bfinance

Response to the CMA Investment Consultants Market Investigation *Working Paper: Asset Manager Product Recommendations*

April 2018

Amsterdam | Chicago | London | Montréal | Munich | Paris | Sydney | Toronto

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Executive summary

Emerging findings and methodology

Whilst at a high level the emerging findings may appear to be consistent with our view that the widespread use of buy-lists controlled by a small number of dominant providers presents challenges, we do not feel in a position to make conclusive comments on the statistical results without more information on the methodology used in the data analysis.

Specifically, we consider it important to better understand the

- Formulas applied
- Gross to net fee adjustments
- Grouping of products
- Benchmark assignment
- Treatment of styles

Provisional decision report - differentiating 'buy lists' from other forms of IC guided selection

To avoid unhelpful and unintended consequences, we believe it is important that the CMA's provisional decision report in July explicitly separates the assessment of, and any conclusions about, traditional 'buy-lists' from other forms of investment consultant (IC) guided manager/product selection.

Whilst the buy list approach is dominant in the UK, there are numerous approaches to manager selection and the features of each are quite different [*see Appendix 1.1*]. There appears to be a risk that CMA conclusions relating to buy list approaches may be explicitly or implicitly extrapolated to other forms of manager selection and we believe that would be detrimental for investors and the continued development of the industry more generally.

Potential remedies – opportunity to consider and learn from procurement-based selection

We believe there is an opportunity to learn from procurement-based approaches to manager selection and would welcome the opportunity to engage with the CMA and assist further in this regard.

It may be relevant to note that the genesis of our business model was the growing number of investors observing that traditional buy list approaches to manager selection were inappropriate for their purposes; the manager universe was deemed too large and dynamic to constrain to a limited number of rated managers. It was clear to them and ourselves that another approach was required. We therefore constructed a bottom-up, full market, customised, practitioner-lead and procurement-based methodology, through which we undertake highly customised reviews of the manager universe. This is our specialism and we believe we have relevant and helpful information to contribute.

Next steps

We'd welcome an opportunity to engage with you further to share more about our approach and experiences. We are confident in our 'value add' and proud of our clients' experiences and feel that the broader industry could benefit from the adoption of similar techniques.

In the context of your paper, it may also interest you to note that we measure the performance value-add to our clients as part of our own assessment of our work. Naturally we'd be happy to share the associated results and methodology with you to inform your review and any future recommendations the CMA may make.

Working paper review

In the sections below, we have mirrored the structure of the working paper and provided comment.

Where:

Blue text denotes a direct quote from the working paper
Black text denotes our response

1. 'Executive summary'

- 'We have conducted quantitative analysis in order to test whether asset management products which are **recommended by investment consultants (ICs)** outperform their respective benchmarks' | Source: page 4, bullet point 1
- 'This analysis fits into our assessment of outcomes in terms of **whether ICs are providing value for money** in relation to the quality of their services' | Source: page 4, bullet point 2
  - Whilst the traditional 'buy list' approach to manager selection is dominant, we are concerned that other forms of IC guided manager selection may explicitly or implicitly be assumed by recipients of the CMAs reports to behave similarly
  - There are numerous approaches to manager selection and the features of each are quite different [*see Appendix 1.1*]. We believe the extrapolation of analysis and conclusions regarding 'buy list' approaches to other forms of IC guided selection would be detrimental for investors and the development of the industry more generally
  - To avoid unhelpful and unintended consequences, we believe it is important that the CMA's provisional decision report in July explicitly separates the assessment of, and any conclusions about, traditional 'buy-lists' from other forms of investment consultant guided manager selection.
- 'These are our emerging findings and we **invite comments on the analysis**' | Source: page 4, bullet point 7
  - We do not feel in a position to make conclusive comments on the statistical results without more information on the methodology used in the data analysis. As highlighted within our response to other extracts below, we would appreciate the opportunity to receive a more detailed breakdown of the methodology employed and specifically to understand and address the following:
    - Formulas applied
    - Gross to net fee adjustments
    - Grouping of products – including asset class categorisation and weightings
    - Benchmark assignment – treatment of strategies without benchmarks on eVestment
    - Treatment of styles – e.g. how value or low volatility managers been assessed

2.'Recommendations/ratings processes'

- No comment other than to note we don't adopt a 'buy list' approach to manager selection

3. 'Quantitative analysis'

3.2. CMA analysis – methodology

- 'We conducted the main analysis for **all ICs**, but conducted a sensitivity looking at the performance of ICs individually'.| Source: page 17, bullet point 3.2

- We are concerned that report recipients will respond to references **to 'all ICs'** and assume the findings (relating to large 'buy list' driven consultants) can be generalised to cover ICs providing other approaches to manager search and selection

