

INVESTMENT CONSULTANCY MARKET INVESTIGATION

RESPONSE TO CONSULTATION ON DRAFT REMEDIES ORDER

This submission sets out the response of Mercer Limited (**Mercer**) to the Competition and Market Authority's (**CMA's**) formal consultation on the draft Investment Consultancy and Fiduciary Management Market Investigation Order 2019 (the **Order**) and accompanying draft Explanatory Note.

We welcome the opportunity afforded by the consultation for the CMA to gather views from across the market and we would be happy to engage in further open discussion with the CMA, for example, through industry roundtables, to ensure that the Order operates effectively and uniformly in practice.

1 Interpretation (Part 2)

Definition of "Competitive Tender Process"

- 1.1 The definition of "Competitive Tender Process" (**CTP**) states that trustees must use "best endeavours to obtain bids for the provision of Fiduciary Management Services from three or more unrelated Fiduciary Management Providers". We have two comments on this definition:

- (a) We are concerned that the proposed definition means that for historical mandates (under Articles 3.3 and 4.2 of the Order) trustees will be required to undertake a CTP in circumstances where they have already adequately tested the market and are satisfied with their current fiduciary management (**FM**) provider.

It is increasingly common for trustees to test the market (either by using a TPE and/or undertaking some form of tender exercise) before entering into a FM arrangement.¹ As such, many trustees will have already tested the market and will be aware of the options available to them. In such circumstances, running a CTP will result in trustees spending time and resource on an additional process for little practical gain. This risks imposing a burden on those very trustees that have, to date, been proactively engaged in testing the market.

We therefore ask that the CMA consider revising the definition of CTP and/or the operation of Articles 3.3 and 4.2 of the Order to allow for greater flexibility as to what constitutes a CTP in the context of historical FM mandates.

- (b) The Order stipulates that "unrelated" means "independent of each other and thereby in a position to compete with each other". We assume that historical bids made by separate undertakings that were, at the time, independent of one another, and that have subsequently merged, will be considered as bids from unrelated Fiduciary Management Providers. This could helpfully be confirmed in the Order and/or Explanatory Note.

Definition of "Fiduciary Management Services"

- 1.2 We have previously submitted detailed comments on the CMA's proposed definition of "Fiduciary Management Services"² and we continue to have a number of concerns:

- (a) In order to fall within the scope of "Fiduciary Management Services", firms must provide both advice to trustees on investment strategy / investments and make investment decisions on behalf of trustees. On this basis we interpret the definition as excluding appointments where a FM provider is merely implementing decisions on behalf of the trustees and has not / is not providing any advice to the trustees in relation to investment strategy / investments. We believe this should be made clear in the Order and/or Explanatory Notes.

¹ Mercer response to Provisional Decision Report, paragraph 2.16.

² See Part 3 of our response to the consultation paper titled "Drafting definitions for the purpose of potential remedies" submitted to the CMA on 13 November 2018.

- (b) There may be circumstances in which trustees seek to use their IC provider to access a product solely for the purposes of gaining passive exposure. In such cases, the manager of the fund will seek to replicate a market index, as opposed pursuing an active strategy that aims to beat the market. [X] For the avoidance of doubt, we do not believe it would be appropriate to carve-out passive mandates from the definition of Fiduciary Management Services where broader investment decision-making is delegated.
- (c) As we have previously submitted, we are aware of at least one current arrangement in the market where FM services are provided jointly by two separate providers, with one firm providing the advice element and the other firm implementing that advice. We would expect that the CMA's proposed remedies would apply to such an arrangement, but, as it stands, it would appear not to be captured by the definition in Part 2 of the Order.

Definition of "Occupational Pension Scheme"

- 1.3 The CMA has chosen to adopt a definition of "Occupational Pension Scheme" that differs from the definition set out in section one of the Pensions Act 1993 (**PSA93**) and which is commonly used throughout pensions legislation. We consider that introducing an alternative definition is unnecessary and has the potential to cause confusion, and accordingly suggest that the CMA revise its definition to mirror the PSA93.

