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A regular analysis of strategic issues in the institutional investment business

Deeper Perspectives

Excellent Client Management Provides Tangible Added Value

In this edition Spence Johnson reveals what it is that makes for excellence in client management.

Much has been written about the investment performance 'halo' that surrounds most decisions made by pension funds in relation to their asset managers. Generally pension fund decision makers quite rightly choose their managers in the trust of future expected superior investment returns. After all this is an investment industry. But asset management is also a relationship business above all else and there is real evidence that the better the relationship, the greater the lee-way a manager will be given in periods of underperformance.

In late 2014 Spence Johnson interviewed 41 UK pension fund decision makers responsible for assets in excess of £13 billion on the subject of client retention. This was a repeat of similar research undertaken in 2008. Excellent client management today could buy an extra 20 months in some cases which translates into income of over £300,000 on a £100 million mandate. This buys a lot more client servicing within an asset manager. The actual time and fee income secured are highly dependent upon mandate and fee level (source: LCP for fee levels).

There is a sting in the tail though. Pension fund decision makers have become less patient since 2008 because in some cases about 2 years extra grace was awarded 6 years ago. Spence Johnson analyses the reasons for this here.

Spence Johnson has also audited multiple asset manager reports, a critical element of any client service relationship in this industry. Indeed, of the 30 or more client management criteria that Spence Johnson tracks every year, the quality of performance explanation is almost always in the top five. To that end it would have been expected that managers would by now have improved their reporting on this. Alas, this is not the case as shown in this month's Deeper Perspectives.

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Spence Johnson provides five research-based services to asset management and insurance companies. Our clients use us to help them identify or retain clients in five key sectors within their institutional investment businesses.

Excellent client service gives up to 1 year extra

Excellent client management today could buy an extra 20 months in some cases which translates into income of over £300,000 on a £100 million mandate. This buys a lot more client servicing within an asset manager.

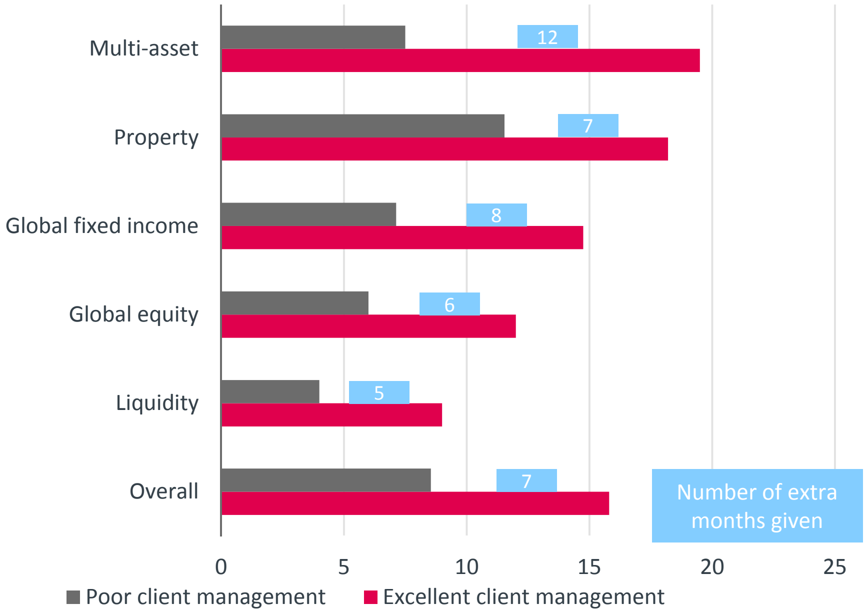
In research completed in late 2014 Spence Johnson interviewed 41 pension fund decision makers in the UK with over £13bn in assets about the difference excellent client management makes.

Respondents were asked how long poor versus excellent client management would give an asset manager that was underperforming a benchmark by 1% for around a year. The question was asked across key asset classes: multi-asset, global fixed income, global equity, liquidity and property.

Responses show that excellent client management keeps clients for more than 12 months extra in multi-asset. The extra months given in other asset classes range from 5 to 8 months as can be seen in the chart alongside.

If a manager underperforms a benchmark by 1% (for about a year), how much longer does excellent/poor client management give you?

