INVESTMENT & PENSIONS EUROPE

Consultants: Changing roles

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IPE asked pension consultants across Europe and beyond how they are responding to changes in the wider pension sector. Here is a selection of their views

The questions

• How has your role as investment consultant to pension funds changed over the past five years? To what extent did you drive the change, and to what extent was it driven by external factors?

• How do you expect to respond, from a strategy standpoint, to innovations in investment, regulation and technology, as well as the future challenges of the financial markets?

Kirstein A/S, Denmark

We have significantly increased the dialogue with our fiduciary clients over the past years and cemented our relationships across the board. In an ever more complex world, we are continuously challenged by our ability to think 'outside of the box' while constantly matching our clients' expectations. The industry increasingly demands our ability to act independently. The market environment has, to a large extent, led this development. Yet, the ability to react and adapt is very much expected from us. From a strategic standpoint, our portfolios will become broader in terms of both new asset classes as well as factor exposures. Maintaining stable and well-diversified portfolios that are exposed to a variety of risk factors will be of high importance as well.

Looking ahead, opportunities will predominantly be found by increasing pure risk, illiquidity and complexity. In terms of illiquidity, the focus and demand for real asset investments have become much more concrete compared to previous years. This is an important tool for us to develop. In terms of complexity, the demand for more innovative solutions is prominent, and often linked to opportunities for yield pick-up for clients subject to regulatory regimes such as Solvency II.

Casper Hammerich (left) and Philip Riise, principals, Kirstein A/S

Fixage Actuaries & Consultants, France

The main changes in our role as investment consultants can be summarised in three points. There is more pressure on fees on a consolidated basis. Clients seek more efficiency in risk control: the maximum drawdown indicator is now preferred to volatility as a risk criterion. Finally, most requests for proposals (RFPs) seek information on specialised mandates, rather than balanced ones.

From a strategic point of view, the changes taking place in the market have affected the choice of quantitative methods and led to the introduction of new benchmarks. Asset-liability management (ALM) has moved to stochastic methods and takes ESG criteria as well as regulation into account. In regulation, our work is influenced not just by rules on pensions but also by Solvency II and cost transparency. The main challenges are justifying management fees and implementing effective diversification strategies, at a time when correlations are not stable and interest rates are very low.

Michel Piermay, CEO, Fixage Actuaries & Consultants

European Investment Consulting, Italy

The main factor driving change in our activity has been the new asset allocation framework established by a recent ministerial decree (law 166 of 2014). The law expanded the investment universe for Italian occupational pension funds to emerging markets and set a clearer framework for investment in alternatives.

With regard to emerging markets, most allocations to equity now include this asset class. We are also seeing investors take a more flexible approach to emerging market debt as part of global mandates.

In alternatives, very few occupational pension funds are already invested, and mainly in domestic private debt and private debt. There is only one exception, an investor that has a more European approach.

Other than regulation, a major factor for change has been the search for yield. Investors have increased the share of credit, both investment grade and high yield, in bond portfolios. The allocation includes global sovereigns, corporates (mainly US) and hard currency emerging markets debt.

Looking to the future, we see a number of challenges. There is an urgency to adapt factor investing, which presents significant opportunities, to the needs and capabilities of pensions funds. We also see a challenge in managing the impact of rising of interest rates on portfolios that are still focused on bonds. Finally, assisting pension funds in investing in illiquid alternatives and in managing these investments is a key requirement for successful consultants.

Silvio Bencini, managing partner at European Investment Consulting

Ortec Finance, Netherlands

Over the past years, our role has changed in several ways. First of all, asset-liability management (ALM) has gradually become focused on the medium term, instead of the relatively longer horizons we used to see.

There is a general trend of focusing more on governance and risk management, which is why several clients selected us to be their oversight or risk manager. In the corresponding mandates, countervailing power to asset managers with fiduciary mandates is important. Fiduciary management, or outsourced CIO, have also given rise to first-tier investment consultants competing head to head with the asset managers. In our view, this development does not fit in the trend of more focus on governance.

A second important factor is the low-yield environment, which has brought more focus on alternative asset classes, private markets and cost. Since alternative asset classes are typically more complex, medium-sized institutional investors need more advice and guidance from consultants. Cost efficiency has led to a dichotomy in the implementation of asset allocation decisions. On the one hand, we see low-cost passive investments. On the other hand, there are highly active satellites.

An increase in complexity requires more delegation and increases the need for specialisation, and hence for expert advice.

We believe that technology will play an increasingly important role in pension fund governance. We have always developed realistic scenario models, based on vast amounts of data, and combined them with software technology to unlock complex knowledge. Our strategy is to leverage our technology by licensing the tools to large pension funds and pension fund advisers, including asset managers, professional service providers, and independent investment consultants. The need for timely, reliable and appropriate information is paramount for several reasons. The management of pensions has become more and more complex, and as a result there is a need for the supporting technology infrastructure to keep pace.

