

INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of hearing with IC Select held on 23 November 2017

Introduction and description of services

1. IC Select was established in 2007. They helped pension funds select and oversee their investment consultant and fiduciary manager.
2. IC Select tended to work with large pension schemes, with assets under management (AUM) of £1bn and above, with regard to their selection and oversight services on investment consultants. Those below that level of AUM tend not to have the governance resource, or don't appreciate the need, for having oversight of their investment advisor. Most of their clients in selection and oversight of fiduciary management (FM) have assets under management between £100 million and £1 billion.
3. IC Select had undertaken three searches for advisory this year. One for a very large pension scheme and the other two for large pension schemes. In FM, it had undertaken four searches for smaller pension schemes, AUM of between £100m and £1bn. It also performs oversight work for one advisory scheme, however that work has been running down since 2010.
4. IC Select has developed by word of mouth through other pensions schemes on the advisory side.

Level of Competition within the advisory sector

5. IC Select believed that there are a lot of firms but only ten credible Investment Consultancy (IC) advisory firms, with a very good level of competition between them. However, trustees struggle to understand what the differences between the various firms mean for them. Trustees don't define their goals or governance model well. Trustees should be focused on strategic allocation which academic evidence demonstrates and IC Select believes delivers most value (probably around 80%), whereas trustees in practice spend most of their time on choosing fund managers.

6. IC Select stated that trustees should consider the following factors when selecting an IC firm:
 - (a) the knowledge level of the trustee board;
 - (b) the governance model they want to build, including the use of an investment committee and delegation to in-house teams, an investment consultant or a fiduciary manager;
 - (c) the level of investment complexity they are comfortable with;
 - (d) the amount of time the board wants to devote to investments;
7. IC Select's research focused on about 12 fiduciary managers. Over the last three years there has been a noticeable reduction in fees as a result of the oversight work undertaken for clients by IC Select.

Number and frequency of Investment Consultancy tenders

8. IC Select stated all its work is done through competitive tendering; a disciplined and structured process done through shortlists.
9. IC Select believed the level of tendering varies considerably across the market. This may have been because IC firms who also offer FM services are recommending their own solutions.
10. IC Select found that IC firms do not necessarily recommend the strongest FMs when they have been asked to do so by clients.
11. IC Select stated that IC firms now recommend third party firms, following the FCA commencing its review into asset managers. Third parties could see where they have been recommended. However, they stated that they were only aware of 5 per cent out of the 60 per cent of searches that the recent KPMG survey says were put out to tender.
12. IC Select thought that brand recognition and existing relationships played a big role in IC firms influencing clients to move from advisory into FM. It does not think that greater clarity to trustees when moving to a different type of service or prohibiting IC firms from providing FM to their clients would address any conflicts.
13. IC Select believes tendering should take place when trustees are dissatisfied with the current fiduciary manager, rather than performing a mandatory tendering exercise every few years.

Barriers to entry and expansion

14. IC Select believed establishing a new investment advisory firm did not encounter many barriers but subsequent growth is more difficult. However, this is not the case with FM. They expected the growth of new FM firms would outpace those of new advisory firms.
15. IC Select believed access to trustees is challenging so can restrict the potential challenge of incumbent consultants. Due to their lack of historical presence in the market, newer firms were often overlooked during shortlisting of consultants.

Benchmarking

16. IC Select believed improved performance and fee benchmarking would help address many of the concerns raised by the CMA. They stated that some initiatives such as their Footprint Concept would bring together performance and fee benchmarking information. This concept would look at an annual investment cost report, benchmarks for FM, standardisation of performance calculations for advisory clients and benchmarks for advisory consultant performance.

Fiduciary Management Performance Standard

17. IC Select developed its Fiduciary Management Performance Management Standard (the Standard) when they began conducting FM tendering exercises. They noticed that FMs have a substantial influence on trustees' decisions and was concerned with their track record, as they seemed to report performance based on different criteria. They believed a standardised approach of reporting performance would benefit the market and increase its brand recognition in the process. The standard was mostly designed to help pension schemes when they are selecting a FM provider rather than for ongoing oversight. The standard was a methodology for calculating performance relative to the liability benchmark of a scheme (ie. the cash flow of the scheme).
18. IC Select has now undertaken a lot of work creating a database of pension schemes and the composites which would allow scheme performance to be benchmarked.
19. IC Select said that last year, the CFA Institute concluded that a firm the size of IC Select should not be setting a standard for the industry and approached the CFA Institute to take on the future maintenance of the standard. Subsequently, the CFA Institute and IC Select have been involved in

processes aimed at creating a global standard which will be known as the Global Investment Performance Standard (GIPS) for Fiduciary Management. The IC Select Standard is currently overseen by a steering committee comprising UK based independent trustee firms and competitors of IC Select among others. In creating a global standard the CFA Institute will establish new committees with a global membership.

20. IC Select indicated that the Standard will be rolled out by the end of February.
21. IC Select had also started to develop a standard for investment consultants which was very similar to the FM Performance Standard but with some differences (for example, it also takes into consideration various tiers of governance, since the governance model will affect the outcome of IC performance). IC Select had discussed this with many investment consultants. But it did not think that the CFA will pick this up.