INVESTMENT CONSULTANTS - MARKET INVESTIGATION

Summary of hearing with Cambridge Associates Limited (Cambridge) held on 12 January 2018

Introduction

1. Cambridge Associates said that it provided investment advisory services to a wide range of clients, but had a large number of charities in its client mix. This strong link with charity clients went back to the founding of the original business in the 1970’s in the US, where Cambridge had originally worked with Ivy League university endowment clients. Initially, its UK presence was established as an FSA regulated branch of the US company, but in 2008 it was incorporated as an FSA regulated UK company.

2. Cambridge had always focused on institutions as its clients and over time had added wealthy families and latterly pension fund clients in the UK (which comprised only a small part of its client base). Its view was that the pension funds market was well provided with of quality and entrenched suppliers.

Charity – v – pension schemes

3. Cambridge explained that the core advisory role they carried out was broadly similar for charity and pension clients, focusing on the nature of the objectives of the investor and its governance and resources. However, the investment goals of a charity are many and varied and are very different from those of a pension fund. The investment goals of the majority of Cambridge’s clients were to ensure that assets generated long term returns to allow purchasing power to be maintained and at the same time provide revenue that would be available to be spent each year on the mission of the charity.

4. Cambridge said that their work related to a liability stream, but one that was typically discretionary rather than contractual. The modelling of the stream is different for charities than for pension funds. Cambridge will work with charities on: their investment policies; defining their investment objectives; their risk tolerance and investment beliefs as well as determining how much can be withdrawn each year into the charity’s operating budget. These steps will help to develop the charities’ investment strategy. Once the policy is set,

Cambridge will work with their client on implementation – what portfolio is appropriate to meet the goals, the mix of active and passive funds and recommendations for the selection of asset managers.

5. Cambridge's role could vary from being a monitoring role and 'sounding board' for the investment committee to a discretionary investment management[1] role with the ability to make investment decisions and move money. There were a range of levels of engagement between these points that Cambridge offered charity clients. Some larger charities will have their own dedicated investment staff which Cambridge will support.

6. Cambridge explained that charities typically invest in longer term assets such as public or private equity or property,[2] with some diversifying strategies such as hedge fund interests. Some clients have a need for near-term liquidity – this tended to sit outside of the work that Cambridge did.

7. Cambridge stated that, unlike pension funds, charities will not typically get involved in hedging approaches such as LDI, as charities do not have the same exposure to fluctuating contractual asset liability risks as pension funds.

8. Cambridge also explained that their charity clients recognise that there will be year-on-year fluctuations in their asset values, but they are more tolerant than pension funds of the movement in their asset values as they are long term investors and are more concerned with the returns they are receiving from their investments over many years than they are of hitting a target for the value of their assets next year.

9. Cambridge explained that the skill sets for advisors working with charity clients and pension clients were essentially the same, but the governance of the schemes and the regulatory environment that they both operate under will differ. In addition, it was important to understand the tax status of charities (for example, to determine which funds were better suited to charities given that, for example, they do not pay stamp duty on certain transactions).

10. Cambridge said that there was an enormous range of charities by asset size. Its clients ranged from those with assets of £50m to over £1bn. The sources of advice for charities are fairly broad: advice can be provided by trustees, individuals within a charity, as well as firms such as Cambridge. The larger charities (with investible assets of over £50m going up to £2-3bn) are, for a wide variety of reasons, able to attract some very sophisticated people to sit on their investment committees. Even a relatively small charity may have, for

[1] Cambridge takes the terms 'fiduciary management' and 'discretionary investment management' to mean the same thing (and use such terms interchangeably).
[2] Cambridge do not advise on direct investments in real assets or infrastructure

example, a CEO of an asset management company on its investment committee. So, charity clients can be active informed clients who are engaged in, and robustly challenge, investment matters, over and above what could be expected given the level of assets under management.

11. Cambridge said that it is not unusual for charity clients to put their own ideas into the investment 'pot'. This results in a higher level of engagement with charity clients and a feeling of working in partnership with the client.

12. Cambridge said that some smaller charities access pooled investment management services – via one of a number of pooled charity funds. It is much more difficult to pool assets together for investment advisory services as underlying advice needs to be provided on a bespoke, client by client, basis.

13. Cambridge explained that measuring the market size and market share is very difficult, as full knowledge of charity assets under management is very difficult to obtain or analyse. There is also a large tail of small charities and a small number of very large charities (for example, the Wellcome Trust and the Church Commissioners). Cambridge does not provide services to small charity clients. Cambridge's core client base is composed of charities with investment assets of between £100m and £2bn. Cambridge estimated that:

    (a) its clients comprised around 20% to 40% of UK charities (by number) with investment assets of between £100m and £2bn and

    (b) these clients definitely held less than 50% of the investment assets held by all UK charities with investment assets of between £100m and £2bn.

Demand side

14. Cambridge said that the universe of charities requiring investment advice appeared to have increased over the past ten years. Through market returns and donations there had been an increase in the number of charities with assets of over £50m who desire access to investment advice. The number of competitors in the market has not really changed over that same period. The growth in the last ten years has been in firms supplying one-stop ways of managing an account, for example offering a single managed account that clients will invest in. Cambridge observed that the charity departments of investment banks had fallen behind in this area.

