INVESTMENT CONSULTANTS - MARKET INVESTIGATION

Summary of roundtable with Asset Managers held on 12 February 2018

Attendee List

- AllianceBernstein
- Aviva Investors
- BMO Global Asset Management
- Deutsche Asset Management
- Insight Investment
- Janus Henderson Investors
- JP Morgan Asset Management
- Vanguard
- Fidelity International
- The Investment Association (observer)

Introduction

1. The purpose of the roundtable was to obtain views from asset managers on the roles played by investment consultants and fiduciary managers in the investment value chain, and the competitive features of these markets.

The role of investment consultants

2. Asset managers considered investment consultants to be an important part of the value chain of investment management services. From the perspective of the asset management industry, investment consultants act as a gate keeper with the majority of new business opportunities coming through investment consultants. They play an important role in driving scale in the asset management industry, as the demand side is highly fragmented.

3. Asset managers considered manager ratings and recommendations to be very important, due to the influence exerted by investment consultants on the investment decisions made by institutional investors and the scale of assets affected by their advice. In this regard, they noted that it was important to get their products rated by a diverse range of investment consultants, including

smaller consultants. They stated that investment consultant ratings were a significant driver of fund flows. They indicated that assets under management can change more quickly when an investment consultant has a fiduciary mandate than when an investment consultant has an advisory mandate.

4. While noting that investment consultants' resource for manager research is finite, asset managers indicated that investment consultants undertake the same level of due diligence on asset managers of different sizes and that there is added value in the due diligence process, which ensures that rated asset managers meet minimum quality and operational standards. Investment consultants research a range of asset managers in order to diversify their clients' portfolios. In this regard, asset managers considered that investment consultants' manager research serves many clients and is efficient for both institutional investors and asset managers, as the breadth and depth of research undertaken would be difficult and costly to replicate at individual client level.

5. Asset managers noted that some funds which they considered contained their best ideas are capacity constrained. As a result, when a larger investment consultant rated any such product highly, they noted that it may not be possible for that consultant to recommend it to every client. This can also result in such capacity constrained ideas not even being researched/rated because the consultant will not be able to generate enough revenue from searches to justify the research costs.

6. They also noted that manager ratings and recommendations may inhibit product innovation on the part of asset managers, as investment consultants may not have capacity to accommodate a new product yet to be rated. However, they noted that investment consultants are well placed to understand their clients' needs and so to drive the development of relevant investment products.

7. Asset managers stated that they do not consider that any business relationships that exist between themselves and investment consultants (such as an investment consultant advising an asset managers' own pension scheme) would have influenced ratings given by investment consultants.

8. They noted that attending investment consultants' conferences helps asset managers to better understand investment consultants' thinking and indicated that strong relationships with investment consultants benefits their clients. They did not see this as affecting the independence of decision-making on either side.

9. Asset managers considered that investment consultants were able to successfully negotiate discounts and are well-placed to do so. Negotiating expertise was not dependent on the size or type of investment consultancy firm; rather, it was more about the skill set of the individual consultant. Asset managers believed that investment consultants have the potential to achieve better price reductions than institutional investors could do otherwise. However, they prefer to deal with clients directly and most are resistant to relationship pricing across a given investment consultant's client base. In this regard, asset managers often seek to agree terms under which they do not offer discounts on the basis of the totality of an investment consultants' advisory clients' funds, but rather on a client-by-client basis. However, for delegated mandates asset managers are prepared to apply discounts on an aggregated basis.

10. Asset managers stated that they did not believe that gifts and hospitality played a significant role in their relationships with investment consultants and drew a distinction between gifts on the one hand and hospitality on the other. In this regard, they indicated that gifts are not prevalent and have long been restricted. More generally, they considered that changes to the regulatory environment and increased competition in the asset management industry has led to a decline in the level of gifts and hospitality across the industry.

Competition within investment consulting services and within fiduciary management services

11. Broadly, asset managers viewed fiduciary management as a suitable governance solution for some pension schemes, as they believe that some pension scheme trustees generally lack sufficient investment expertise to take complex financial decisions. However, they also noted that there are a number of very well-funded, well-managed schemes that use advisory-only services. Many of which use professional trustees who help facilitate better decision-making. In this regard, asset managers considered that the use of professional trustees ought to introduce a higher level of expertise to the existing advisory process.

12. Asset managers attributed the growth of fiduciary management to an increasing recognition among sponsoring employers that it is a better governance model for some pension schemes.

13. Asset managers considered fiduciary management to be a method of pooling institutional investors' funds, which could achieve lower costs and provide greater exposure to different managers.

14. They believe that fiduciary management will continue to grow and expect it to become commonplace for DC schemes. Additionally, they supported consolidation more generally and pointed to the Australian model as an example of consolidated investment management.

15. Asset managers identified two separate fiduciary management decisions that need to be taken by pension scheme trustees. The first is whether fiduciary management is suitable, and if so, the second is who is the best provider in the circumstances.

16. While asset managers viewed fiduciary management as a potentially beneficial investment governance solution, they indicated that the provision of fiduciary management services by investment consultants could be problematic in a number of ways. They stated that firms that provide both investment consultancy services and fiduciary management services may have incentives to recommend fiduciary products (full or partial) when an advisory only service may be more appropriate. In this regard, they noted that the incumbent investment consultant may have an advantage should a client wish to move into a fiduciary management mandate, due to the pre-existing relationship.

17. However, asset managers also stated that firms that only provide advisory investment consultancy services may have incentives to not recommend fiduciary management services.

18. Asset managers stated that investment consultants have begun offering their own in-house funds and products, which compete with asset managers' products. They stated that such firms may have incentives to select their own in-house funds or products, when other products would offer better value for money for the client. They noted that this could impact upon the way in which asset managers interact with investment consultants. For instance, they indicated that asset managers would have to consider not sharing information on fees and product innovation if the investment consultant was competing directly against the asset manager i.e. in cases where investment consultants are making direct investments themselves.

Possible remedies

19. Asset managers stated that while a case could be made for a structural remedy prohibiting investment consultants from providing both investment consultancy services and fiduciary management services, this would not address the demand side issues in connection with trustee engagement in complex financial decisions.

20. They believed that investment consultants would view their fiduciary management services as more valuable to their business than their advisory services and if forced to choose, would likely choose their fiduciary management offering. Asset managers stated that internal separation of services could be an effective way of managing potential conflicts of interest – and said that greater regulation could have a role in ensuring that this takes place.

21. Asset managers recognised that there would be some benefit in trustees obtaining advice independently of their incumbent advisor on whether fiduciary management is suitable for their scheme. Some also considered there would be benefits in a mandatory tendering process when first appointing a fiduciary manager.