that only a small fraction of all internally acquired schemes were “tendered”. [REDACTED]. It appears therefore that the CMA has chosen to discount a “structured process” as a type of client engagement.<sup>29</sup> We disagree with this approach as it risks significantly understating the extent of engagement: clients that have followed a structured process have taken active steps to evaluate their provider and should not, therefore, be treated as disengaged clients.
- 4.22 *Second*, the CMA’s analysis produces very mixed findings:
- (a) Figure 1 of the WP shows that internally acquired clients have significantly lower engagement levels than externally acquired clients. Figure 4 of the WP, however, provides inconsistent results.
  - (b) Figure 4 of the WP is reproduced below and then in Exhibit 1 we simply reformat the data to make visual comparison easier. Figure 4, in fact, shows that internally acquired clients pay much lower median prices than externally acquired clients, even if the former are treated as disengaged. Even the highest median price paid by internally acquired clients is below the prices paid by externally acquired clients.

<sup>28</sup> Paragraph 130, for example, notes: “To conduct our analysis, we undertook a significant amount of data cleaning to address various inconsistencies .... [t]his required some assumptions ...”.

<sup>29</sup> We note that footnote 63 of the WP says that the CMA “had to manually map several responses into a more consistent categorisation [of method of acquisition]”. It appears that in doing so, the CMA has excluded clients that were exhibiting engagement with other FM suppliers.



Figure 4: Median FM prices paid split by different indicators of engagement.

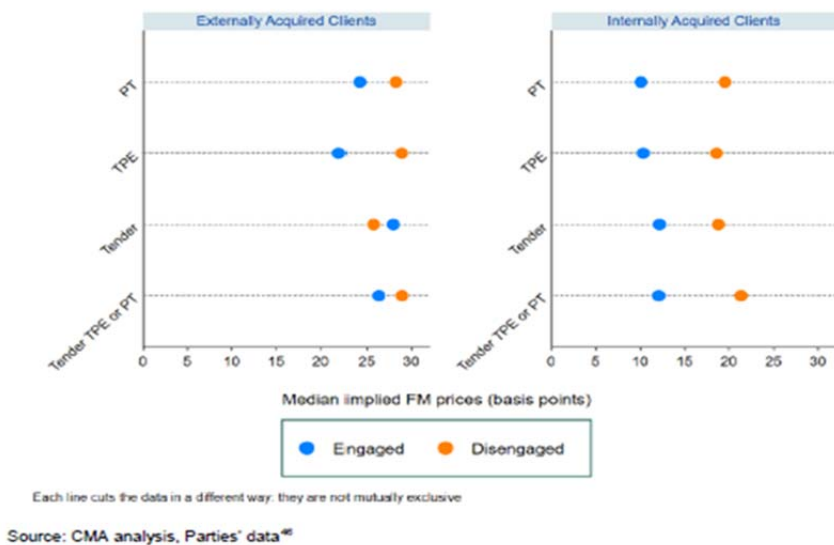
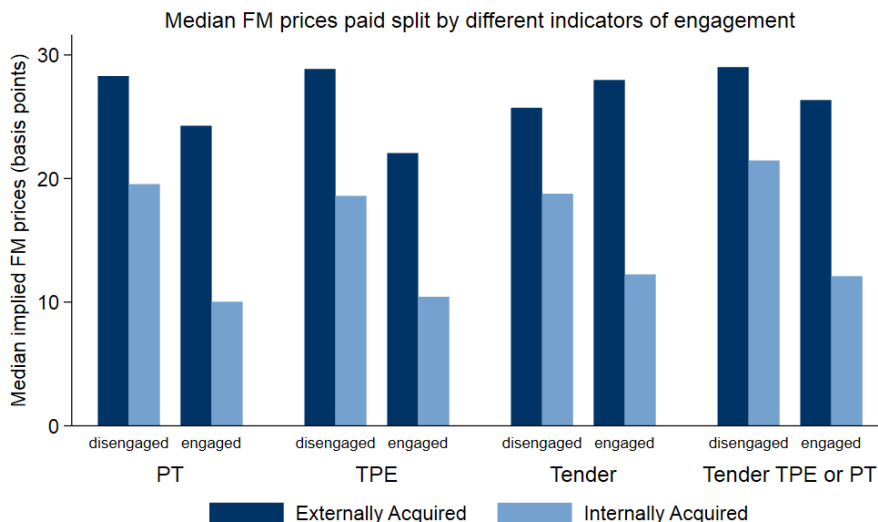
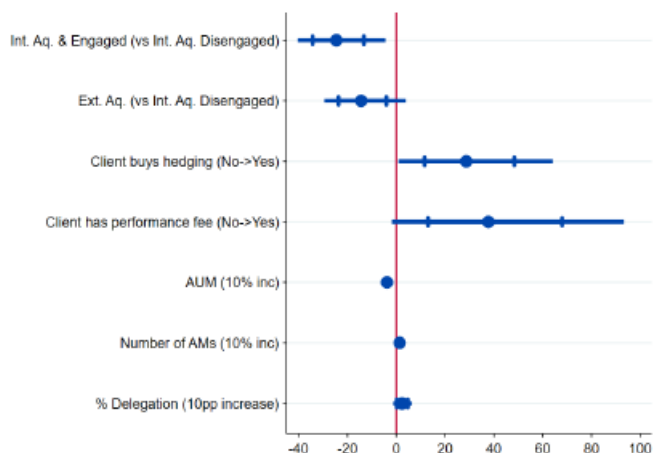


