

# Choosing Pension Fund Investment Consultants

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**Individual and institutional investors rely on investment advisors and investment consultants when making investment decisions and evaluating financial products** [Inderst and Ottaviani, 2012](#); [Gennaioli, Shleifer, and Vishny, 2015](#); [Spatt, 2020](#).

**Investment consultants are important intermediaries in the asset management industry:**

- They collectively advise \$19 trillion of U.S. public and private retirement assets .
- 96% of pension funds employ a general investment consultant.
- 44% of pension funds had a specialized consultant in 2020 (compared to 13% in 2001).
- Most investment managers are hired through a consultant.

**Evidence shows that consultants' recommendations have a significant effect on flows, but they do not add value.**

**Why do pension funds increasingly rely on investment consultants?**

- **Prior research focused on the impact existing consultants have on allocation policy and performance** Jenkinson, Jones, and Martinez (2016); Jones and Martinez (2017); Jaiswal (2021); Andonov and Rauh (2022); Begeau, Liang, and Siriwardane (2023).
- **We focus instead on consultant turnover, at the extensive margin:**
  - What are the factors driving hiring/termination decisions? How are they selected?
  - Does consultant hiring lead to different allocations, improved performance, more access?
- **Contribution:**
  - Discuss the disciplining mechanism for under-performing consultants;
  - Show that the increased reliance on consultants may increase overall investment costs, may expose pension funds to more agency conflicts, and may increase flow correlation.

# What is the Role of Investment Consultants?

## ① Specialized financial intermediaries that provide expertise:

- Intermediaries with informational advantage (Allen, 2001; Garleanu and Pedersen, 2018).
  - Board members have low financial skills (Andonov, Hochberg, and Rauh, 2018).
  - PFs face compensation constraints to attract talented managers (Dyck, Manoel, and Morse, 2022).

## ② Powerful gatekeepers to certain investments products and asset managers:

- Provide access to well-established network with asset managers (Cohen, Frazzini, and Malloy, 2008; Rossi et al, 2018). Especially important in alternatives (Sensoy, Wang and Weisbach, 2014).

## ③ Shield against headline risk:

- Money doctors (Gennaioli, Shleifer and Vishny, 2015).
- Shift of responsibility (Lakonishok, Shleifer and Vishny, 1992; Goyal and Wahal, 2008).
- Protection against public criticism and legal consequences (Sharpe, 1981; Van Binsbergen, Brandt, and Koijen, 2008).

- Institutional Setting: Pension Funds and Investment Consultants.
- General Consultants.
- Specialized Consultants.
- Implications for expenses and flows.

# Sample: U.S. Public Pension Funds, 2001–2020

## Pension fund data:

- 173 pension funds (138 from PPD and 35 hand-collected).
- Pension plans aggregated at the retirement system level.
- Preqin data on investments in private funds.

## Investment consultants data:

- Hand-collection: CAFRs, newswire, and RFPs.
- Separate consultants into general and specialized.
- 129 unique consultants after M&A adjustments.
- SEC Form ADV for consultant characteristics.

	Obs	Mean	StDev
<b>Panel A: Pension Fund Characteristics</b>			
Assets (\$ bil)	3,135	18.799	34.219
Return	3,135	0.064	0.103
3Y Return	2,660	0.065	0.053
%Equity	2,850	0.513	0.105
%Fixed Income	2,850	0.261	0.072
%Real Assets	2,850	0.091	0.060
%Private Equity	2,850	0.063	0.055
%Hedge Funds	2,850	0.048	0.067
%Other Alternatives	2,850	0.019	0.055
%Cash	2,850	0.004	0.023
<b>Panel B: Governance and Internal Investing</b>			
Internal Mandate	3,135	0.035	0.105
%State Political	3,085	0.269	0.226
%Elected Participants	3,085	0.345	0.255
Investment Board	3,091	0.117	0.322

# Classification of Investment Consultants

① **General investment consultant** hired by almost all pension funds:

- Asset allocation, asset manager searches.
- Benchmarking and performance evaluation.
- Risk control, macroeconomic outlook.
- Security lending agents / custodian bank searches.
- Board and staff education, etc.

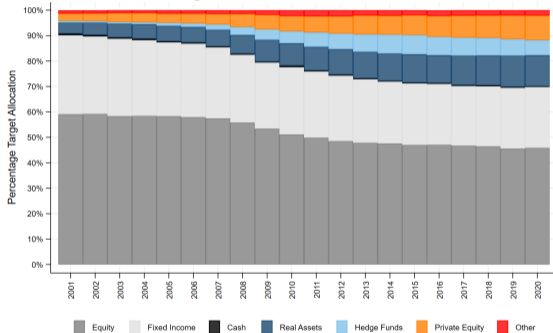
② **Specialized investment consultants** hired usually in alternative assets:

- Asset managers (general partner) searches.
- Benchmarking and performance evaluation.

