

The Consultants Watching with interest, and awe

In this end of year edition of Broad Brush we have collected together six findings from across the 19 projects we have completed in 2011.

After we had chosen our favourite six, we looked for a theme that linked them all. It leapt out at us straight away: the Consultants.

One of our favourite hobbies is watching and interpreting what is happening across the maze of activities and organisations that make up the loose federations otherwise known as Mercer, Towers Watson and AON Hewitt. But we also enjoy observing and hearing about all those smaller consulting (and 'EBC') firms in this neck of the woods. An interesting insight or two about these firms emerges from virtually all the work we do.

In this piece we say that the Consultants are doing a good job. They face challenges for sure, and we often hear about the many pressures they face and the weaknesses in their models that they must overcome. Some of this is reflected in the six observations in this piece.

But our point is that when you assess what they do, you must consider their strengths. Consulting firms have shown they can swat away challenges in the past. We are in awe of the way in which they have adapted to carve out niches for themselves in new markets such as Fiduciary Management and DC Pensions. We are full of respect for the franchise that the Consultants have, and the depth of the trust accorded to them by their clients. And we also recognise that they play a very valuable role in insisting on Open Architecture, which gives opportunities to Asset Management firms who would otherwise find themselves frozen out of new markets altogether.

Have a great Christmas.



A regular analysis of strategic marketing issues in the European investment business

The clear niche that Consultants have carved out in DC

One of our main jobs in the research business is to analyse demand. But before you can ask what people want and why, you have to work out who the buyer or selector is, to whom these questions should be put. This is usually the hardest part of research into demand.

As we know from our own research work in the past, there are parts of the European investment landscape where it is relatively simple to identify who the buyers or 'selectors' or 'pickers' of funds are.

But identifying the buyer or selector is certainly not simple in Defined Contribution pensions in the UK. There are so many types of people involved in the decision in one way or another that we have given up calling them 'selectors', and have called them 'influencers' instead.

Our survey of 22 such influencers in DC pensions this Autumn showed for the first time how fund selection is carried out by a variety of Scheme Sponsors, Pension Providers and Investment Consultants. They are stationed at five different decision stages in the overall Fund Influencer Funnel, shown to the right. The funnel eventually leads at its spout to the all important decision on the make-up of the default fund.

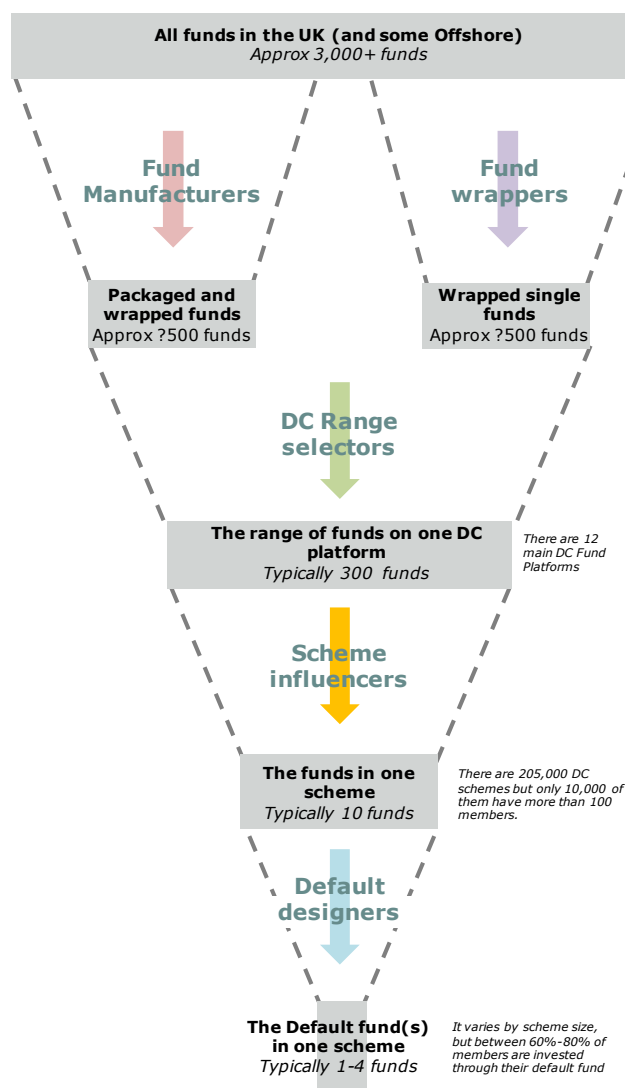
Of course as you might expect, the Consultants have found a role for themselves by dominating the business end of the funnel as what we have termed 'Scheme Influencers' and 'Default Designers'.

