Talking heads

IPE put some questions to pension consultants across Europe. Here is some of what they had to say

The questions

1 After the financial crisis pension fund advisers focused on improving portfolio risk management and integrating this with broader asset-liability and operational risks. Can you give examples of how your organisation has strengthened its practice in these areas?

2 Can you identify investment themes, asset classes or strategies that you are currently recommending to
a. Your largest clients?
b. Your medium-sized clients?
c. Your smallest clients?

3 Isn't it easier for a large asset manager to bolt on an advisory service than for a consultant to develop an asset management capability and infrastructure?

4 What progress has been made to mitigate the conflicts of interest associated with combining advisory with implementation services, both by the wider industry and your own organisation?

5 Has your firm done enough to prepare for a world dominated by DC and other forms of individual retirement provision?

6 Where have you added resources recently? Where will you add resources in 2011 and beyond?

Dirk Söhnholz, Managing partner, Feri Institutional Advisors (Germany)

1. One major focus of development has been to expand our risk overlay services, which we have offered very successfully since 2005, to cover more asset classes and investment strategies. Before the crisis the focus was mainly on equities and bonds. Furthermore, we have expanded our so-called platform services and changed some corresponding suppliers. The platform services enable our clients to receive leading edge "consolidated" custodian and administration services across all asset classes.

2. We do not differentiate the services we offer by client size: All clients should receive the best advice possible, only the form may vary from case to case. Thus, we rather recommend funds of funds to small investors and direct/co-investments to the very large ones. Current recommendations in asset classes include infrastructure investments (which we explicitly shied away from before the financial crisis) as well as European private equity, real estate – including opportunistic – and some hedge fund strategies. Topics like emerging markets equities and bonds as well as commodity investments have always been prominent on our recommendation list.

3. We agree with this statement in terms of short-term 'easiness': asset management firms have larger financial resources at their disposal than consultants and can therefore build up resources for advisory services by hiring the respective staff more easily. On the other hand, it is very difficult for asset managers to manage conflicts of interest and we expect the asset management side within a company to ultimately 'win' against the new advisory activities, in most cases.

6. We have added resources in implementation and reporting/controlling and will further add resources in overlay services and on the client advisory side.

Patrick McCoy, head of investment advisory, KPMG (UK)

3. A core part of our business is advising on the identification, selection and appointment of a fiduciary manager. We stand out in the investment advisory community because we do not provide fiduciary management or implemented consulting and hence are able to provide clear independent advice. We'd conclude that contenders from both 'camps' have developed strong fiduciary management solutions [and] that there are easily eight or nine very strong contenders.

In terms of relative ease, it's probably more difficult for a consultant to build the asset management side up to become a full fiduciary manager than the other way around. This is simply because to add consultancy to asset management requires the addition of key people. This can be bought in. Adding a full asset management capability to an existing consultancy requires both people and infrastructure. But it would be incorrect to assume that this means that fiduciary managers that have evolved from pure asset management firms are the 'winners' in terms of the level of service provided. The most important part of a fiduciary management service is the strategic advice offered and consultants have a longer and often stronger track record here.

4. The industry is increasingly recognising the inherent conflicts that can arise. Clients should take an unbiased view of the range of solutions on offer often by seeking independent advice on the marketplace and providers. When their existing consultant offers fiduciary management or implemented consulting trustees should do some due diligence on the market.

Chris Ford, Head of investment, EMEA, Towers Watson

1. We already had a multi-faceted approach to risk management (eg, floor protection, economic scenario analyses, taking into account interest rate/inflation/longevity, liquidity models including stress tests) with a high weighting to tail risks and a process that favoured more transparent and less leveraged strategies than suggested by quantitative models. In addition we have developed the so-called 'value based ALM': a model that values optionalities in (contingent) liabilities and dynamic contribution payments.

We have also broadened and improved our monitoring services aimed at helping pension funds better manage their coverage ratio. A new service, AssetLiabilityWatch, periodically assesses the risk-position of the pension fund against previous expectations [enabling better monitoring of] the financial position and risk position instead of just doing an ALM-study every 3-5 years

2. a. Emerging market wealth; direct hedge funds; gilt total return swaps/repo.
b. Emerging market wealth; alternative betas (eg, REITS, short volatility, reinsurance).
c. Emerging market wealth; diversified growth funds.