Exhibit 1: Reformatted Figure 4



- (c) Figure 4 is based on median prices, rather than averages (where averages are more susceptible to extreme values), but Table 5 indicates that for implied basis points the median and means are very similar. This suggests that the results of Figure 4 should be similar when considered in “means”.
- (d) Figure 4 is also inconsistent with the baseline regression results of the FM static analysis shown in Figure 6 of the WP (and displayed below). Specifically, the second row of Figure 6 shows that externally acquired clients (whether engaged or not) pay, on average, FM prices 14% lower than internally acquired clients that are disengaged. Yet this finding is at odds with the results for median prices in Figure 4.

Figure 6: Baseline regression specification, Static Analysis, graphical presentation



Source: CMA Analysis, Parties' Data

- (e) The mixed pattern of results appears again in Figure 5 of the WP, where median FM price differentials are shown for different firm sizes and hedging strategies. The only segment where disengaged schemes appear to pay more than engaged schemes irrespective of hedging is for “Small Internally Acquired” schemes. In all other cases the pattern is mixed and confounded by hedging strategy.
- (f) We agree that some of the controls (e.g. hedging and AUM) included in the baseline regression have the expected sign. However, the “percentage of assets” delegated variable appears to have an insignificant effect which is unexpected. In contrast, in the FM transition analysis, the degree of FM delegation is shown to have a significant determinant on FM-to-IC spend ratio. The analyses are based on different data samples,<sup>30</sup> which show that the regression results are not robust to the data sample. However, without the underlying data we cannot further examine the robustness of results and so cannot comment on why this important variable is not influencing the FM static analysis.

4.23 We cannot assess what is driving these inconsistencies in the findings, but they appear to be fundamental issues. At present, Figure 4 suggests errors in the CMA's regression analyses.

**(e) Concerns with the FM transition analysis**

4.24 The concerns noted above for the FM static analysis about the appropriate inclusion of Mercer's data and the classification of “structured processes” also affect our assessment of the FM transition analysis. We have also noted above our concerns about the robustness of the FM-to-IC ratio as a measure of outcome.

4.25 The FM transition analysis is undertaken on a very small sample size and covers only “Internally Acquired” customers. Table 7 indicates that the maximum number of observations with IC-to-FM information is 120. Indeed, due to the small sample size, the CMA includes DC schemes in this analysis, which itself creates a further uncertainty about the reliability of the results given the very different nature of DC schemes and their fee structures.<sup>31</sup>

<sup>30</sup> According to paragraph 131, both FM analyses are based on data provided by five parties (Aon, WTW, Mercer, JLT and River and Mercantile). However, the FM static analysis' sample covers all FM clients whereas the FM transition analysis' sample only covers data for internally acquired FM clients (see paragraph 98).