> 'We conducted the main analysis across all asset classes, but conducted a sensitivity for individual asset classes'. | Source: page 18, bullet point 1.3

> 'We split the analysis by asset class'. | Source: page 24, bullet point 4

- In order to understand and interpret the analysis we would like to know more about the asset class and sub-asset class categorisation used and the weightings within the overall sample

> 'We (additionally) conduct analysis on product level data, rather than aggregated data, which allows for greater statistical power and robustness'. | Source: page 23, bullet point 2

- We would request more information to understand the methodology/formulas used within the analysis

> 'We looked at measures of risk for products with different ratings'. | Source: page 24, bullet point 5

> 'We didn't find definitive evidence that 'buy-rated' products are more risky or less risky than 'unrated' products.' | Source: page 33, bullet point 6

- We welcome the consideration of risk and would suggest the inclusion of risk-adjusted return measures e.g. sharpe and information ratios

3.4. CMA analysis – initial results

Table 4: Headline initial results of quantitative analysis

	Average active return	
	Gross	Net
Buy	0.230***	0.033
	(0.005)	(0.691)
Buy - Unrated	0.096	0.057
	(0.227)	(0.552)

Source: CMA analysis of data sourced from eVestment and investment consultants

Notes:
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$
p values are reported in parentheses

> Adjacent table | Source: page 31

- We recognise that the CMA approach differs from the original FCA methodology and request further information regarding the gross to net of fee adjustments as the implied fee level shown within the adjacent table appear high

3.5. CMA analysis – emerging findings'

> 'We find that the above results hold for all ICs individually, and for all significant asset classes'. | Source: page 35, bullet point 2.1

- As noted above, we are concerned that report recipients will respond to references to **'all ICs'** and assume the findings (relating to large 'buy list' consultants) can be generalised to cover ICs providing other approaches to manager search and selection

> 'That being said, we find that 'buy-rated' hedge-fund products outperform their respective benchmarks on average, and 'buy-rated' hedge-fund products outperform 'unrated' hedge-fund products on average'. | Source: page 35, bullet point 2.2

- We request further information about benchmark assignment and specifically the treatment of strategies without benchmarks recorded on eVestment

4. 'Parties' claims'

4.3 information presented in marketing/other materials

Table 6: Variation in application of particular methodology used to assess 'manager recommendations'

	Main outcome measure	Time-period	Manager fees	Example asset classes
[✂]	Return of highly-rated managers vs benchmark. Split by asset class.	Calendar years + 3, 5 years and 10 years.	Net.	Unconstrained UK equity. Unconstrained global equity.
[✂]	Return of highly-rated managers vs benchmark. Split by asset class.	By calendar year, they show 3 and 5 year performance.	-	UK equity. Global equity.
[✂]	Return of highly-rated managers vs benchmark. Split by asset class.	Calendar years + quarter, 1, 2 ... 10 years + since inception.	Gross.	UK equity, small cap. Global equity, core.
[✂]	Return of highly-rated managers vs benchmark. Split by asset class.	Varies; up to 10 years.	Gross.	Equities. Credit. Hedge funds.

- Table above | Source: page 44

- We note the wide variety of marketing approaches adopted and welcome initiatives to appropriately standardise and facilitate fair assessments across ICs
- We would caution against the creation of a buy list comparison template without considering the applicability to other forms of IC guided manager selection
- We provide a tried and tested customised practitioner lead procurement based manager selection service to our clients and feel we can help inform the CMA assessment of this alternative approach

4.5 Emerging findings'

- 'When we annualise our quarterly headline figures of 0.23% (gross of fees), we find outperformance of nearly 1% per year (0.92%) (not allowing for compounding)'. | Source: page 49, bullet point 5

- As noted above, we recognise that the CMA approach differs from the original FCA methodology and request further information regarding the gross to net of fee adjustments as the implied fee levels shown within the working paper appear high

5. 'Emerging findings'

- No additional comments

6.'Potential remedies'

- 'In our analysis we have found firms present information on the potential or actual impact of their asset manager product recommendations in different formats and using different terminology. If we were to find that this is a feature that constitutes an AEC we would need to consider potential ways to address this, for example by improving this information. To consider the design of any potential remedies we are keen to hear views from parties on the following:' | Source: page 53, bullet point 1

- To avoid unhelpful and unintended consequences, we believe it is important that the CMA's provisional decision report in July explicitly separates the assessment of, and any conclusions about, traditional 'buy-lists' from other forms of investment consultant (IC) guided manager selection

