INVESTMENT CONSULTANTS - MARKET INVESTIGATION

Summary of hearing with Momentum Global Investment Management Limited (Momentum) held on 12 January 2018

Introduction

1. Momentum stated that they offered investment advisory services. They did not have its own master trust, nor did it offer administration, actuarial or other services. In particular, Momentum did not offer fiduciary management (FM) services[1]. However, Momentum considered that their clients valued the fact that Momentum did not offer FM services, particularly as this removed the potential conflict for Momentum should they recommend a move to FM for a client.

2. Momentum had developed a strategy of focusing on the advantages that a small, dedicated team can bring to clients. The majority of Momentum clients were larger pension schemes with assets under management (AUM) of £1 - 2bn to £10bn. Momentum has found that smaller pension schemes find it harder to work with a new, smaller, firm.

3. Momentum focusses on working for DB schemes. They had found that advisory work for DC schemes is a specialist area and that there is less demand for advisory work from DC schemes as it is paid for by the scheme sponsor, rather than from the scheme's funds as DB fees are. Momentum observed that DC investment strategies are more risk-averse and less ambitious.

Demand side

4. Momentum said that they believed that its clients were very informed buyers. In recent years buyers had been helped by the increasing use of independent and professional trustees. These trustees provided a comparison of the performance of investment consultants across a number of different pension schemes.

[1] Momentum believed there are a wide range of mandates that are called FM. However, in general, FM is really the management of a fund of funds account.

5. Momentum stated that all trustees were well aware of their duty to represent the needs of the scheme members.

6. Momentum explained that one of the major challenges for the industry is that measurement of performance of investment consultants is very difficult, Momentum believed that it was very difficult to come up with an effective, objective way of measuring Momentum's performance, or indeed, the performance of pension schemes. The time horizon was one area where measuring scheme performance was challenging: it would not be fair to judge the performance of an investment that was designed for a 10-year duration after, say, five years.

7. Momentum said that they were aware of the work of IC Select on potential performance measures.

8. Momentum said that they considered that any measurement of performance will have flaws and worried that the flaws could lead to clients reaching conclusions and making decisions for the wrong reasons. Notwithstanding this, Momentum believed that something, even a flawed measurement system, would probably be better than nothing, even though it would be difficult for clients to understand the impact of any flaws.

9. Momentum believed that any measurement of the performance of an adviser must also include an appreciation of softer measures (such as the clarity of information provided by the adviser). These measures are, however, subjective.

Switching and tendering

10. Momentum stated that the majority of their clients have come through winning a competitive tender. Some, especially the earlier clients had been appointed on the strength of the Momentum team's historic relationship with the client. [✄].

11. Momentum did not offer scheme administration or actuarial services but found that its potential clients were only tendering for investment advisory services so this was not an issue.

12. Momentum stated that competition for mandates was strong. There are a number of good adviser firms for potential clients to choose from.

13. Momentum stated that they recognise that - as a small firm[2] - in order to be awarded new mandates, they had to convince potential clients that size didn't

[2] Momentum considered that: a small firm would have less than 50 investment staff; a medium sized firm would have between 50 and 200 and a large firm would have over 200 investment staff.

matter, and that the attributes of a smaller firm can sometimes be an advantage. Momentum found that feedback from potential clients who did not award them the mandate was, most often, that the successful firm was a bigger or more experienced firm – and therefore perceived to be safer – option.

14. Momentum explained that increasingly schemes are inviting one big, one medium and one small firm to tender. In their opinion, the size of a firm was not, in general, an important factor, however:

    (a) A number of potential clients had explained that they did not award the final mandate to Momentum as their preferred firm was bigger - this was often cited as a reason why a larger firm is 'better'; for example, clients have argued that 'larger firms carry out more extensive asset manager research', Momentum argued that this was an 'easy explanation';

    (b) Momentum did recognise that there were some asset classes (e.g. hedge funds) where size was an advantage;

    (c) When approaching the end of a tender process when choosing between two evenly matched advisers, then factors, such as size and experience, can be highlighted.

    (d) Some potential clients believed they were taking on a reputational risk when awarding a mandate to a smaller firm – 'you don't get fired for hiring IBM'. Momentum believed that this perceived advantage was initially related to purchasing from the 'big 3', but are finding that this attitude has spread to a number of the medium sized firms as well (such as LCP, Hymans, Cardano and Redington).

15. Momentum explained that small firms cannot try to compete with the bigger firms on what they do well. For example, smaller firms cannot carry out a comprehensive search of the 'full universe' of asset managers; smaller firms need to adopt a different strategy. Momentum had no separate research team – the research function is spread out across the team who know some very good managers and do 'maintenance research' on well-established strategies (e.g. credit) rather than wider research to find 'the next best manager'. Momentum prefers to focus its research effort on newer strategies with certain characteristics. This enables it to narrow the universe of managers that it researches.

16. They do not tend to compete on price, they generally aimed to provide advice cost effectively and to provide cost certainty (eg on a fixed fee, rather than per hour).

Conflicts of interest

17. Momentum said that they did not believe that they had a conflict of interest when recommending that a client should move to a FM service.

18. Momentum said that it did not believe that compulsory tendering was necessary, although it did believe it would be good practice for clients to consider going out to tender when first introducing a fiduciary management mandate.

19. Momentum believed that gifts and hospitality, for example event holding, was a thing of the past and had been reducing in volume for many years. Gifts and hospitality were particularly reduced when the FCA published its guidance a few years ago.

Outcomes

20. Momentum said that they aimed to drive competition between asset managers. Momentums fair on fee negotiating stance has helped obtain better deals for its clients. Momentum will regularly seek to obtain 'most favoured nation', clauses for its clients. Momentum did not believe that driving asset management fees down to their lowest level was necessarily the best approach for clients as this would threaten the level and quality of service.

21. Getting the strategy right (for example agreeing and setting the risk appetite) was more important to Momentum's success than choosing between good asset managers.

Innovation

22. Momentum cited the evolution of 'journey planning' as one example of innovation in which it had engaged. That involved thinking about multiple dimensions, including the integration of liability hedging and structuring liability hedges in ways that made it more attractive as an investment option.

Regulation of investment consultants by the FCA

23. Momentum believed regulation was necessary in a wide range of financial services as it brings safeguards and protection to investors. However, a balance needed to be found as higher levels of regulation impacted disproportionately on smaller firms and some regulations have a larger impact than others. Financial services was already a highly regulated industry.

24. Momentum said that they operated their business in a way that upholds regulatory standards across the whole business, even those areas which are not covered by regulation.

Barriers to entry

25. When Momentum was set up, many of the founder members (who previously worked for Mercer[3]) operated under a restrictive covenant preventing them from discussing their motives for moving from Mercer with clients and from soliciting clients for a year after they left Mercer. Momentum thought the restrictions placed on them by Mercer were standard covenants for the industry and not an unreasonable imposition, which allowed Mercer to protect its investment in its clients.

26. Momentum had a supportive sponsor when they entered the market, which provided them with business support in areas such as compliance, legal, admin and payroll. Without this support Momentum would have found it very much more difficult to enter the market.

27. When they launched, Momentum knew a large number of quality asset managers in a wide range of asset classes, who could deliver good results for clients. This asset management research would be difficult for a new firm to replicate without extensive prior experience.

Barriers to expansion

28. Momentum explained that they did not aspire to be a 'big' firm as they appreciated the collegiate approach they were able to adopt as a small team. Momentum recognised that this ambition may evolve at some point in the future as they grow the business.

[3] Momentum currently comprised a team of 8, of which 6 were formerly from Mercer.