Number of months



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Excellent client service gives £300K in fees

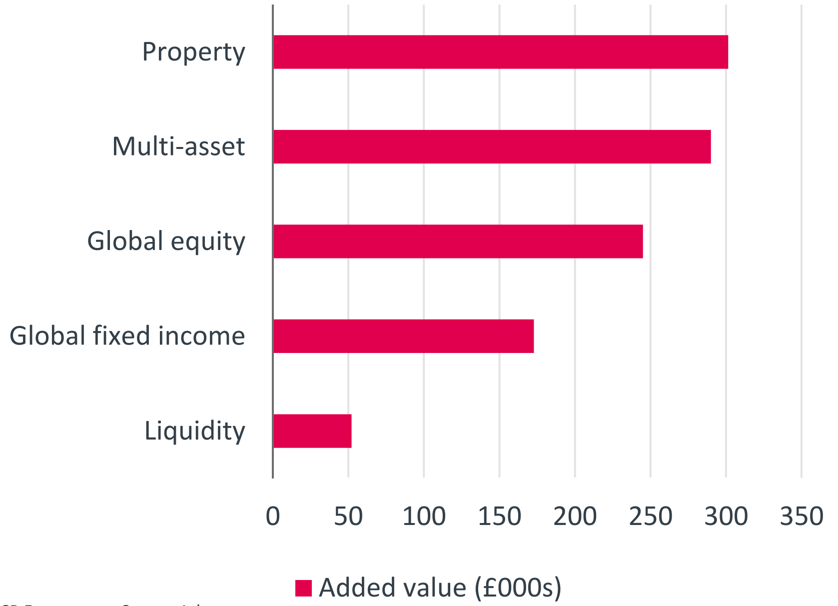
Excellent client service could deliver up to £300K in extra fees on a £100m property mandate and even at the lower end could still deliver over £50K on a £100m liquidity mandate.

For a £100 million multi-asset mandate respondents stated that a year extra would be awarded for excellence in client management. This equates to about £290,000.

Spence Johnson's research covered property, fixed income, and equity, as well as liquidity mandates, with the latter showing the lowest added value at 5 months extra. This would still give over £50,000 in fees.

The value of fees (Annual Management Charge – AMC) generated from excellent client management: months x AMC

£000s – based on a £100m mandate



LCP Fees survey, Spence Johnson

Investors more impatient than in 2008

When compared to similar research carried out in 2008, it is apparent that pension fund decision makers are more impatient now than they were then. In 2008 excellent client management gave an asset manager nearly two years lee-way compared to 15 months in 2014.

Pension fund clients have become less patient since the financial crisis in 2008/9. Back in 2008 excellent client management would have given a manager nearly 24 months, or two years, extra time despite investment underperformance. This is 8 months more than excellent client service delivers now.

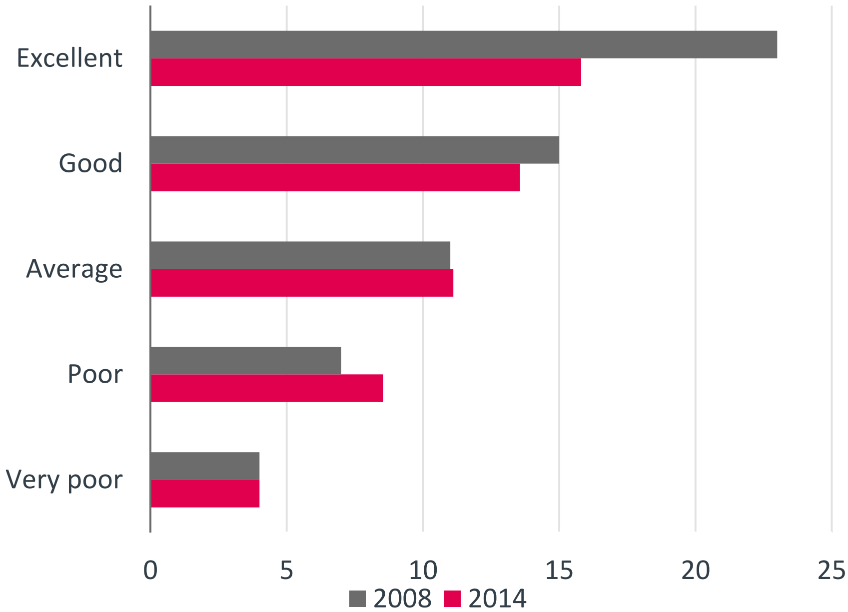
The following reasons were given for this growing impatience with managers:

- 2008/9 financial crisis
- Disappointment with active management
- More onerous monitoring of mandates
- Emergence of solutions and scheme specific absolute return benchmarks
- Greater level of staff discontinuity at asset managers since 2008
- Improved pensions governance

Spence Johnson believes that this impatience is one of the key drivers for pressure on institutional fees. Despite market recovery since 2008/9 it is likely that managers will remain under greater scrutiny.

Excellent client management will continue to be important in this environment.