The implication for asset managers of the scope of this funnel is clear: it is a mightily complex sales environment, and requires a considerably more thoughtful strategy than just 'sucking up to Consultants', which is broadly speaking what passes for a distribution plan in most of mainstream DB pensions in the UK.

DC fund sales teams might want to cut out this page and put it on the desk of their Head of Distribution, along with a Christmas card which says something like: 'Now perhaps you will understand why we are so busy'.

DC Fund Influencer Funnel

Fund selection decision stages in Defined Contribution



Source
DC Market Intelligence 2011



The clear position that Consultants have in Fiduciary Management

At the beginning of this year we offered up the first ever sizing of the Fiduciary Management market in Europe. Our measure has been broadly confirmed by subsequent attempts to do the same thing. What we concluded was that there is €761bn in Fiduciary Management AuM across Europe.

But along with that measure we made a series of other observations, rather important ones although we say it ourselves. We believe that 89% of the market is from Netherlands clients. Only 6% is in the UK. This means that 82% of all Dutch pension assets are in Fiduciary Management, but the equivalent proportion is only 4% in the UK.

Some people say that this shows how little appeal there is for Fiduciary Management in the UK. We think the opposite - it shows how much potential there is for growth. One key piece of evidence for our view is the recent acceleration in the number of Fiduciary appointments, which is shown by the graph to the right.

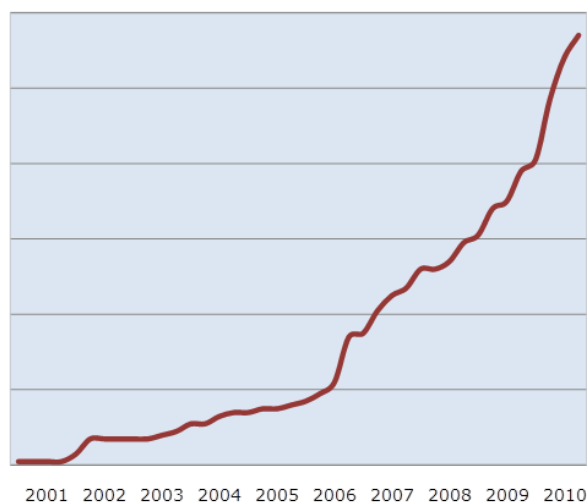
But we have also shown how the growth of Fiduciary in the UK has been quite different in nature to that in other countries. In the UK we see a predominantly Consultant-led market, as shown in the chart to the right. Elsewhere it is asset managers (Germany) or Pension heritage firms (Netherlands) that dominate.

The implication for those who want to access this market, either as providers of Fiduciary Management or as providers of funds to Fiduciary Managers, is that they must recognise that the Consultant model of Fiduciary Management in the UK is the market leader - for now.

One of the reasons for this is revealed on the next page.

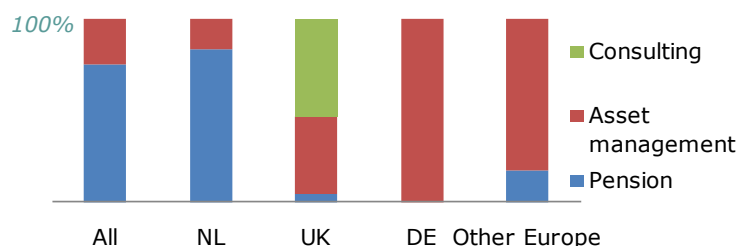
Fiduciary management appointments by date

Aggregate number of appointments, 2001-2010
116 Respondents who each now use Fiduciary Management in 2010



Fiduciary Management AuM 2010

By country and by heritage of provider



Source
Fiduciary Management
Market Intelligence 2011



A regular analysis of strategic marketing issues in the European investment business

The deep trust that binds consultants and Trustees

Pension fund Trustees rely on Consultants for advice. We all know that. What is less well known is how much Trustees and Pensions Professionals in general are reliant on Consultants for something else: information. We think this is a proxy for *who they trust*.