2 Mandatory Tendering for FM (Part 3)

- 2.1 In addition to our concerns set out in paragraph 1.1(a), we have a number of comments about the effectiveness and operation of the proposed mandatory tendering regime for new and existing FM appointments.³

Effectiveness of the minimum threshold for new and existing FM appointments

- 2.2 Article 3.2 of the Order currently provides that trustees are exempt from the obligation to run a CTP when they enter into FM arrangements that cover less than 20% of a scheme's assets. We agree with this approach in principle, but the detail of how the CMA proposes the 20% threshold will operate in practice means we do not think it will actually be used. This is because as currently drafted the requirement is that, once the 20% threshold is exceeded, all FM mandates (even those below the 20% threshold) have to be put out to tender. In practice, we expect trustees will decide that they might as well run a tender on first appointment of FM, even where this is below the 20% threshold, rather than risk having to re-procure the same services if the 20% threshold is subsequently exceeded.
- 2.3 In order to ensure the 20% threshold is effective, we believe that it should operate so that any appointment which represents less than 20% of the scheme's assets is exempt from the CTP requirement both at the time at which it is awarded and subsequently. The obligation to run a CTP would only take effect for an appointment which took the total assets under FM above the 20% threshold and then only in respect of the assets that are covered by the new appointment. Under this proposal, trustees would of course still have the ability to carry out a CTP for assets under the 20% threshold if they consider it appropriate in the circumstances.

Specific exemption

- 2.4 As we have previously submitted, we believe that existing investments made in closed-ended funds (such as private markets mandates) should be excluded from the scope of Part 3 of the Order. These funds are structured so that an investor exiting the fund before the end date would incur a significant penalty unless the investor could find a buyer for their interest on the secondary market. Given that it is highly unlikely in practice that a client will, in light of those costs, decide to switch

³ See paragraphs 5.7 to 5.41 in our response to the Provisional Decision Report submitted to the CMA on 31 August 2018 and paragraph 3.14 in our response to the consultation paper titled "Draft definitions for the purpose of potential remedies" submitted to the CMA on 13 November 2018.

away from such a fund, we believe that compelling trustees to run a tender exercise in these circumstances would incur substantial additional cost with no resulting benefit.

3 FM performance standard – appointment of independent person (Article 11)

- 3.1 In the event that an independent person is appointed to oversee the development of the FM performance standard, we believe it would be fairer and more straightforward to levy a flat charge across all FM firms. The support and level of input from different firms will not necessarily correlate to their size and so an approach based on revenue is not appropriate.

4 Monitoring and compliance (Part 9)

- 4.1 We have two concerns in relation to the practical operation of the monitoring and compliance regime:
- (a) Articles 15.1 to 15.4 and Article 15.6 provide IC and/or FM providers with one week between the end of the relevant reporting period and the date by which the relevant compliance statements must be submitted to the CMA. We do not think that one week is sufficient time to allow IC and/or FM providers to conduct the requisite internal audits to confirm compliance with the relevant provisions of the Order in relation to the latter part of the reporting period. In order to ensure IC and/or FM providers are in a position to provide up to date and accurate compliance statements, we request that the preparatory period be extended to four weeks.
 - (b) Article 15.4 requires FM providers to provide compliance statements to the CMA on a quarterly basis in order to confirm adherence with Article 10.4 of the Order, while IC and/or FM providers must only provide annual compliance statements in order to confirm adherence with the other relevant Parts of the Order. We do not believe it is necessary for FM firms to confirm quarterly that they have adhered to the requirement to use the FM performance standard when reporting past investment performance of their full FM clients. Such a requirement creates an unnecessary burden without adding material useful information; an annual compliance statement capturing all the relevant confirmations required under Part 9 would be sufficient.