If a manager underperforms a benchmark by 1% (for about a year), how much longer does excellent/poor client management give you?
Number of months



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What is excellence in client management?

Spence Johnson regularly questions pension fund decision makers on what the most important criteria are in client management. Between 25 to 30 criteria are assessed, ranging from the importance of an online facility to access reports and other data to the need for a single point of contact at the asset management firm.

■ In 2014 the most important were:
1. Responsiveness – both in terms of quality and timeliness
2. Continuity of staff – having a single point of contact
3. Quality of performance explanation
4. Clarity and trust on investment process
5. Face-to-face meetings

Since 2008 when this research was first carried out, responsiveness and the quality of the performance explanation have always been in the top 5.

The quality of the performance explanation is mostly communicated via client reporting and with this in mind Spence Johnson benchmarked asset manager reports from 8 leading asset managers in the UK, responsible for more than £1.7tn in assets under management. Spence Johnson was surprised by the wide variances between reports in terms of contents, quality and length and especially by the lack of high quality performance explanations in all but one of the reports.

Client reports were benchmarked on over 30 criteria in 6 sectors

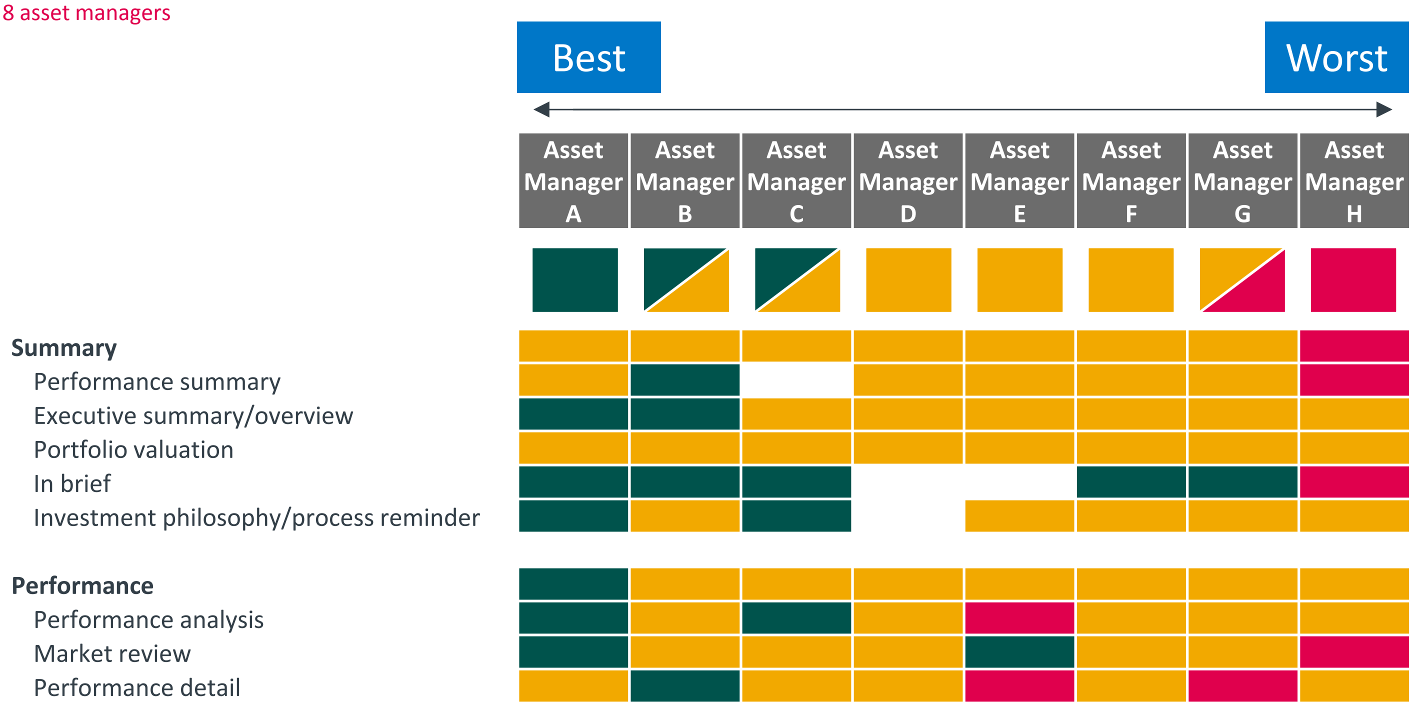
Spence Johnson benchmarked client reporting in the UK across the following criteria