What we have discovered from one short and seemingly unimportant question in a wide ranging Pension fund survey we did in the Summer is this finding: Trustees and Pensions Professionals rely much more often on Consultants for information on investment matters than any other source. Over half of the sample of 64 DB schemes told us this, as shown to the right.

This is an insight into the minds of Trustees which we had not really grasped before. Where you get your advice is one thing, but where you get your information shows at its most raw *whom you trust*. When they get the basic information they need, they don't really trust anyone as much as they do Consultants. In effect we believe this data is proof that Consultants are trusted very deeply indeed by Pensions Professionals.

The implication for those who predict the demise of the role of the consultant in UK pensions, is that they should be wary of assuming that this will happen quickly. If at all.

One wrinkle in this message is shown on the table to the right. Private sector schemes certainly rely on Consultants for information and therefore trust them. But note that Public Sector schemes, whilst showing a significant degree of trust for Consultants, show even greater trust for Asset Managers. Hmmm.

Main sources of information on investment matters

Percent of respondents

Two sources were named by each respondent

Sources of investment information	Pension Fund	
	Private sector	Public sector
Consultant	57%	50%
Newspaper	40%	14%
Trade publication	27%	14%
Asset Managers	25%	64%
Bloomberg , Reuters etc	7%	36%
Web site/blog	7%	14%
TV Radio	2%	
Other	17%	14%
Number of respondents	60	14

Source
Confidential Client
Assignment 2011

The clever way that Consultants survive a shift to Bundling in DC

A Bundled Defined Contribution pensions provider is one that offers administration, communication and investment services under the same roof. In the UK, there are 12 main providers who fall in this category. Most are insurers, but two are asset managers.

The bundled providers, particularly the more established insurers, have suffered from the myth that they only serve Contract-based schemes, contained in what appears as the bottom end of the market in our segmented market diagrams to the right. Not that long ago, the words 'Bundled' and 'Contract-based' were apparently synonymous with 'Lower quality' and 'El Cheapo'.

The myth also had it that Consultants tended to get cut out of the action when a bundled provider was appointed, and so they rather preferred to strut their stuff in the upper reaches of the market, whispering into the ears of Trustees in larger Trust-based schemes, which they usually persuaded to remain unbundled.

We did say this was a myth. At their best, Contract based schemes are now virtually indistinguishable from Trust based in what they offer. But more to the point here, Bundled providers now have a significant share of the Trust-based, as well as virtually owning the Contract-based market.

In our 2011 edition of 'DC Market Intelligence' we predict that between them Bundled providers will service 89% of the schemes by 2021, up from 86% today. As we show in our market maps to the right, significant penetration even exists in the top left of the map, where bundling was once non-existent.

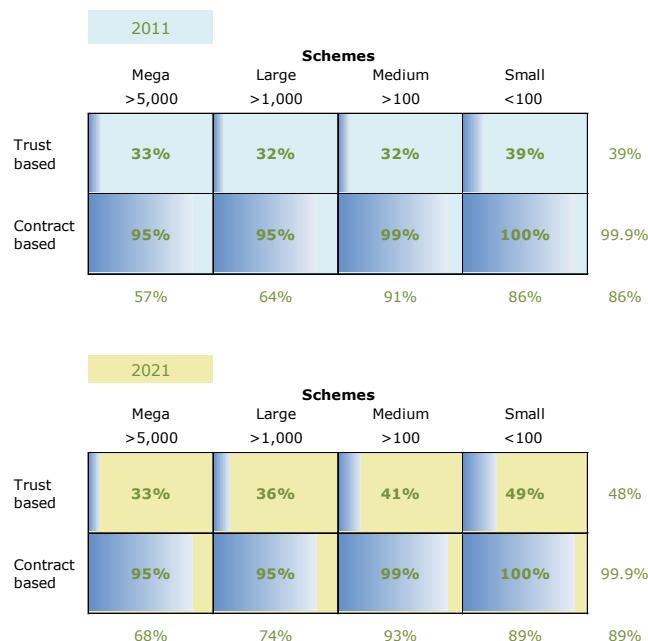
The implication for Consultants of the growth of Bundled providers is not as alarming for them as the myth implies, because they have found ways to carry on earning fees (advising on default fund architecture and governance structures for example) even after a bundled provider is appointed.

