

Professional Pensions, October 2000

Consultancy Concentration

The recent Myners discussion document has highlighted the question of whether the investment consultancy market for pension funds is overly concentrated. Yet the reported view of the ACA is that there are few barriers to entry for investment consultancies. In this article, I want to demonstrate why I believe both viewpoints to be valid, and why I also believe the onus is on pension fund Trustees and employers to help reduce the concentration.

Barriers to entry

My own small firm may be a good example of how there are indeed relatively few barriers to entry, in that once you have gone through the hoops of setting up a company (or equivalent), and obtained authorization to give investment advice under the Financial Services Act, then indeed there is theoretically nothing stopping you from getting on with dispensing investment advice. We underwent this process in the summer of 1999, and it was relatively painless, thanks to the experienced assistance we received from our accountants and the Institute of Actuaries.

Since we got up and running, however, we have come up against various technicalities, such as just how flexible you can or can't be on client-investor categorization and (to me) some obscure accounting audit issues. When these quirks rear their heads, which is fortunately not too often, they seem to do a pretty good job of getting in the way of doing what we are meant to be doing!

Research

One area often trumpeted by larger investment consultancies, and probably supporting the ongoing concentration referred to in the Myners discussion document, is their ability to do in-depth investment research into managers, particularly for highly specialized mandates. However, this does not seem to feed through to 'surprising' or 'innovative' manager selections by Trustees, especially for the sub-£100m fund market where the need for a specialist (say) Emerging Markets manager is somewhat reduced. This is hardly a surprise, given the risk-averse nature of many such Trustee groups, and it therefore begs the question of whether they really *need* the larger consultancies for this service at all.

It's also worth noting that even a small operation such as Jagger & Associates has access to significant levels of manager research information (eg via investment databases, via the managers themselves, and from other information services). Small consultancies can (and do) maintain a series of update meetings with investment managers, and will also have the capacity to carry out detailed research visits as and when required. The critical feature of manager research to me is the *use* of the information generated rather than the volume or staff-hours generated.

I also believe that far greater emphasis applies for strategy and broad manager structure issues than on specific manager appointments – it is all too easy to get caught up in the 'froth' of an issue involving a particular manager, rather than trying to keep sight of the wider picture.

So, if research should not dictate a concentrated market, what about staff resources?

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Personnel

Cynics sometimes ponder the question of just how many truly able investment consultants (as opposed to quasi client relationship comfort management managers) there are in the market place for consultancies to employ in the first place. Arguably, you can expect a fairly concentrated market if there are not that many such consultants, and the reported difficulty some consultancies have in recruiting staff of the calibre they demand supports this.

So, it then follows that the number of staff or size of department is not a good guide to a firm's collective ability (a controversial concept, to put it mildly). At which point you have to ask if it is the clients themselves driving the concentration.

Too much power?

If ever there was an example of too much power in too few hands, I fear that the investment consultancy side of the local authority sector may be it. A case study of our recent experience may be of interest. A pension fund from the sector put out an advertisement asking firms to express an interest to tender for the role of their investment consultant, and this we duly did. We, along with other firms, were subsequently invited to tender.

Now, as far as I am aware, the extent of local authority sector-specific *investment* regulations is much less than for, say, liability-based considerations, such as retirement procedures or valuation requirements. Consequently, the need for local authorities to specify that sector-specific experience is required for their investment consultants is much reduced. So I did not believe that it should matter overly much that we were a relatively new entrant to the investment consultancy market, with no direct sector experience. I was wrong.

I understand only four firms actually tendered for the appointment, of whom three will be well known to all readers. This implies that many medium-sized firms did not even believe it worth the time for applying, whereas at the outset I believed it was. However, of the four firms, three were interviewed, and you get no prizes for guessing the firm which was omitted, and the single ground on which we were passed over.

Conclusion

The onus must be on Trustees and employers to help develop a more competitive investment consultancy market, and for investment consultancies to help break down the prejudices and (arguable) misconceptions held by Trustees and employers.

Big is not necessarily best, and ultimately schemes should benefit from a broadening of consultancy choice, otherwise Trustees will have only themselves to blame. Capable new consultancy players should be given a fair chance.