WHITE PAPER

TAPPING ASIAN CONSULTANTS FOR MANDATES

Research | Analytics | Consulting

The use of investment consultants among Asian institutions has not picked up as much as in the United States and United Kingdom. There are a few reasons for this. One is that Asian institutions tend to be highly fee-conscious, and most—except some large public pension funds—are not required by regulation to engage third-party consultants, unlike their U.S. and U.K. peers. Compared to these two markets, where consultants are hired on retainer basis for two to three years, Asian asset owners generally tend to work with consultants on an ad hoc project or assignment basis.

Over the last few years, it has become challenging for consultants to operate in the region on low-earning, project-basis assignments, due to the higher costs incurred in providing such services for institutions. This has forced consultants in the region to review their business models. In addition to traditional advisory services, consultants have forayed into the fee-based asset management businesses by offering discretionary investment management or fund-of-funds solutions to asset owners. For instance, Mercer merged its investment and retirement divisions into its newly named wealth business, while Willis Tower Watson recently conducted a business review to focus on core markets—Australia, Japan, and Greater China—instead of emerging Southeast Asian markets.

In Australia, a key consultant-driven market, several firms have taken steps towards implemented consulting, wherein investments for a client take place on the consultant's own internal platform. JANA is the biggest, with A$350 billion (US$ 268.2 billion) under management as of June 2017. It has A$80 billion funds under management for institutional clients on its implemented consulting platform.

The dual roles that consultants are playing in terms of advisory and asset management are conflicting. One wonders if there could be stringent controls from regulators in this part of the world, as we have seen from the U.K.'s Financial Conduct Authority, which has increased its scrutiny of the opaque nature of consultancies' operations.

What is interesting is that while consultants have made forays into the asset management business, some large asset managers have stepped into consultants' shoes by offering services in the form of free advice to institutions, in hopes of getting mandates. What does the future hold for consultants and for managers who desire to tap the institutional pie through consultants?

Summary

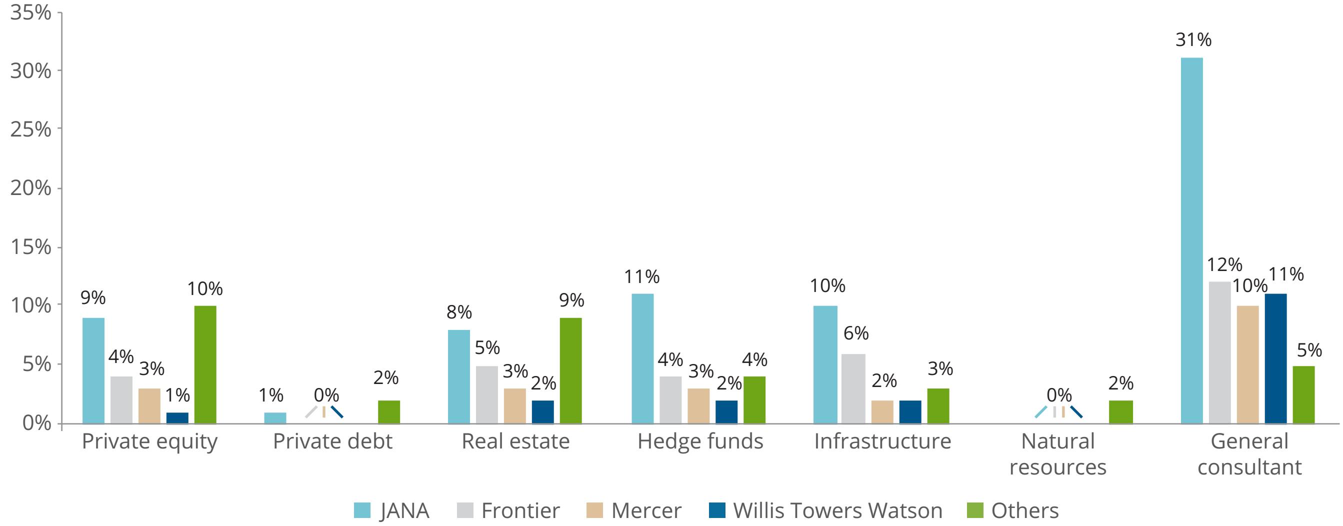
Notwithstanding investment consultants' changing business models, Cerulli believes it will be critical for managers to remain on consultants' radars. With the persistent uncertain macro environment, institutions will be forced to look for consultants' expertise in selecting managers for sophisticated, exotic, and low-cost strategies to boost returns on their investment portfolios.