- Summary
  - Performance summary
  - Executive summary/overview
  - Portfolio valuation
  - In brief
  - Investment philosophy/process reminder
- Performance
  - Performance analysis
  - Market review
  - Performance detail
- Governance
  - Fees and expenses
  - Governance summary
  - Voting/dividend activity
  - Compliance
  - Financial statements
  - Securities finance
  - ESG
- Commentary
  - Market background
  - Investment outlook
  - Special topic
  - Your portfolio
- Portfolio review
  - Portfolio characteristics
  - Asset allocation
  - Market allocation
  - Valuation
  - Risk management
  - List of holdings
  - Relative performance
  - Fund activity/trading
  - In flows/out flows
- Other information
  - Contact
  - Your team
  - Glossary
  - Key personnel changes
  - Awards
  - Other news

There is work to be done on client reporting

Spence Johnson compared the reports of 8 leading UK asset managers across the 30 criteria in 6 sectors listed on the previous page. The assessment below showing the summary and performance sectors only shows that for many managers the quality of performance explanation is a gap. In all sectors content, quality and length all varied widely.

Asset manager report benchmarking - assessment on summary and performance
8 asset managers



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In Spence Johnson's client report benchmarking research three managers simply did not pass muster on the quality of output. Elementary mistakes were made on length of commentaries, lack of pithy executive summaries and performance explanations that simply misled the reader. Fee transparency, poor risk management explanations as well as a low level of ESG compliance were also in evidence.

Length is also an issue. One quarterly investment review was a massive 62 pages. The shortest was a mere 16 pages.

Why the difference in quality of output? It is Spence Johnson's view that too much emphasis has been put on industrialising the client reporting process without taking full consideration of the quality of output. There is a trend toward bespoke and tailored reporting as pension funds embrace ever more complex pension solutions and asset managers will need to work hard to ensure their reports meet client needs.

Feedback from asset managers with good client reporting tells us that the clue is to identify portfolio managers who can write well and use their skills for the commentaries.

From Spence Johnson's benchmarking research it is clear that for many asset managers there is work to be done on client reporting.

Previous editions

Previous editions Available from http://http://www.spencejohnson.com/research#deeper-perspective

February 2014 - Number 25 - Opportunities across the map
We look at how asset concentration and distribution issues are related in Europe.

December 2014 - Number 24 - The year of the master trust
As with target date funds, master trusts also offer a less intermediate channel than those for more traditional trust or contract-based schemes, especially in the large scheme sector.

November 2014 - Number 23 - European growth opportunities for US asset managers
The European Institutional market is a market going through transformation. As this transformation takes place, we have identified 3 growth opportunities that US managers could take advantage of.

October 2014 - Number 22 - Opportunities in a transformed market
Retirement Income is now predominantly an investment based fund market. Both the life & pensions and asset management sectors are facing major challenges to protect and grow their strategic interests in this £1.7 trillion opportunity.

September 2014 - Number 21 - Solutions will win in the end game
Not only will the specialist third party asset manager share be greatly reduced but the source of assets greatly changed. Specialist providers in the future will look to solutions providers for nearly 40% of their assets.

May 2014 - Number 20 - DGFs still room for new players
The speed of adoption by DB schemes witnessed in 2013 was much faster and more significant that expected. The market grew by £10 billion from this source in 2013, off a previously estimated base of only £30 billion.

April 2014 - Number 19 - Smart Beta the new alternative
Alternative index product flow is estimated to be largely from UK clients, unlike flows into advanced beta and advanced index products which are estimated to emanate more from European clients.

December 2013 - Number 18 - The three spirits of pensions, past, present and future
In this holiday edition of Deeper Perspectives we evoke the Three Spirits of Pensions – Past, Present and Future – to enlighten and inspire our readers about the exciting world of pension investment.

November 2013 - Number 17 - New opportunities for asset mangers in workplace pensions
In this new edition of Deeper Perspectives we make four predictions of the future of workplace pensions that could have a significant impact on your strategic planning today.

October 2013 - Number 16 - New opportunities emerge in Insurance Asset Management
We describe how the management of insurers' general accounts is a growing and changing revenue opportunity for European asset managers

June 2013 - Number 15 - Growth of US OCIO reveals one clear winner
We share some high level findings of our OCIO Market Intelligence report, and we describe one very clear winner emerging in this market

Nov 2012 - Number 14 - Growth in DC assets
DC assets will grow at 11.6% pa to triple in size over the next 10 years, we say.

Nov 2012 - Number 13 - Fiduciary Management starts to mature
Throughout 2012 we have uncovered growing evidence that the European Fiduciary Management market is maturing. This will continue to have a significant impact on the wider institutional investment landscape

July 2012 - Number 12 - Guarantees Funds in DC Pensions
Guarantees will re-emerge in the middle ground in UK pensions