3. No, it is not easier. There are different challenges. If done properly, fiduciary management is all about becoming the clients' dedicated investment staff, with all the contextual understanding that implies. This would be very difficult for an asset management organisation to learn overnight. Oversight of implementation using external managers is a skill most asset managers don't have. That said, continuous implementation excellence is an area where con-

sultants need to do more work.

It may be worth noting that building an asset management organisation is probably more complex (eg, in terms of systems needed) than building a consulting organisation. Also, levels of investment needed to build an asset management organisation are on average higher than those for a consulting organisation.

4. It is early days, but progress by the wider industry has been slow so far. In order to make more progress, trustee boards need to focus their efforts on being able to monitor the fiduciary manager. This can vary from being a similar process, to monitoring staff within a business, to effectively replicating what consultants do when they monitor asset managers.

Various specialist firms that wish to oversee fiduciary managers are emerging. While they provide independence, their ability to dig into the detail is limited unless they have a reasonable size of staff. Those that do are likely to be competing with the larger consulting firms and so there is a potential conflict of interest there.

In the asset management world, consulting divisions are being set up as different business units, which provide a degree of separation. That said, asset managers, especially large ones, have conflicts of interest when trying to develop a consulting business and may want to add 'free' advice to asset management.

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5. According to our research, almost 80% of trust-based defined contribution (DC) schemes run by FTSE100 companies now use an investment gateway to deliver their investment strategy and access investment managers. We established investment gateways as the preferred method of accessing best-in-class investment options in 2005 and continue to advise our clients in this way.

Furthermore, our research shows that half of trust-based DC schemes now use bespoke white-labelling of funds. This is a very positive trend, and one which we have driven, as it goes hand in hand with stronger investment governance, making investment choices easier for members to understand and giving fiduciaries greater control and flexibility. The move towards white-labelling reflects how many more fiduciaries are now beginning to take proactive control of the DC investment strategy – playing more of a 'leadership and guidance' role than just a pure 'facilitation' one.

On the downside, schemes are generally being slow to respond to investment change and too many schemes still haven't taken diversification on board and still use 100% global equities.

Specific to the Netherlands, Towers Watson has developed tools to assess the risk appetite of DC-members in order to align the investment strategy and risk position with the level of risk-aversion of the participants. Another feature which is central to our DC advisory is journey planning. Instead of following a static age-dependent lifecycle, journey planning involves more than that and compares the current position with the projected replacement value.

Towers Watson has developed a concept for third generation DC that combines the attractive features of DC, like flexibility and individual choice, with the attractive features of DB, such as (insurance) guarantees and low-cost implementation. We see especially added value for a new type of DC pension provider vehicle in the Netherlands, made possible by legislation since the beginning of 2011.

6. Towers Watson Investment has doubled in size in the past seven years and now numbers over 660 associates, having added around 50 in 2010 alone. A particular area of growth in associate numbers has been in the areas of implementation support and reporting, reflecting the additional support our clients have needed to manage complex portfolios, particularly where they wish us to take on greater responsibility. We will continue to add resources this year across the breadth of our business.

Richard Dowell, head of clients, Cardano (UK and the Netherlands)

1. Cardano has focused for over 10 years on helping clients to manage asset, liability and operational risks. We help clients set clear and quantifiable investment and risk objectives, usually combining asset-liability modelling with sound risk-management principles. This has been our focus since we set up in 2000 in the Netherlands, long before the recent global financial crisis, and since 2007 in the UK.

The fact that we typically implement the risk management solutions ourselves, rather than only providing advice, means that we have been very focused on operational risk. In particular, for a decade we have successfully managed counterparty credit risk on tens of billions of euros of tailored derivative contracts: our clients have not faced a loss as a result of a counterparty defaulting. In addition, we have carried out the operational role of collateral management on a regular basis.

We have developed the range of instruments that we use to manage clients' liability risks, to allow them to get the best balance between yield, risk management, capital efficiency and operational risk management. For example, in the UK we have increasingly used gilt total return swaps and gilt repo. Finally, we have typically increased the frequency of our collateral management programme to mitigate counterparty and operational risks.

2. We generally recommend the same themes, asset classes and strategies to all of our clients, regardless of size. One of our current themes is that that 'the strong will get stronger'. This means that the currencies, countries and companies that are currently strong and healthy should continue to get stronger at the expense of weaker alternatives. We have been recommending a diversified range of emerging market currencies as well as equity managers who have a bias towards high quality companies with strong balance sheets.