Key Points

- Institutions' use of consultants is quite prevalent in markets such as Australia, Japan, and Hong Kong, while in other Asian markets, the channel is still emerging. In Southeast Asia excluding Singapore, institutions do their investments and outsourcing very much on their own.
- There is a growing drive among institutions to use consultant services for alternative asset classes and overseas investments. Our survey of managers also highlights that they will increasingly work with consultants for environmental, social, and governance (ESG)-related investments.
- As competition stiffens, managers will need to resort to all modes, whether direct, through request for proposals (RFPs), or through consultants, to win mandates from institutions. Therefore, building and nurturing relationships with both institutions and consultants is a must.

Exhibit 1: Australian Super Funds' Use of Consultants by Asset Class, 2017

Although some asset classes are in particular demand, general consulting is still highly sought after.



Sources: Preqin, Cerulli Associates

Key consultant-driven markets

The use of consultants is quite prevalent in markets such as Australia, Japan, Hong Kong, and Singapore, while in the rest of the Asian markets, the channel is still emerging.

In Australia, most of the 214 super funds regulated by the Australian Prudential Regulation Authority use investment consultants to varying degrees. Four names dominate this field: JANA, Frontier Advisors, Mercer, and Willis Towers Watson. The role they play varies from fund to fund, but typically they advise on asset allocation and manager selection.

JANA is considered the leader with around 100 institutional clients, including some outside the superannuation sector such as charities, insurers, and foundations. Mercer, another leader, has sought to diversify its client base away from just superannuation funds to insurers and endowment funds. Sometimes funds use more consultants, but with fewer responsibilities for each. It is sometimes the case that a fund might appoint one investment consultant for manager selection or stress testing, and another for macro or research in a particular asset class.

There is a school of thought that consultants are losing their power at the very biggest funds, as they beef up expertise to manage assets in-house. It is argued that the top 10 use consultants less than they used to five years ago. We are of the view that even if investment consultants do not control the market as intensely as they once did, they remain trusted advisors to at least a trillion Australian dollars of wealth that fund managers want to reach.

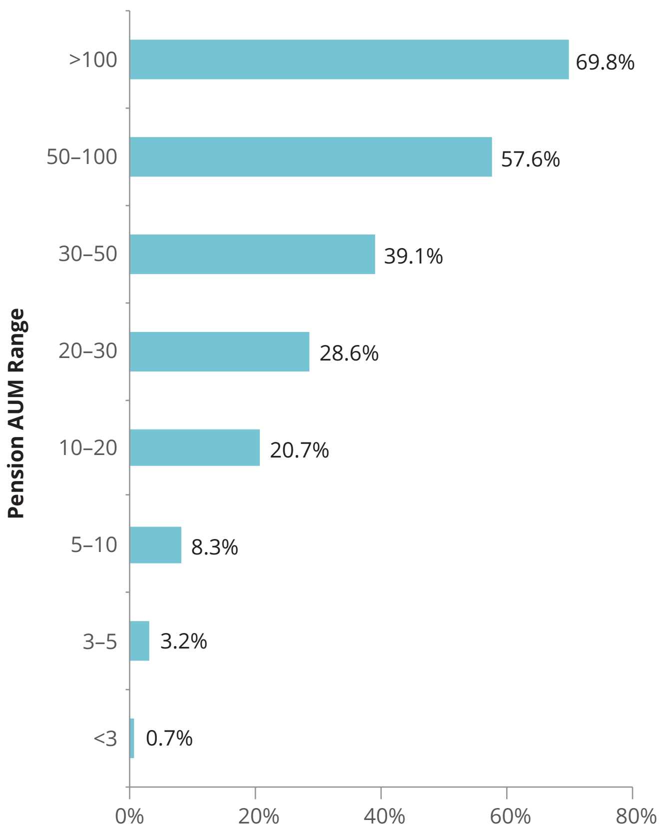
Insourcing could be a growing trend at the biggest super funds, and potentially damaging to external managers. Hence, relationships with the investment consultants that act as gatekeepers to super funds are vital.