<sup>31</sup> Footnote 55 notes: “Due to the limited number of data points, the transition analysis is based on all scheme types (e.g. including DC) except where noted.”

- 4.26 The FM-to-IC ratio itself appears volatile. For example, the median increase in FM-to-IC across the sample is a ratio of 3.2, meaning that half of schemes experience this ratio or below. The mean of the sample is, however, much higher at a ratio of 5.1, which is likely pulled upwards by some unusually high ratios (the maximum ratio in Table 7 is shown as 24.8). It would be instructive to plot these FM-to-IC ratios against AUM and against the number of IC services originally consumed, as we are concerned that very small clients may be having a disproportionate effect on the results. As noted in paragraph 4.13(b) above, this is particularly problematic as these small schemes are likely to see the greatest impact from a move to FM – and therefore the value they achieve from the FM fees they pay will be more significant.
- 4.27 Our key concern, however, is that the FM transition results are not robust to small but important changes in the model specification:
- (a) Table 12 shows what happens when the sample is restricted to those schemes “Buying 2+ IC services only”. This reduces the observations to 51 versus the 104 in the baseline. On this subset the impact of engagement is not statistically significant. This suggests that the baseline results are being driven, in part, by schemes that were originally buying fewer than two services (of at least five available<sup>32</sup>) from their IC provider. It indicates that schemes with very limited usage of IC are driving the transition results in the baseline regression.
  - (b) Table 13 column (1) shows what happens when the sample is restricted to “Full FM only” schemes. This regression includes more than half of the original sample. Again, on this subset the effect of engagement is not statistically significant. As shown in Figure 12, the majority of FM clients use Full FM. If the results of the regression are not robust for this important subset, then the overall result is called into doubt.
- 4.28 The lack of robustness of this result means that the CMA cannot reasonably conclude, as it does in paragraph 123, that “[o]ur emerging findings from this work are that engaged schemes pay significantly less than disengaged customers when moving into FM with the same provider they have used for IC”.

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<sup>32</sup> Paragraph 29 notes: “... [the] services a scheme purchases [are] categorised between strategic asset allocation, bespoke liability hedging, dynamic asset allocation, monitoring and derisking, and manager recommendations.”

## Annex

### Inconsistent results and errors

- Paragraph 48 has acknowledged inconsistencies with Figure 1.<sup>33</sup>
- Footnote 46 has acknowledged inconsistencies with Figure 4.<sup>34</sup>
- Table 3 is a table with eight columns including the left-hand column showing labels. Row “Externally Acquired”, however, has nine columns (and eight coefficients) squeezed in, meaning one of the figures is incorrectly placed.
- Paragraph 79 is incorrect due to an error: “For Internally Acquired schemes, the chart shows that disengaged schemes usually pay higher prices than their disengaged counterparts, although for large scheme this is not demonstrated” (emphasis added).
- Paragraph 142 does not describe Figure 11 accurately. The chart does not show that any one provider has a lower proportion of schemes in FM.
- Paragraph 153 is incomplete, but the paragraph is referred to as presenting important results in three paragraphs in the main body of the WP.
- The CMA survey found that clients had been with their existing FM provider for approximately seven years (around 32% had been with their current FM provider for 10 years or more.). Table 5 of the WP, however, shows that in the FM 2016 sample the average “Year of [FM] mandate acquisition” was 2013q2 and the median was 2013q3, which are both under four years, and indeed the earliest record in the sample was 2010q1, which is seven years. Therefore, the 2016 dataset appears to have a different coverage to the CMA survey.
- Footnote 88 notes that WTW was omitted from one specification of the analysis but included in the baseline. No explanation is given.

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<sup>33</sup> [§<].

<sup>34</sup> [§<].