3. We believe that the firms most suited to fiduciary management are those that have been specifically built for the purpose. This allows them to have the skill-set and knowledge to cover decision making across assets and liabilities in a consistent way, as well as having an experienced team of consultants who understand trustees' objectives. This is the model that we followed when we set up in the UK in 2007.

Conceptually it is easier for an asset manager to bolt on an advisory service than a consultant to develop an asset management capability. However, managing pension funds holistically requires an integrated approach to asset and liability risks, which few asset managers have historically had. In addition, many suffer from a potential conflict of interest by only having access to their own funds, or an inability to access best-of-breed managers in every area.

4. Progress in overcoming potential conflicts of interest across the industry has been slow. We believe that the best way to mitigate conflicts of interest is to align the financial interests of the fiduciary manager as closely as possible with the pension fund objectives. Typically, this would be done by having a performance fee that is paid only if the fiduciary manager improves the funding ratio in a stable way. We adopt this approach for all UK clients where we take delegated responsibility against a liability-related benchmark.

In 2010 we also saw the emergence of fiduciary management selection firms, and over time these will also help to some extent to overcome potential conflicts of interest.

5. We have actively sought to highlight cost-efficient alternatives to pure DB plans that ensure a fair balance of risks between stakeholders. This includes hybrid schemes and collective DC arrangements. Cardano's founder, Theo Kocken, wrote his book 'Curious Contracts' on the subject of pension fund redesign and this has been followed up with a number of real-life client projects and case studies.

6. We have recruited steadily across all areas of our business in both the Netherlands and the UK in 2010.

Duncan Howorth, managing director, JLT Benefit Solutions (UK)

2. a. For many large clients, finding assets to support scheme cash flows is a high priority. Access to infrastructure and other long-term high, steady, yield assets helps manage risk and volatility
c. One of the big challenges for smaller schemes is decision-making and execution. I believe that delegated consulting is something that these schemes should consider.

3. This area is still poorly defined but there is risk for overlap where the capabilities and roles meet. Consultants' principal role is to develop strategies according to clients' circumstances which leads to the asset allocation decision and fund selection. Asset management (in the context of stock selection) is the primary role of the asset manager. All I would say is: watch this space.

5. It is dangerous to ever think you are fully prepared. At JLT we have moved into wealth management to meet the demand and oppor-

tunity for greater responsibility for retirement planning and the recent tax changes; we have invested in our DC consulting resources and we are ready to take the initiative to address the shortcomings of DC default funds. At the very least the industry needs active defaulters with actively managed default funds.

6. I see the short and medium-term opportunities in DB investment consulting and de-risking and in supporting clients re-design and manage benefits around auto enrolment, together with DC investment options. We are therefore principally investing in these areas.

Fabrizio Ammirati, director and senior adviser, Kieger Institutional Investment Consulting (Switzerland)

1. All our DC clients are asking us to avoid the same amount of stress they experienced in autumn 2008. This is really an intellectually challenging task. In response, we developed a set of procedures [including] introducing volatility target limits that, once reached, trigger a semi-automatic decision to reduce the risky assets in favour of less risky ones. This process aims at helping the pension fund trustees to institutionalise reactions to crash scenarios and avoid panic decisions.

The second area that required our attention is the punctual analysis of the holdings in the portfolio. We defined a set of market parameters that act as a filter for all securities in the portfolio, both equities and bonds. We select the worst decile for each parameter and we are then able to focus on the securities that are facing trouble with more parameters, simultaneously. We then challenge the investment managers to check the suitability of those investments in the client portfolio.

2. We are suggesting an increased diversification of issuers in the government bond space. We are also advising clients to consider inflation-linked bonds.

3. It is obviously easier for an asset manager to create advisory services, whereas consultants can surely develop tactical asset allocation frameworks that require sound and consistent processes and risk management capabilities. During the 2008-09 market collapse we saw the difficulties managers faced in taking asset-allocation decisions due to the fear of benchmark risk. For that reason, we think that consultants are much better positioned to help pension funds take asset allocation decisions that adhere to the risk-return profile of the plan participants.

6. We will develop a tactical asset allocation framework work for increasing the specialisation of the investment managers in the client portfolios. We have hired specialised advisers in the field of private equity and alternative investments and we will invest much of our resources in those fields.