As a result, those consultants who not that long ago told their clients to avoid Contract-based structures and Bundled providers are now largely reconciled to both. The Consultants have shown a remarkable capacity for adaptation and survival in DC.

Bundled schemes in DC

Proportion of defined contribution schemes using same supplier for both administration and investment services.

Estimate for 2011 and projection for 2021



Source
DC Market Intelligence 2011



A regular analysis of strategic marketing issues in the European investment business

The slight squeeze being applied to Consultants by large companies

New regulations together with stockmarket volatility have prompted a revolution in the role of FDs towards pensions - more formality, more rigour, more resource, more focus.

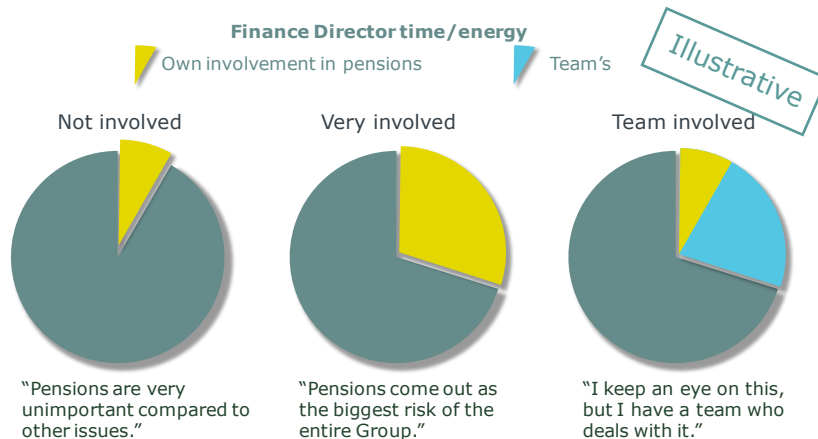
In a study on the emerging importance of FDs in pensions that we did earlier this year, we came to the conclusion that FDs are becoming much more involved in pensions.

FDs have a notoriously wide range of responsibilities, and in the past pensions did not claim their attention. This is still true of many who in the illustration to the right we have called the 'Not Involved'.

But this is changing, and pensions are becoming a high priority. There are increasingly FDs like those who we characterise here as the 'Very Involved'. And there are also FDs in larger companies, who whilst not personally involved, are building significant team resources dedicated to pensions, who act as their eyes and ears. These are the 'Team involved' on our illustration above.

There is a very important implication of this new team building in the larger firms: the big three consultants on whom they have traditionally relied are being used less to 'drive the pensions agenda' and to lead the pension debates. Instead these consultants are being used for specific issues or to inform specific debates, but they are having to compete with new emerging pensions consultants like Redington and the audit firms for this project-focused work.

Our guess is that the large consultants are probably finding revenues from larger firms harder to earn than in the past. They are in all likelihood becoming more reliant on revenues from smaller clients, which will in turn mean they are competing more with the smaller consulting firms.



Sources
'New Centres of Influence'



A regular analysis of strategic marketing issues in the European investment business

The real benefit that Consultants offer to Asset Managers

We think that the term Open Architecture can be used to describe an arrangement where at least half the assets are managed by third party suppliers. On this definition we think that significant elements of both Fiduciary Management and DC Pensions are not Open Architecture.

In our DC and Fiduciary research issued earlier this year we supplied our estimates of the measure of the use of third party funds in each of these markets. They are shown to the right.

In the case of Fiduciary Management the UK is Open Architecture, and Germany is not, while the Netherlands is on the cusp. In the case of DC Pensions in the UK, small and medium schemes are probably not Open, while Medium and Large ones probably are.