In Japan, larger pension funds tend to use consultants. About 70% of corporate pension funds with more than ¥100 billion (US$918 million) of assets under management (AUM) use consulting firms, and close to 60% of pension funds with ¥50-100 billion of AUM do so. Use is low among smaller pension funds, largely reflecting their smaller pockets. They do, however, ask for advice from trust banks or insurers, which offer consulting services in their asset management mandates, at no extra cost.

Apart from Australia and Japan, managers need to increasingly work with consultants in Hong Kong and Singapore markets. In Hong Kong, institutions use the services of consultants for a wide array of activities, including short-listing managers and evaluating their performances, and reviewing strategic asset allocation. In some cases, consultants could also be involved in reviewing managers' presentation to institutions. It is no surprise then that almost 42% of asset managers surveyed by Cerulli in 2016 believed that RFPs from consultants is the prime channel for mandate opportunities in Hong Kong, while this stood at 16.7% for Singapore. In Hong Kong, retirement funds, foundations, and endowment funds use consultants, while in Singapore, educational institutes, endowment funds, or government-related agencies at times use the services of consultants, though the mandate size could be small.

Exhibit 2: Use of Consultants in Japan by Pension Assets Under Management, March 2016 (¥ billions)

Bigger pension funds tend to have a higher use of consultants.



Sources: Pension Fund Association, Cerulli Associates

In Southeast Asia, with the exception of Singapore, institutions invest and outsource very much on their own. Consultants do come into play, but typically quite strategically—for example, in institutions' use of manager databases, such as Mercer's Global Investment Manager Database, or when institutions foray into an asset class or strategy new to them. For instance, Malaysia's Kumpulan Wang Persaraan (KWAP) or Retirement Fund Incorporated hired a consultant when it looked to farm out a global environmental, social, and governance (ESG) mandate, its first such investment. Cerulli understands the consultant helped with various stages of the process, including the RFPs, providing long lists and short lists of managers, and manager scoring. The Philippine Social Security System considers using consultants only for foreign investments, while Thailand's Social Security Office uses consultants for strategic asset allocation but not for RFP issuance and manager selection.

Gung-ho on alternatives

There is an increasing drive among institutions to use the services of consultants in alternative asset classes and overseas investments, as they lack in-house expertise in these areas, yet need to use these strategies to beef up returns on investment portfolios.

For managers targeting Australia's superannuation fund mandates, there is room for all investment styles, from passive to highly specialist. However, international equities and global illiquid asset managers are in strong positions to win mandates, and investment consultants are expected to help with access to assets in under-researched or illiquid markets.

Corporate pensions and public pension funds in Japan are also searching for nontraditional assets in a negative interest-rate environment. They tend to approach large foreign firms such as Mercer, Russell Investments, and Willis Towers Watson for advice more often because of their wide array of offerings. Domestic consulting firms also provide advice, but this is largely limited to domestic asset classes, rather than foreign products and alternatives. The Government Pension Investment Fund (GPIF) started investing in alternative products in 2016, which include private equity, infrastructure, and real estate. Its allocation to alternative products as of December 2016 was a mere 0.07% of the Fund's total assets, far from the limit of 5% of total AUM on such investments.

The Chinese University of Hong Kong uses the services of a U.S.-based consultant for its long-term alternative investments, which include hedge funds, private equity funds, and limited partnership. According to the University's annual report, fund managers handling these investments are experienced in administering endowment funds of private universities in the U.S., and use comprehensive monitoring systems to reduce risks as well as conduct onsite due diligence visits.

Meanwhile, in September 2017, the Singapore Tourism Board (STB) in September floated a tender to appoint an investment consultant to search for external fund managers, which includes the evaluation and selection of managers for its investment portfolio that comprises commingled funds and segregated bond mandates. It aims to appoint the consultant by October and start its fund manager search by November, finalising it by late January or early February 2018.

Exhibit 3: List of Selected Institutions in Hong Kong and Singapore Using Consultant Services

Consultant services differ on a case-by-case basis.

