CHOICE

New market developments make it a good time to shop around for investment advice says Richard Dowell Cardano (UK)

Much has been written in recent months on how many investment advisers are changing their business models. The main rationale is that trustees are now in need of more help to cope with the increasing complexity of their investment arrangements and to understand and evaluate new opportunities in the market. These new market developments also present a challenge as the boundaries between the territories occupied by advisers, asset managers and investment banks are becoming increasingly blurred.

Dowell: take your pick

What has not changed is that trustees have always demanded clear advice and support to help them manage the investment arrangements and solutions which solve their problems.

As the traditional investment advisers change their business models and new entrants join the market, there is much more choice available to trustees. While choice is normally a good thing, it can also be confusing. Phrases such as "directive advice" and "implemented consulting" are becoming commonplace. The right investment advice is crucial in achieving successful results and therefore it is important for trustees to understand the range of approaches now available, before deciding which one to use. So what is now being offered to trustees?

Range of options

Until relatively recently the traditional way of providing investment advice was for the consultant to deliver a range of options, with relatively little in the way of recommendations, from which the trustees could make a choice. This approach lent itself well to the peer group approach of the 1980s and scheme specific benchmarks of the 1990s – the majority of which only contained two or three asset classes – and the main focus was on monitoring the managers. However, the move towards specialisation and changing legislation resulted in trustees demanding more from their consultant.

We are now in a different era. The investment strategies of many pension schemes have evolved to include many more asset classes, investment managers and risk management solutions, often using derivatives. Markets are throwing up opportunities all the time, some of which can only be accessed within a short time window. However, often the structure of the relationship between the trustee and the investment adviser is not conducive to taking advantage of these opportunities. In addition, trustees are being

SELECTION

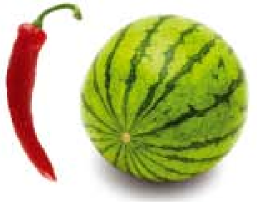

Table: How investment advice is provided

Traditional • historically the advice has been in the form of pros and cons, but is slowly becoming more directive • all strategic and day-to-day decisions remain with the trustees • provision of advice normally centres on the normal trustee meeting cycle and is often reactive • ability to consider timely opportunities and new ideas is very dependent on governance position of the trustees	**Implemented consulting** • an extension of the traditional approach, but with some of the decisions taken and/or implemented by the adviser. • decisions delegated are often limited to investment manager selection, thus only relieving some of the governance burden • typically strategic and some day-to-day decisions remain with the trustees As some of the governance burden is lifted there is a greater opportunity to consider more investment opportunities and new ideas
In-house investment team • specialist team hired by sponsor or trustees to provide dedicated focus and support to the trustees • mainly the luxury of the larger pension schemes eg BT, railways • historically many in-house teams also managed the physical assets, although increasingly this is outsourced to specialist managers • an external consultant may still be used for certain projects	**Solvency manager** • an external specialist investment and risk team working under delegated authority, with a clear mandate to improve and/or stabilise the funding level • the trustees retain high level decisions relating to the overall solvency target, the time frame in which to achieve results and attitude to risk • approach lends itself well to being holistic and dynamic, ie considering the relationship of the liabilities and assets at all times • the level of delegation will vary depending on the scheme, although greater delegation will enable greater exploitation of market opportunities

more vocal in their demands for value added advice and are reconsidering whether the traditional approach really works for them. It has never been a better time to review whether your current adviser meets your needs.

Over the past few years four main approaches to providing investment advice and support have emerged in the UK, which are summarised in the **Table**.

Which one to choose?

The traditional approach to consulting will tend to suit those trustees wanting to retain all investment decisions relating to their scheme's strategy and investment managers. The governance budget will have a direct impact on the type of investment solutions which can be adopted. Those with greater budgets will have more flexibility. Assessing the impact of the traditional consultant remains challenging as the approach does not lead to them having accountability for their recommendations. Performance fees are an option, but only appropriate if there is a clear alignment of interest in the objectives of both parties.

Implemented consulting has the benefit of removing some of the governance burden from the trustees. They are then able to focus on higher level strategic decisions, which they are arguably better placed to do, with the consultant looking after more of the detail. It is important that trustees make the implemented consultant accountable for their actions – the use of performance fees can work well in achieving this accountability. However, there can be the added complication that the implemented consultant often helps to set the objectives. If so, an additional independent adviser or specialist performance measurer may be appropriate.

The in-house team is a luxury many cannot afford and the approach can vary from helping trustees to set strategy or select and monitor investment managers to managing the assets themselves. The in-house team brings together an alignment of interest the previous two approaches would find it difficult to achieve.

The solvency manager approach requires the trustees to formalise their role as non-executive directors and appoint the solvency manager as the executive team. The trustees retain their overall fiduciary responsibility and high level strategic decision making, such as the funding target and risk tolerance. However, they delegate some or all of the day-to-day management of the scheme's solvency – such as deficit reduction or providing stability – to a specialist team. Many issues relating to governance budgets are overcome as trustees focus on managing the overall scheme while the solvency manager focuses on building and implementing the right holistic solution. This approach is therefore an extension of implemented consulting, but where the lines of accountability between trustees and adviser are most clearly defined.

The day-to-day management focus provided with this approach allows decision-making and hence investment strategies to be much more dynamic, which is arguably required in this new era of pension scheme investment. Assessing the solvency manager is achieved by simply assessing the change in the solvency position of the pension scheme.

If trustees delegate any functions to a consultant or solvency manager, they need to ensure the firm has the right back-up to implement and manage the investment decisions.

Suit yourself

Ultimately the approach which will best suit a group of trustees will depend on their own circumstances and preferences. The focus on diversification and risk management has led to investment strategies becoming more complex and this requires a significant commitment of resources. Only time will tell whether these complex solutions result in better outcomes for trustees. The impact of the governance budget will be different for the various approaches, often impacting on the investment solution adopted and hence the results achieved. Whichever approach is used, it is important that trustees understand the underlying business model of the firm they employ and its plans for the future. There is nothing more frustrating in hiring a firm than to find out you are being dragged in a direction which suits them rather than you. We may see the emergence of more firms helping trustees decide what suits them, as well as which firm to employ. Might this then lead to the emergence of firms advising on the choice of selection firms? Now there's a thought... PW

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In a nutshell

- changing business models and evolving markets mean there has never been a better time to review whether your current adviser meets your needs
- there are four main choices of advice available to trustees ranging from traditional consulting to solvency management
- governance budgets and/or views on delegation will ultimately determine the approach you choose.