Martijn Vos, managing director for pension & insurance risk management, Ortec Finance

CPPS, Spain

Over the last years, consultants have had to specialise. They must focus on an increasingly broad range of assets. Fixed income, which used to account for 70% of a pension fund portfolio, has provided sufficient returns so far. But its progressive decline in profitability has led investors to seek different risks and incorporate new investments, or strengthen their presence in asset classes that represented a marginal sections of the portfolio.

This has forced consultants to be more proactive when searching and gaining knowledge of alternative assets that balance the revenue lost in fixed income. Consultants also need to be proactive in decorrelating the portfolio from the economic cycle, without forgetting that it implies increasing illiquidity risk, country risk, or complex financial structures in pension fund portfolios. In complex market scenarios, a consultant's ability in the analysis of these products will be especially exposed.

Technological innovation has been essential for economic growth and the financial sector is not unaffected by this process. Technology has improved portfolio optimisation, it has helped inject more liquidity into the market and

democratised financial advice. However, it has brought new risks, such as computer errors that could generate market volatility in certain cases. Regulators should anticipate these potentially negative outcomes by monitoring the use of technology.

Still, it is worth remembering that money is fearful, the market has 'emotions', and no matter how technology moves forward, the market is not possible to model it exhaustively. Models may be replicated and therefore, lose their effectiveness. Hence, we may not completely rely on them, but instead be cautious, evaluate risks and, above all, we should maintain a rigorous and continuous monitoring of the evolution of different assets and markets.

Mariano Jiménez Lasheras, director of governance, CPPS

Complementa Investment Controlling, Switzerland

The very low interest rates are a burden for all pension funds at the moment. The ageing society and the proliferation of regulations are putting additional weight on the administration of funds. As a consequence, our clients have diversified away from government bonds into other fixed income-type assets including alternative investments. To lower the risks, we are encouraging better diversification. Demographic changes are more pronounced than expected and need to be managed with care. Changes in benefits are very common in Switzerland. The regulator has implemented rigorous transparency rules for which we have developed a new product, our TER (Total Expense Ratio) report, to ensure clear cost reporting.

It is fundamental to ensure that in pension funds' supervisory boards there is enough know-how to understand the mechanisms of the markets and the products. This need for expertise has grown and we work closely with our clients to ensure know-how transfer, for instance by offering special workshops.

There is also a regular exchange with asset managers to encourage them to launch products that fit the needs of investors and the market. In Switzerland, an association of pension fund consultants is ensuring that our views and

concerns regarding regulation issues are discussed before they are put into the law and into practice.

Heinz Rothacher, CEO, Complementa Investment Controlling

Hymans Robertson, UK

Our role has changed as we have driven the agenda in the market about the importance of meeting cashflows as schemes mature, and making sure this can be done without being a forced seller of any asset. We have helped our clients plan the evolution of their portfolio structures accordingly. In particular, we have helped them diversify their growth assets over the last five years, taking advantage of the opportunities available in broader credit markets to make future outcomes more certain. To enable us to do this we have developed and implemented our GrIP (growth, income, protection) approach to portfolio construction. This adds the income, or cashflow, dimension to portfolio construction, while the growth and protection elements continue the necessary process of managing the balance sheet risk.

To keep ahead and respond to industry changes, we have continued to invest heavily in technology. We seek to remain at the forefront of innovation. This ensures that all our services and advice can be delivered cost-effectively to our clients. For example, our modelling capability covers the range of asset classes and strategies now available to pension schemes, and we continue to innovate in technology. An illustration of this type of innovation is our Guided Outcomes platform which we developed for the DC market. It has been, and remains, the market leader in using this kind of technology to help members achieve better financial outcomes in the future. Our research approach is highly targeted at the areas of the market which offers useful solutions for our clients, increasing focus and avoiding an expensive scattergun approach.

Johan Walbaum, head of investment consultancy, Hymans Robertson

Cambridge Associates, US

Increasingly, whether we are retained to serve a scheme’s entire portfolio or a portion of it (for instance a private investment, hedge fund or real assets mandate), we are acting as the primary decision-maker for investment implementation, and are accountable as such. We have evolved into a very engaged and directive investment management role for many relationships, as opposed to purely consulting or providing investment office support.

While this change is a function of many external factors impacting plan sponsors, we have welcomed it, and aligned our resources accordingly, as we believe it leads to better outcomes for schemes and beneficiaries.

As markets continue to become more complex and schemes' investment objectives more challenging to achieve, expert and active management of the total portfolio and nimble access to alpha-generating strategies is critical. This is driving this new investment management model for many pension schemes.

Economic and market conditions, regulations, and scheme demographics create new needs. We continue to anticipate what is ahead to the extent possible, identify the solutions needed, rigorously inspect them, and integrate them efficiently within each scheme's construct. While strategies and tools may change, success will always be dependent on having the best global unconflicted resources to deliver on portfolio construction and management.

Brian McDonnell, global head of pensions, Cambridge Associates