- 1.'Are trustees easily able to compare claims regarding the impact of asset manager product recommendations made by different firms during a tender, for instance? | Source: page 53, bullet point 1.1

- We do not believe that trustees are currently able to compare claims regarding the impact of asset manager product recommendations made by different firms during a tender, nor do we believe many trustees run tenders to select firms
- When we're assessing a manager, we work hard to assure that the information gathered can be compared on a like for like basis and believe trustees would also benefit from the improved rigour and ability to do this when selecting ICs for specific activities

- 2.Would trustees benefit most from information on returns achieved by recommended asset manager products on a gross or net basis? | Source: page 53, bullet point 1.2

- We believe both add value. Fees paid by different investors for the same product can be different. Our approach is to typically start with information on a gross basis and make adjustments from there based on the client's specific circumstances and negotiating power e.g. mandate size, client bargaining power, etc. Our experience is that in order to get the most "value for money" it is best to start with a focus on finding the most suitable manager(s) for the investor's specific needs and then to negotiate fees with that manager

- 3.'How could the presentation of the impact of asset manager product recommendations be made more comparable, comprehensive, relevant and useful?' | Source: page 53, bullet point 1.3

- As above we agree that the industry would benefit from an industry standard to compares IC contribution to performance
- We have a methodology used to asses our own performance value add which may be deemed applicable to other manager selection approaches such as buy lists
- We would be in favour of the formation of an industry-wide working group to devise and recommend an approach to the assessment of asset manager product recommendations
- We are also in favour of measuring client satisfaction independently and do so using a Net Promoter Score (NPS) framework that captures impact wider than performance, measuring client satisfaction with things like process, team, understanding client needs, adapting to client requirements, etc
- We would welcome an opportunity to engage with you further to share more about our approach and experiences. We are confident in our 'value add' and proud of our clients' experiences and feel that the broader industry could benefit from the adoption of similar techniques
- We'd be happy to share the performance value add analysis and methodology we've employed as part of the assessment of our own work to inform your review and any future recommendations the CMA may make

- 4.'What are the challenges of developing a common methodology? Should this be mandatory and, if so, should there be scope for divergence in specific circumstances?' | Source: page 53, bullet point 1.4

- Not all investment consultants employ "buy lists" and other types of manager selection are available. The challenges therefore include the identification of all the approaches employed and an appropriate common methodology (or family of methodologies) to cover those
- We believe there is an opportunity to learn from customised procurement-based approaches to manager selection and would welcome the opportunity to engage with the CMA and assist further in this regard

- 5.'Should any claim in relation to the impact of a firm's recommendations be subject to external benchmarking or scrutiny and should this be assessed against a common methodology for presenting impact?' | Source: page 53, bullet point 1.5

- If the industry can come up with an appropriate methodology, we believe that some external verification would give weight to that information
- The GIPS approach has improved the ability of investors to compare funds. Perhaps a similar approach can be adopted with respect to IC performance

➢ 6. How should any change in presentation be implemented and enforced?' | Source: page 53, bullet point 1.6

- It's too early to have a definitive view on this until we have more clarity on the findings. The CFA (GIPS like) and local regulators like the FCA may be appropriate arbiters

Appendix

1.1 Approaches to Manager/Product selection

There are numerous approaches to manager selection and the features of each are quite different. Some common but not exhaustive approaches and high-level traits typifying these approaches below.

Approach	Typical traits
Buy list	Typically, a roster of pre-researched and approved / rated managers is maintained covering a sub-set of the whole manager universe Managers from this sample are regularly reviewed and rated as "buy", "sell", "hold" etc These buy lists are predominantly controlled by Investment Consultants whose employees use them as a menu from which to recommend products / actions to their underlying clients (client requirements are matched to the buy listed products)
Procurement based	Typically, open to an exhaustive universe of managers responding to customised client requirements that are specified at the outset (matching product to client requirement) Option for an open, clear, auditable process Often more ability to benefit from manager competition through the process Ability for aspects of the bids to flex / be negotiated throughout the process or to pre-specify all selection criteria up front (depending on the provider)
Database driven	Typically, a third-party database of managers representing a large but unexhaustive sub-set of the manager universe is employed from which to select a short list of potential managers/products on some pre-identified criteria High level product information and past performance tend to weigh heavily in the short list selection process The short-listed managers are then invited to tender / 'pitch' to the investor
Market familiarity	In this category, an investor is typically responding to circumstance, identifying a pool of potential managers/products from past experience, network recommendations and fund manager marketing activities (distribution team engagements, press, placement-agents etc)
Hybrid	Some combination of the above, typically Database and Market familiarity driven approaches

1.2 The bfinance manager selection process

[redacted]

1.3 Contact details

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