Institution	Consultant	Remarks
Hong Kong		
Chinese University of Hong Kong	Greystone Consulting	For management of alternative asset classes
Hong Kong Housing Authority	N/A	Reviews strategic asset allocation for the fund
Hospital Authority Provident Fund Scheme	N/A	In selection of managers. Consultant services could be used to develop a long list in asset classes, where the Fund lacks in-house resources. Consultants could also be in the presentation panel.
Singapore		
Nanyang Technological University	Cambridge Associates	Appointed in August 2015 to provide investment consultancy services until July 2018
Singapore Management University Endowment	Cambridge Associates	N/A
Singapore Tourism Board	To appoint in October 2017 and commence new fund manager in late January 2018 or early February 2018	To conduct an external fund manager search that includes evaluation and selection of fund managers, and transition from the existing fund manager to the new fund manager.
Urban Redevelopment Authority	Mercer	To review its strategic asset allocation, do a study of multi-asset funds, and short-list suitable managers.
Tote Board	Cambridge Associates	To monitor and report the performance of appointed external managers and provide recommendations on tactical asset allocation and portfolio rebalancing.

Sources: Company and government websites, Preqin, Cerulli Associates

In Korea and Taiwan, we expect more reasons for institutions to use investment consultants as they seek overseas diversification and exposure to alternatives. Allocations to private and alternative asset classes—mostly overseas—have already motivated more institutions in major markets to hire consultants, because of their lack of familiarity with these classes and offshore markets. Those going into private assets have also found themselves reaching out to consultants for data.

ESG adoption

Our survey of managers has also showed that they will increasingly work with consultants for ESG-related investments. These factors are increasingly important and part of the superannuation mainstream in Australia.

Malaysia's KWAP has taken "ethical" investments seriously since the government promoted such strategies last year. KWAP began its foray into this space with MYR1.5 billion (US$348.5 million) domestic mandates farmed out to four managers in 2014 and 2015. Taiwan's Bureau of Labor Funds (BLF) issued its first ESG mandate in April 2017, with Willis Towers Watson handling the RFP and selection processes.

Despite the increasing intent on working on ESG strategies, managers must note that ESG investment principles and evidence of such investments need to be articulated thoroughly to consultants in their true spirit, with no window-dressing.

Exhibit 4: Asia ex-Japan Asset Managers on How They Expect Their Engagement with Investment Consultants to Change in the Next Three Years, 2017

A majority of managers plan to keep consultants more updated on their strategies and funds.

Engagement with Investment Consultants	Increase Engagement	No Change	Decrease Engagement
Invest in resources (including new staff) to build or strengthen our relationships with consultants	38.1%	61.9%	0.0%
Provide consultants with regular updates/data to ensure we are on their list of managers	61.9%	38.1%	0.0%
Raise more institutional assets through consultants	52.4%	42.9%	4.8%
Work with consultants on ESG-related investments	61.9%	38.1%	0.0%
Access new markets and/or institutional segments in the region	23.8%	76.2%	0.0%

Source: Cerulli Associates

Building and nurturing consultant relations

In a survey of managers conducted for ***The Cerulli Report - Institutional Asset Management in Asia 2017***, more than half of those polled aim to increase their engagement with consultants in the region to raise assets. However, a majority of managers have no plans to increase their resources in their consultant relations team, because many have already hired key personnel for consultant relations.

Over the last few years, we have noticed several managers building or strengthening consultant relationships in Asia. In the past, most global firms handled these out of the United States or Europe, given their lack of dedicated on-the-ground resources in Asia. In some cases, institutional sales staff could also wear the consultant relationship hat.

These days, however, managers such as BlackRock, BNY Mellon, Fidelity, Franklin Templeton, Invesco, Mirae, and State Street have at least one person in charge of such relations in the region.

Notwithstanding consultants' changing business models, Cerulli believes it will be critical for managers to remain on consultants' radars. With the uncertain macro environment persisting, institutions will be forced to look for expertise of consultants in selecting managers with sophisticated, exotic, and low-cost strategies in order to boost the returns within their investment portfolios.

One cannot deny the influential role consultants play—sometimes in the background—while working with institutions. Hence, managers should not ignore consultants as a channel to tap into institutional opportunities. Regular liaison with research consultants and field consultants is an essential for managers to be in their good books. In fact, managers surveyed are also cognizant of this, and believe it is a must to provide consultants with regular updates and data.

As competition for assets stiffens, managers will need to resort to all modes, whether direct, through RFPs, or through consultants, to win mandates from institutions. Therefore, building and nurturing relationships with both institutions and consultants is a must. ◆