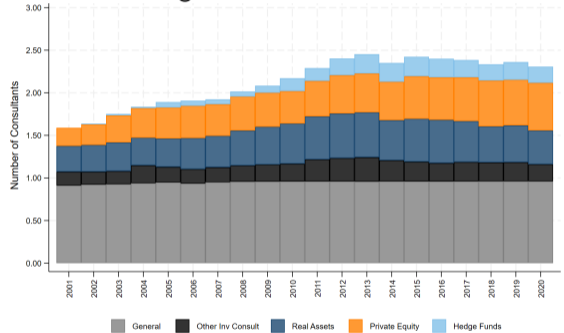
Investment Consultants		
	#Unique	Obs Cons
All Consultants	129	6,085
General	52	2,978
Real Assets	35	1,162
Private Equity	40	1,150
Hedge Funds	16	386
Other	35	406

# Target Asset Allocation and Hired Consultants

## Target asset allocations

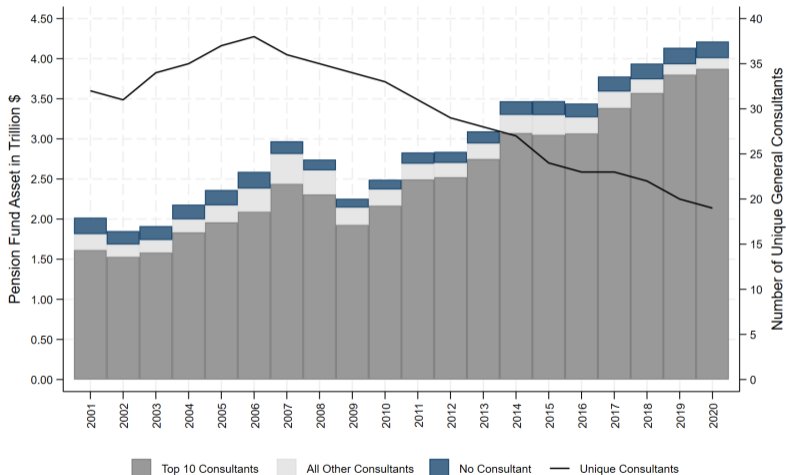


## Average number of consultants





# Concentration of General Consultants



- Institutional Setting: Pension Funds and Investment Consultants.
- General Consultants.
  - Turnover and Replacement.
  - Implications for Asset Allocation and Performance.
- Specialized Consultants.
- Implications for expenses and flows.

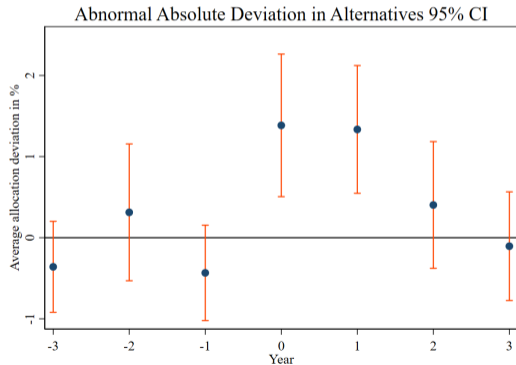
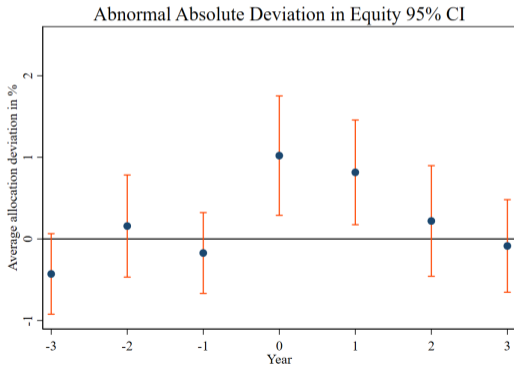
# Replacement of General Consultants

A drop in the 5-year performance ranking from the 75th to 25th percentile leads to a 3.4 pp higher probability of hiring a new GC.