15. Cambridge said that when charities are appointing an investment advisor, they are looking for someone who works with people like them, who can empathise with their issues, needs and requirements, and who isn't trying to impose a generic investment industry template on them. They want to deal

with people who are experienced in investment matters and can help them navigate the investment industry. Assessment of an adviser is rarely a 'box-ticking' exercise, but is generally more personal.

16. Cambridge explained that fees for the services provided are specified in the contract, either a fixed fee, or a basis point charge (there is no performance fee). MiFID II, which came into force in January 2018 requires Cambridge to produce a disclosure document for clients prior to entering into an agreement. This document sets out how Cambridge will set fees, and what visibility the client will have of the breakdown of those charges (eg expenses). On an annual basis Cambridge is obliged to provide clients with a statement setting out what they have been charged, both in percentage and absolute terms, and the effect that this has had on their holdings, if appropriate. In addition, Cambridge communicate and agree changes to all fees, costs and charges in advance, and memorialise such agreement with formal contractual amendments.

17. Cambridge also offered some charity clients a fiduciary management service, under which Cambridge makes portfolio management decisions that they believed were in the best interests of the client.

Switching and tendering

18. Cambridge said that the market for firms who operate in the charity sector is fragmented for smaller charities: on the one hand, in terms of investment consultancy/advice, there was a narrow universe of firms; however, on the other hand, small charities could choose from a long list of charity investment managers. Cambridge observed that Jewson used to be active as a consultant before they merged with an asset manager; some smaller pension investment consultants, for example Barnett Waddingham, have some activity in the area; of the 'Big 3' only Mercer is active on a regular basis.

19. For smaller charities, there are a large number of charity investment managers who offer a one stop product which the charity puts all its money in. These charities would likely find it beyond their budget to pay a fee to an investment consultant as well as a fee to an investment manager. Cambridge will occasionally be approached by charities for advice on a one-off project. Some of these charities have told Cambridge that they struggle to find an advisor that focuses on their issues.

20. Cambridge obtained its business on a passive referral basis (and often at the initiative of prospective clients). They said that what charities are looking for is a long-term partner, not an advisor for a specific period. Charities see themselves as long-term investors and tend to resist approaches which result

in a continual chopping and changing of asset managers and strategy. Increasingly it has been built into good governance procedures that there should be a regular review of all service providers, this has led to increasing reviews of Cambridge's services – for example a major review every six years with a desk review every three years is now not unusual.

21. Cambridge said that some clients will appoint a third party to carry out an independent review of Cambridge's performance; others will ask Cambridge to present a report on what they have done and what they plan to do in the future and compare this against similar presentations from competitors.

22. Cambridge said that fees regularly come up for review.

Endowments

23. Cambridge said that the term 'endowment' is drawn from the nomenclature from Cambridge's founding in the US. In the UK, Cambridge's endowment clients, such as universities, were registered charities with a pool of money put aside to support the organisation or charitable purpose. There may a difference between a grant giving organisation (a foundation) and an endowment organisation in the way they behave and invest. For example

    (a) The endowment of the [✂] contributes about five per cent to its operating budget. So, [✂] is operating a large budget with a small contribution from endowment.

    (b) Others may have an endowment that contributes 40% – 50% of the operating budget, making them more sensitive to year to year volatility

    (c) A grant giving organisation may only have income from the endowment and their mission depends on the income from the endowment. Nevertheless, the amount they spend in a given year may be highly discretionary.

    This leads to the attitudes to investment and risk being very different both between and among these organisations, even though they could be considered to be in the same area.

24. Cambridge stated that some endowment clients have a greater tolerance of risk as they have a longer-term goal. Conversely, some charities take a more cautious approach to risk than perhaps they need to because of what they perceive is expected of them in terms of prudence given their status as a charity.

Conflicts of interest

25. Cambridge said that they have a very strong conflicts policy to ensure they are entirely independent from the underlying managers. They do not accept any direct fees, rebates or monetary commissions from underlying managers.

26. Cambridge recognised that other market participants might face a potential conflict of interests in recommending fiduciary management to their existing advisory clients when this could be more profitable. However, as Cambridge does not recommend its own services and products to its own clients, Cambridge does not believe that such conflict can arise in its business. Should a client express interests in its discretionary services, Cambridge would prompt the client to obtain advice from an independent third party before the client engaged Cambridge to provide such services. Similarly, Cambridge avoids making recommendations on competitors fiduciary management products or ‘one stop shop’ charity funds

Regulation of investment consultants by the FCA

27. Cambridge told us that:

    (a) Cambridge’s clients have tended to be at the top end in terms of the level of assets they held, with investible assets of £50m and more.

    (b) the guidance to charities is that they should obtain investment advice from someone with appropriate knowledge. This can be either through having a knowledgeable trustee, or through using an outside firm.

    (c) If advisors are carrying out an advisory role, then they will need to be cognisant of the charity’s tax status, its legal structure and any know your client (anti-money laundering) requirements plus the charities internal resources to implement and monitor any proposed strategy

Barriers to entry

28. Cambridge said that there are no barriers to providers of services to pensions offering to provide those same services to charities. For new firms, the most difficult aspect of setting up in business is the move from providing high-level, strategic, policy advice into advice on manager selection and implementation. This is a step change in the level of resources required.