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Investment consultants take on more asset management responsibilities

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Fund managers and investment consultants have pushed aggressively into each others' territory this year, blurring the line between the two disciplines.

Under the traditional investment model, consultants offer advice to investors, who then decide where to put their money. However, as pension scheme sponsors apply pressure on funds to close deficits and improve performance, demand for consultants to take on the responsibility for investment decisions has grown.

Zuhair Mohammed of Hewitt Associates, who joined from investment consultancy P-Solve this summer to develop a formal implemented consulting solution for the firm, said: "Previously, trustees delegated asset management to manager of manager solutions, but kept asset allocation responsibility. Now the regulatory goal posts have moved, there is a wider opportunity set with solutions such as liability-driven investment, and a wider diversity of asset classes they can invest in."

While asset managers including Insight Investment have teams to advise clients and manage assets with specific goals such as liability matching, consultants are taking on managing portfolios for specific asset classes such as hedge funds or private equity, as well as fiduciary responsibility for entire pension funds.

One consultant said: "Historically, asset managers have taken a huge amount of the pension funds' investment fees, when the real driver of their returns is consultant advice. By going into implemented consulting or fiduciary management, consultants are looking to take back a realistic share of that revenue. Asset managers see that and want to move into it as well, and take even more fees."

He pointed to academic studies, such as a 1986 paper by renowned investor Gary Brinson and others, which contend that fund manager selection accounts for only about 10% of a portfolio's variability, leaving more than 90% depending on asset allocation.

Consultants P-Solve and Watson Wyatt have offered implemented consulting services for several years. Investment consultants Mercer launched a bespoke service driven by its consulting operation in May and Cardano, a Dutch consultant that calls itself an implemented consulting business, opened a London office in July. Hewitt Associates manages assets for some clients on a delegated consulting basis.

In October, Mercer hired Michael Kinney, former head of research of the multi-manager business at boutique investment house Bramdean. Cardano has also hired staff from rivals and won two mandates. In July, Kerrin Rosenberg joined the firm as London chief executive from his position as senior investment consultant at Hewitt Associates and, in September, Mercer's director of European investment consulting Ralph Frank joined Cardano as head of investment solutions.

The firm has already won two advisory mandates formerly held by Hewitt Associates; the £1bn (€1.4bn) Southern Electric pension scheme and the £3bn UK pension fund for pharmaceutical group AstraZeneca.

Watson Wyatt's European director of investment consulting Paul Trickett said demand has increased in the past two years and the firm's European investment consulting business has grown from 210 staff to 230 as a result.

He said: "We have been offering implemented consulting services for seven years, but there has been growing interest over the past two years as interest has grown in corporate governance."

Watson Wyatt has about 30 clients with at least a portion of their assets managed on an implemented basis, accounting for £15bn to £20bn of assets. Compared with the £250bn to £300bn of assets under advice in the firm's European consulting business, it is a small but significant proportion, said Trickett.

The firm manages some segments of large client portfolios, while other clients have given the consultant whole funds of more than £1bn in assets to manage.

However, although there is demand, implemented consulting is more labor intensive than traditional advice. Trickett said that while there is probably enough demand to double the assets managed by its implemented consulting team in the next 12 months, it would be unable to grow its resources to cope with this increase in such a short time.

By comparison, Hewitt has fewer than 10 clients with a total of £4bn managed on a delegated basis, while P-Solve has 36 clients and just over £1.5bn of assets in its equivalent service.

Consultants also have different fee models for their implemented consulting services. Watson Wyatt offers clients a combination of a base retainer fee, which is an absolute fixed fee unrelated to assets, and a performance fee if clients want it. According to Trickett, half its clients chose a combined fee structure, while the remaining half opted for a pure retainer fee structure.

Cardano's preferred structure is for funds to pay a charge based on the improvement in their funded ratios, though it also offers a fixed fee. Whichever structure a consultant settles on, they all expect to generate higher profit margins as well as increased revenue from implemented consulting services, as opposed to providing traditional advice.

US-based multi-manager SEI Investments reentered the consulting business in November when it launched a combined implemented consulting and multi-manager service, PensionConnect, in the UK. The offering includes advice on investments and corporate finance, as well as asset allocation and multi-management.

John Conroy, principal at P-Solve, said: "It has surprised me that fund managers have not got into this more. I think you will see more movement by fund managers."