	Hiring New General Consultants (Unconditional Prob. = 6%)					
	(1)	(2)	(3)	(4)	(5)	(6)
3Y Return	-1.067*** [0.336]					
5Y Return		-1.511*** [0.308]				
3Y Rank			-0.064*** [0.021]			
5Y Rank				-0.068*** [0.017]		
Low 3Y Rank					-0.131*** [0.033]	
High 3Y Rank					0.012 [0.038]	
Low 5Y Rank						-0.116*** [0.040]
High 5Y Rank						-0.012 [0.042]
PF and board characteristics	Yes	Yes	Yes	Yes	Yes	Yes
Lagged Target Allocation	Yes	Yes	Yes	Yes	Yes	Yes
Lagged Gap Allocation	Yes	Yes	Yes	Yes	Yes	Yes
Year × Reporting Month FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	2,306	2,058	2,306	2,058	2,306	2,058

# New General Consultants: Impact on Asset Allocation

- Larger than average changes in asset allocation policy in the first two years of the mandate;
- Changes concentrated in equity and alternatives.



# New General Consultants: Impact on Performance

**Pre-hiring period:** Significantly lower relative performance and ranking.

**Post-hiring period:** Weak improvement in performance; possibly mean reversion.

	Pre-Hiring Period				Post-Hiring Period		
	-3 to 0	-2 to 0	-1 to 0	0	0 to 1	0 to 2	0 to 3
Relative Return	-1.033** [0.438]	-0.522* [0.301]	0.083 [0.208]	-0.021 [0.170]	-0.073 [0.219]	0.093 [0.290]	0.092 [0.312]
Difference					-0.156 [0.290]	0.615 [0.372]	1.125** [0.525]
Rank	0.421 [0.025]	0.452 [0.024]	0.498 [0.023]	0.512 [0.022]	0.519 [0.022]	0.514 [0.023]	0.509 [0.023]
Difference					0.021 [0.031]	0.061** [0.030]	0.088*** [0.033]
Observations	137	148	166	171	166	148	137

# Outline

- Institutional Setting: Pension Funds and Investment Consultants.
- General Consultants.
- Specialized Consultants.
  - First-time Hiring Decisions.
  - Scalability and Access.
  - Implications for Performance.
- Implications for expenses and flows.

# Specialized Consultants: First-time Hiring Decisions

- PFs hire specialized consultants to access and scale up investments, they already have some expertise.
- 10 pp higher gap allocation  $\Rightarrow$  1.8 percentage points higher probability to hire a specialized consultant in asset class  $j$  in year  $t$ .

	(1)	(2)	(3)
	Mean Dependent Variable = 0.022		
$\%Target_{t-1} - \%Actual_{t-1}$	0.172*** [0.057]	0.180*** [0.053]	0.140** [0.061]
$\%Actual_{t-1}$		0.039* [0.021]	
$\%Target_{t-1}$			0.039* [0.021]
PF characteristics	Yes	Yes	Yes
Board characteristics	Yes	Yes	Yes
Year $\times$ Reporting Month FE	Yes	Yes	Yes
Observations	4,259	4,259	4,259

# Specialized Consultants: Enable Access Through Their Networks

**A pension fund is 4 times more likely to invest in a PE fund if another pension fund using the same GC or PE consultant also invests in the PE fund**

- Opportunity set for each private fund and expand dataset ([Goyal, Wahal, and Yavuz, 2022](#))
- Flag those that are in the consultant network
- Dep variable: 1 if the PF invest into the private fund

Network:	GC consultants		PE consultants	
Mean Dep.Variable	0.004	0.004	0.005	0.005
Same consultant	0.014*** (0.001)	0.015*** (0.001)	0.020*** (0.002)	0.021*** (0.002)
PE Fund Size	0.002*** (0.000)	0.002*** (0.000)	0.002*** (0.000)	0.002*** (0.000)
Internal Mandate	-0.002* (0.001)		-0.001 (0.004)	
Investment Board	-0.002** (0.001)		-0.001 (0.001)	
State-political	-0.002** (0.001)		0.001 (0.002)	
Participant-elected	-0.001 (0.001)		0.001 (0.002)	
Public-appointed	-0.000 (0.001)		0.002 (0.002)	
PE-Fund FE	Yes		Yes	
Pension-Fund FE		Yes		Yes
Observations	3,299,868	3,308,198	1,820,739	1,822,742



# Specialized Consultants: Scalability and Access to Rationed Funds

## Scalability: ✓

~ 3 (2) more investments with a PE (RA) consultant

## Access: ✗/✓

- PFs are not able to avoid 1st time private funds
- PFs are able to invest into oversubscribed PE funds
- PFs are not able to be part of co-investments or separate accounts