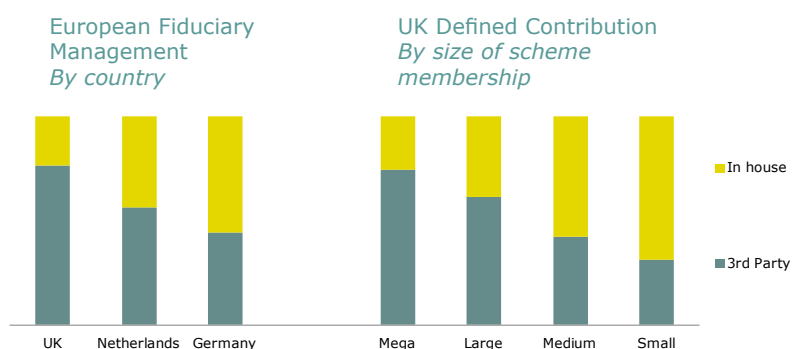
There is a clear reason for this. Where Consultants act as fund selection influencers for their clients in DC or as providers of Multi-Manager offerings to their clients in Fiduciary Management, the 'openness' of Architecture rises.

Of course we hear plenty of evidence that Consultants are now developing their own proprietary offerings in both Fiduciary Management and DC, and this may have an impact on both sets of numbers we show here - the proportion of in house funds used may rise. But it will not change the picture dramatically, and anyway it will do this over time.

Where asset managers want to become suppliers of funds through the 'distribution channels' of Fiduciary Management or DC Pensions, then they are the beneficiaries of the Consultants insistence on or towards Open Architecture. While there may be other reasons for not wanting to send a Christmas card to a Consultant, this is a good reason for doing so. We suggest the message is: 'Thanks for the Open Architecture guys'.

Open Architecture

Proportion of AuM in In house and Third party funds



Sources

- DC Market Intelligence 2011
- Fiduciary Management Market Intelligence 2011



Previous editions Available from <http://www.spencejohnson.com/TheBroadBrush.html>

March 11 - Number 8 - Fiduciary Management - Getting to grips with the finer details Everyone has heard of Fiduciary Management. It has grown to become a prominent part of the institutional asset management and consulting business in Europe. And yet ... no one seems entirely clear what it is. We try to clarify.

March 11 - Number 7 - DC pensions - A Fruitful Segmentation of the market Like an orange, the DC market in the UK is both one big thing, and several segments. We have found that the segments are each quite different. Without understanding the differences in the segments, you cannot understand the whole, well, fruit.

Sep 10 - Number 6 - DC pensions - Collective Communications Solving the communications problem in DC Pensions will be helped by a new "collective" model, where members of many schemes are communicated to at the same time. This already happens in other countries, and we predict that it will start to emerge in the UK.

Nov 09 - Number 5 - DC pensions - The gold rush. Few people would associate the UK DC market with a gold rush. Now may be the time for a rethink. We go so far as to suggest that the DC gold rush could throw up a new pool of £600bn in assets.

Aug 09 - Number 4 - European Asset Management - How many futures? Planning has never been so tough. In this new piece we offer some highlights from the "Five Futures" Study that was published recently in partnership with Alpha Financial Markets Consulting. We hope you find it useful.

April 09 - Number 3 - Offshore Distribution - From Backwater to mainstream. As markets start to recover, we think that one of the most attractive opportunities will be catering to upwardly mobile professionals from developing markets via distribution networks in the International Financial Centres. We asked distributors in three of these centres what they wanted from their providers.

Feb 09 - Number 2 - Thought Leadership - A top tool for troubled times . 'Thought Leadership' is an ideal tool for the current climate. It delivers the Sales Team's need for fresh conversation openings in these fast-changing times, and Marketing's need for a low-cost communications channel in an era of vanishing budgets.

Nov 08 - Number 1 - Private Banking - Factories, Homes and Cottages. A new look at the architecture of private banking in Europe. As the dust eventually settles on the financial landscape, there will be two businesses less damaged than most: Private Banking and Wealth Management. Existing classifications give little clue to the underlying patterns. We suggest a new Segmentation.

Spence Johnson is a privately-owned specialist provider of marketing intelligence. Its research products and consulting assignments support marketing, sales, and strategic planning in investment based businesses - asset management, life & pensions and wealth management.



SPENCE JOHNSON

15 Abchurch Lane

London EC4N 7BW

United Kingdom

Telephone +44 (0) 20 7112 2131

www.spencejohnson.com

Contact Nils Johnson or Nigel Birch

Nils@spencejohnson.com Nigel@spencejohnson.com