Investment Consultants Market Investigation

Response to the Provisional Decision Report:

Derek Scott

I wish to comment on one aspect of your most recent report. By way of background, I have been a professional pensions trustee since 1987 and a former chairman of the UK's industry-wide Railways Pension Scheme and other schemes.

In section 50 on page 14 of your report you state: "Our analysis of investment consultants' recommended asset manager products found that these appear to outperform benchmarks net of fees, but not to a statistically significant extent. Therefore, the evidence does not demonstrate, one way or the other, whether investment consultants collectively add value through this service, although some individual firms may do so."

I am left to wonder if your researchers were aware of research on US equity markets by Tim Jenkinson, Howard Jones and Jose Vicente Martinez in 2013, and later published in 2016 in the Journal of Finance, volume 71, pp2333-2369? See https://www.ipe.com/europes-pension-consultants-are-fees-wasted/10001123.article which also includes vested interest comment by Andy Green, CIO at Hymans Robertson, one of the largest, middle-sized UK consultancies.

I had presumed your researchers would at least be aware of this year's paper by the same trio, joined by the FCA's Gordon Cookson, Investment Consultants' Claims About Their Own Performance: What Lies Beneath? (July 19, 2018). Available at SSRN: https://ssrn.com/abstract=3214693 or http://dx.doi.org/10.2139/ssrn.3214693.

The US study found "no evidence that these recommendations add value, suggesting that the search for winners, encouraged and guided by investment consultants, is fruitless." The more recent UK study concluded for the three largest consultancy firms there was "no out-performance of recommended managers, whereas the consultants themselves claim significant out-performance", and that in general "consultants market their services by claiming that their fund manager recommendations add significant value." "Using detailed data from the leading investment consultants, we find no such evidence."

I am disappointed that the CMA appears to me to be pulling its punches on this critical aspect of your market study, and has caved in to consultants' own extensive lobbying, just as your comments about the degree of concentration among the three largest consultancy firms seem very hard to reconcile with the earlier Myners Review findings in 2001. Since 2001, the "big four" considered in that report – Mercer, Watson Wyatt, Bacon & Woodrow (which included Hewitt) and Hymans Robertson – have become a "big three", with the virtually unchallenged mergers of Willis+Watson Wyatt+Towers Perrin and Aon+Hewitt+Bacon & Woodrow, alongside Mercer, while

Hymans Robertson, who may remain the fourth largest for all I know, have always appeared to me to have a disproportionate, but again unchallenged, share of the market to advise local government pension schemes in the UK.

You also seem to be framing your assessment of consultancy recommendations in terms of "benchmarks net of fees", whereas the Kay Review in 2012 urged that institutional investors should "set [investment] mandates which focus managers on achieving absolute returns in line with beneficiaries' long-term investment objectives, rather than short-term relative performance benchmarks."

Kay observed that "The decisions of asset holders to hire and review asset managers are typically based on their performance relative to index benchmarks, or their performance relative to other asset managers in a defined category. This emphasis on relative performance is found at every point in the investment chain. Advertising to retail customers stresses the relative performance of the promoted funds. Financial intermediaries give advice on a similar basis. Asset holders hire managers by reference to their recent performance relative to other similar managers, and are guided in this choice by consultants who construct databases for this purpose, and then monitor asset managers via benchmarks. The central role of relative performance in the business models of asset managers is mirrored in the bonus structures applied to individual fund managers within asset management companies."

I expected more of the CMA on this important review of investment consultants, which affects the well being of the millions of members of pension schemes and the thousands of employers who sponsor such pension schemes.

Yours faithfully, Derek Scott