	#Investments in Funds (1)	Overall First Time Fund (2)	Private Fund Size / Target Size (3)	Coinv Funds & Sep Accounts (4)
Mean Dep Var	8.091	0.082	1.131	0.050
PE Consultant	3.690*** [0.813]	0.003 [0.010]	0.018** [0.007]	-0.006 [0.010]
RA Consultant	1.628* [0.804]	0.004 [0.009]	0.001 [0.006]	-0.002 [0.008]
PF & board characteristics	Yes	Yes	Yes	Yes
Target Asset Allocation	Yes	Yes	Yes	Yes
Other Board Members	Yes	Yes	Yes	Yes
Vintage-Year FE	Yes			
Fund-Type × Vintage-Year FE		Yes	Yes	Yes
Pension-Fund FE				
Observations	2,811	21,556	18,674	19,410

## Performance: ✗

SC have no impact on performance

- Institutional Setting: Pension Funds and Investment Consultants.
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# Selection of New General Consultants: SEC ADV Form

**Opportunity set:** 48 unique general consultants.

**Peer measures:** Size, geography, PFs focus.

**Results:** PFs select large consultants that engage in asset management and advise peers.

	Selection of a General Consultant (Unconditional Prob. = 2.22%)			
	(1)	(2)	(3)	(4)
Log Clients	0.003*** [0.000]	0.003*** [0.000]	0.003*** [0.000]	0.003*** [0.000]
Discretionary AUM	0.008* [0.005]	0.014*** [0.005]	0.010** [0.005]	0.007* [0.004]
%PF Clients Same Size	0.023*** [0.003]			0.019*** [0.003]
%PF Clients Same State	0.039*** [0.006]			0.034*** [0.006]
Legal Issues		-0.010** [0.005]		-0.001 [0.004]
PF Clients 11-25%			0.005 [0.009]	0.002 [0.008]
PF Clients 26-50%			0.018*** [0.006]	0.013** [0.006]
PF Clients 51-75%			0.025*** [0.006]	0.020*** [0.005]
PF Clients >75%			0.004 [0.009]	0.003 [0.008]
Year FE	Yes	Yes	Yes	Yes
Pension Fund FE	Yes	Yes	Yes	Yes
Observations	4,023	4,023	4,023	4,023

# Compensation of General Consultants

- Pension funds do not substitute GC services by hiring SCs, but rather extend the range of contracted consulting services
- If location to PE up by 10 pp, the compensation of the GC up by \$0.157 million or 38% relative to the baseline compensation of \$0.411 million.

	(1)	(2)	(3)	(4)
	Mean Dep. Var. = 0.411			
#All Consultants	0.009 [0.023]			
#RA Consultants		0.059 [0.046]	0.060 [0.043]	0.059 [0.042]
#PE Consultants		-0.065 [0.045]	-0.071 [0.049]	-0.071 [0.048]
#HF Consultants		-0.017 [0.041]	-0.033 [0.033]	-0.033 [0.033]
Fund Size	0.346* [0.186]	0.332* [0.186]	0.206 [0.138]	0.205 [0.135]
%Equity	0.821 [0.582]	0.795 [0.572]	0.661 [0.476]	0.661 [0.474]
%Real Assets	0.837** [0.377]	0.814** [0.348]	0.622* [0.318]	0.626* [0.314]
%Private Equity	1.565** [0.709]	1.636** [0.724]	1.300** [0.573]	1.294** [0.562]
%Hedge Funds	2.129* [1.042]	2.122* [1.034]	1.533* [0.740]	1.547* [0.763]
%Other Alternatives	1.342** [0.571]	1.362** [0.580]	1.180** [0.466]	1.183** [0.467]
3Y Return			-0.613 [1.072]	
3Y Rank				-0.017 [0.038]
Pension Fund FE	Yes	Yes	Yes	Yes
Year × Reporting Month FE	Yes	Yes	Yes	Yes
Observations	965	965	864	864

## What is the role of investment consultants in PFs?

- GC terminated in case of low peer-adjusted performance  $\implies$  **disciplining mechanism.**
- PFs with existing allocation hire SC to implement asset allocation changes in private markets  $\implies$  **no evidence of limited experience.**
- No evidence that investment consultants are informed intermediaries.
- Results are more consistent with limited access and scalability in alternative assets, and shield against headline risk reasons.

## Implications for asset flows and expenses:

- Increasing reliance and concentration of investment consultants.
- Consultants affect asset allocation but can provide similar recommendations across PFs.
- PFs favor consultants that advise peers and combine advisory and asset management services
- Consultant expenditure grows with the sophistication of the allocation policy.