6 April 2009

FINANCIAL NEWS

Dutch manager unlocks secret to safer pensions

Cardano wants to help employers return crisis-hit funds to solvency, writes Mark Cobley in the second of a series of four profiles of new pension advisory boutiques

Winning combination: Cardano runs and protects clients' pension funds

Gerolamo Cardano, a 16th-century Italian mathematician, was one of the originators of probability theory and also the inventor of the combination lock. While these two innovations may seem unrelated, they are both about chance and risk. One helps to gauge it, the other protects one's property against it.

The Dutch consulting and asset management group that bears his name wants to do the same for Europe's pension schemes. Established in Rotterdam in 1999, Cardano set up in London in the summer of 2007, at what turned out to be an auspicious moment: the cusp of the biggest financial crisis in a generation, which was to send the UK's retirement plans spiralling back into deficit.

The classic investment consultancy model – the trusted adviser providing counsel to non-executive trustees – assumes employers will continue to be interested in running pension schemes. The evidence in the UK, with the buyout market hitting about £8bn last year, is that increasing numbers of finance directors are not. But with asset values battered by the slumping markets, and companies strapped for cash as recession bites, many cannot afford to do these deals.

If they are to solve the pensions question once and for all, they need their schemes returned to solvency. That may mean employing better-quality pensions managers, and paying them by results, with the existing part-time trustees in an oversight role.

Cardano reckons this is where it can help. It has been designing and managing risk-reducing derivatives overlays for Dutch clients for eight years. Clients include De Eendragt, a €1bn ($1.3bn) pensions insurer, and the PNO Media pension fund. Cardano wants to bring its brand of activist, full-time scheme management to the UK.

But the pensions world is slow to change, and Cardano's new

London team found that its first clients wanted to hire it as a traditional consultancy: an adviser, not an implementer.

This model is not only less lucrative, with a small flat fee rather than a performance-related one, but it is also what Kerrin Rosenberg, head of the London office and a former senior consultant at Hewitt Associates, wanted to get away from when he joined the start-up with other colleagues from Hewitt.

In the months since, as the financial crisis has deepened, Cardano's message has become more appealing, according to Rosenberg. He said: "We now have eight clients in total in the UK, with about £7bn (€7.7bn) in assets. Of that, about £1bn's worth is in fully discretionary, delegated mandates. But even with the advisory work, we have been very active. This is not traditional consulting work."

Among its discretionary clients Cardano can count the £1bn Asda Pension Scheme, which hired the firm to run a segment of its assets in January. The £1.2bn Trafalgar House Pension Trust gave it the authority to manage a derivatives overlay in July last year.

Long popular in the Netherlands, there are signs that fiduciary management, as this more activist approach is known, is taking off in the UK too. Last month the pension fund for the home retailer Habitat appointed the US asset manager SEI for a similar mandate, and SEI says it has converted other clients here too.

A lot of fund managers were slow to realise the extent of this crisis

Kerrin Rosenberg, Cardano

Rosenberg said the past few months have been among the busiest of his career and his clients have profited. From the end of June last year to date, Cardano's "model portfolio" – what it might do with a pension scheme, if given full discretion – has produced a positive return, though he declined to give a figure. That compares to a return of -42% for the MSCI World over the same period, and -27% for the UK's FTSE 100 index.

He said: "Across our client base we terminated maybe 40% of the active fund managers last year, including quite a few hedge fund strategies. That is a very unusual level of turnover. A lot of fund managers were slow to realise the extent of this crisis. Some continued to buy financial stocks all the way down, seeing them as an opportunity. Luckily, for many of those we were able to get out before the bitter end."

Cardano's prescription for the crisis is threefold. First, more sophisticated use of the fixed-income derivatives that many pension schemes and consultants are familiar with, second, adding equity derivatives to that mix to inoculate those assets too, and third, seeking opportunities for extra return in the credit markets.

One idea that Rosenberg is particularly keen on is a kind of collar strategy on the forward yield curve in interest rates. Collar strategies give away potential positive returns above a given level, in order to pay for protection against adverse price moves.

Pension schemes are exposed to future interest rates, since the benefits they have to pay to members are linked to them, and a big move in 30-year bonds can have a substantial effect on their total bills. Rosenberg said that since the efficacy of governments' stimulus policies is still unknown, schemes need protection against the effects of both inflation and deflation on the long-yield curve.

Rosenberg says he is pleased with the progress that Cardano has made in the UK so far, having recruited its team of 30 staff – "it has been a good time to be hiring" – and built a respectable client roster. Rosenberg says the London office has capacity to handle about 30 clients, but he added: "We have no plans to become a massive business handling hundreds of schemes. We want to be able to move rapidly in the markets for all our clients at once, and worry about each of them five days a week."