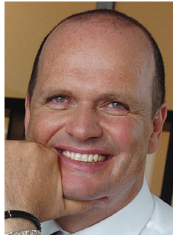
Diego Valera, Novaster (Spain)

1. In two main areas: increasing resources to train our consultants in risks, especially operational risk; and strengthening our practice in socially responsible investment consulting, where we assess non-financial risks in pension funds – because more of them have the potential to become financial risks. Novaster is leading this practice in Spain.

2. For all of our clients: socially responsible investment, emerging markets and hedge funds of funds.

6. We are adding resources in risk management consulting, and SRI consulting as well. We are adding more resources in Solvency II for our practice in insurance consulting.

Olivier Ferrari (pictured), president, and Adrien Koehli, institutional investment department, CONINCO Advisory (Switzerland)

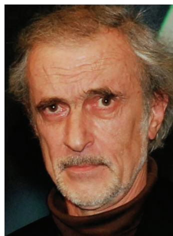


1. Investment restrictions were introduced on foreign currency exposures and hybrid financial products such as structured products and convertible bonds. Foreign bond managers have been diversified to reduce the weight of distressed sovereign debt. Diversification away from the euro and the US dollar in favour of a broader portfolio of currencies was also introduced.

4. Our manager selection is an 'open-book' process for the client, who can compare our proposals clearly with other options available on the market. Also, excluded managers can visit our offices to view the choices we have made and compare them with their own proposals. We exclude from mandates financial products where we are an investment adviser unless clients authorise us to use them: and they are always compared clearly with other market options. All these measures provide good governance and minimise the potential for conflicts of interest.

6. During the last market correction we noted a need to better understand the components of volatility for various asset classes and the evolution of correlation between various asset classes, to improve diversification. As a result we have mainly added resources in the area of analysis feeding into tactical allocation strategy; and in the development of monitoring investment opportunities via the market and contacts with third party managers.

Anton van Nunen, Van Nunen & Partners (Netherlands)



1. We introduced another risk system to the existing one as a second check (specific characteristics concerning tail risk in derivatives). Collateral management has been refined.

2. Higher weighting for absolute return strategies, diminishing interest rate hedge.

3. Implemented consulting is exactly the same thing as fiduciary management. Consultants, however, find it more appropriate to disguise this and use another label. Apart from that, I do agree that it is easier for asset managers to develop advisory services than it is for consultants to develop asset management capabilities.

A little goes a long way

The UK's smaller pension schemes are arguably more varied and challenged than the bigger ones. Martin Steward meets some of the advisers dedicated to helping them cope

Small Consultants

David Fothergill, as head of human resources at Somerset-based buildings merchants Bradford & Sons, deals with the day-to-day running of the firm's £25m closed DB pension scheme. Asked why the scheme uses Bluefin Corporate Consulting as its administrator, actuary and investment consultant rather than one of the big household names, he doesn't have to think too hard.

"Their business is much smaller and a lot more personal," he says. "We've known all the people for years – and it's about having trust in people, isn't it?"

Bluefin specialises in the UK's populous sub-£250m market. Similarly, Mattioli Woods is a leading name in individual SIPPs and SSASs, but also maintains an employee benefits practice for modest-sized schemes. As marketing director Murray Smith puts it: "With a smaller consultant, you can go from being a tiny scheme to being a big client."

That is less 'soft' than it seems. The big boys tend to lavish their bells and whistles on trophy clients while rolling out a house-view 'strategy for smaller pension schemes' for the minnows. "Like it or not, the larger firms do develop solutions that aim to benefit the majority, but which do not necessarily suit each individual scheme," says Hamish Wilson, founder of Hamish Wilson & Co.

And yet the universe of smaller schemes is necessarily more complex and varied than the multi-billion pound elite – a £25m scheme with 400 members is very different from a £250m scheme with 4,000 members (and much more different than a £1bn scheme is from a £10bn one). The more members a scheme has, the more statistically normal its profile and the variety of sponsors – publicly owned, privately owned, family-owned – is also likely to be more varied.

Not only are these clients labour-intensive and low-revenue, they also present other risks to bigger consultants, as Antony Barker, head of investment advisory at JLT's Pension Capital Strategies (PCS) observes. PCS works with some large pension clients. But its ownership of Profund meant that it administers a large tail of sub-£20m schemes which, to limit costs to a few hundred pounds per year, took advice on an ad hoc basis from the consulting service. But that