INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of hearing with SEI Investments (Europe) Limited (SEI) held on 24 November 2017

Introduction

1. SEI explained that it provided fiduciary management with no separate investment consultancy business model. SEI was one of the first companies to offer fiduciary management services to UK clients and has always seen itself as an innovator in the market. SEI's typical client has between £15m and £1bn of assets under management.

2. SEI began offering fiduciary management in the UK in 2007 and sees itself as an innovator and disruptor.

3. SEI said that they offered a Manager of Managers investment process to clients, although SEI believed that a few competitors have a similar investment approach, SEI believed that these competitors do not have the same scale in Manager of Managers.

Fiduciary management tenders and third-party evaluations

4. SEI stated that they have had to compete for each fiduciary management mandate they have won:

   (a) Most clients were seeking a full fiduciary management mandate and the large majority (over 90 per cent) of SEI's fiduciary management wins have been new mandates.

   (b) When open tenders have taken place (which isn't always the case) they have had to compete against incumbent suppliers who are often then either appointed for fiduciary management or retained for investment consulting. Incumbents have had an advantage over other firms as the UK is more relationship based than other jurisdictions.

   (c) SEI have not lost any clients to another fiduciary management provider.

5. SEI said that the frequency of reviews and monitoring (and subsequent tendering, though this is not automatic) of fiduciary management services has increased since 2007, as confirmed by the KPMG statistics. This move appeared to be being driven by trustees being more aware of the possibility of tendering and the more transparent approach to business encouraged by third party oversight firms.

6. The stated objective of each pension scheme is to achieve a fully funded status. As a consequence fiduciary managers are assessed relative to a journey plan which seeks to achieve this objective. The risk budget will vary with each pension scheme and sponsoring employer. This will lead to different interest rate hedging ratios in each pension scheme.

7. They said that there were about 10 firms in the UK fiduciary management market. SEI noted that the provision of fiduciary management by investment consultants had not been welcomed by asset managers because they now view investment consultants as competitors rather than distributors.

8. Switching between fiduciary management providers can sometimes be a lengthy process, particularly if it involved illiquid asset classes. Transaction costs for switching can range from 10-25bps. However, SEI’s structure allows pension schemes to exit easily [✂]

9. Third-party evaluators were essential to the operation of the market as clients must be able to make use of independent evaluation. However, care should be taken as there are many investment consultants who operated as third-party evaluators, these could be incentivised to report that the fiduciary management arrangements are not going well and recommend that the client move back to an investment consultant arrangement.

10. SEI explained that they will only succeed if its clients succeed; client references are key for introductions and invitations to tender.

Demand Side

11. SEI explained the following points:

    (a) There were over 7,000 UK pension funds, many of them are small and rely on advice from an IFA rather than an investment consultant.

    (b) Consolidation of funds was a potential benefit to schemes because of the ability to deliver economies of scale, although it has not yet happened much in the private sector pensions market.

(c) Trustees did not, in general, have the skills and knowledge to allow them to effectively challenge their advisors.

(d) Professional trustees were a growth industry in the UK. This was proving to be an effective way of bringing expertise onto pension trusts.

12. SEI also explained that MiFID II will bring a great deal of change to the transparency in the market. MiFID II will compel firms to be more transparent about: transaction costs; risks; alerting clients when the value of an asset falls by 10 per cent and other features. SEI welcomed these changes, they believe they already act in a transparent manner, but MiFID II will increase the level of reporting.

Fee Structure

13. SEI's fee was based on an asset management fee (i.e. a percentage of assets under management). Fees are quoted separately for SEI and the charges for managing the underlying assets. SEI's first fiduciary management client publicly stated that its underlying asset management costs fell by 30 per cent.

14. Fiduciary management helped drive competition between asset managers. SEI's fee model can help drive down asset management fees: The costs were generally less than if a scheme were to attempt to hire managers directly.

Conflicts of Interest

15. SEI thought that when a pension scheme utilises an investment consultant in the traditional model it is more difficult to meet a fully funded status. The investment consultant revenue model was based on activity not results.

16. There was a clear conflict of interest where an investment consultant recommended that a client move to its own fiduciary management service.

17. SEI stated that Investment consultants / fiduciary managers who are also manufacturers had a conflict of interest if recommending their own products to clients. Such an arrangement should be clear and transparent to the client. SEI's investment approach is to utilise third party investment managers through a Manager of Managers investment process. These external third party investment managers are combined into one investment product which is labelled (wrapped) as an SEI fund e.g. SEI UK Equity Fund. This is not a fund of funds approach.

18. SEI said that in businesses who offer both investment consultancy and fiduciary management services, there may be a conflict of resources whereby the investment consultant might give its fiduciary management clients first access to new investment products and only then advise investment consultant clients to use them.

Remedies

19. SEI noted that advisory services were an integral part of the fiduciary management service so cannot be separated.

20. They supported mandatory tendering of the initial appointment of an investment consultant or fiduciary manager to give trustees a choice. Retendering of contracts should also be considered, but it would be difficult to establish a contract period that would be suitable for all clients. SEI would also want to avoid clients just moving from one big four investment consultant to another as has been seen in the audit sector.

21. SEI have been involved in the recent initiative from IC Select to develop standardised monitoring tools for fiduciary management. This had resulted from a demand from clients for comparison of these services.

    (a) **Fiduciary Management:** SEI thought that IC Select were fairly advanced in the development of a fiduciary management performance model. IC Select has taken some time to come up with an appropriate standard, as fiduciary management is a service not a product and was proving difficult to standardise. The financial services market is used to reviewing products rather than services. This will need to sit alongside more qualitative measures.

22. SEI stated that investment consultants should not be able to promote their own company's products.

Master trusts

23. SEI operated a master trust for defined contribution clients.

24. There were a large number of master trusts operating at the moment. SEI believed there will be fewer in the future due to forthcoming legislation as there are currently too many for all of them to be viable.

Gifts and hospitality

25. SEI had rules and regulations in place to manage any issues with gifts and hospitality to ensure that appointments are not swayed by gifts and hospitality.

International

26. SEI made the following points in relation to the UK and international markets:

(a) The UK pensions sector had a very large number of small schemes compared to other markets.

(b) UK pension schemes were unusual in their reliance on unpaid trustees. In the US, pension schemes are run by the sponsoring employer; in the Netherlands, trustees are paid.

(c) A big difference between the UK and international markets was the dominance of investment consultants as retained advisors to pension schemes in the UK due to the need for pension trusts to take advice under PA95 legislation. In other markets, investment consultancy is more project-based. The UK market appeared to be conservative and slow to develop as it is based on the advisory model developed by the big firms.