How to choose an adviser

What should a pension fund look for when choosing a consultant, what should they check when they have found one and when should they switch? **Rachel Fixsen** has the answers

In a marketplace crowded with specialist fund managers, many pension funds rely heavily on a consultant to help them search for what they want and haggle once they have found it. But choosing a consultant in the first place, and then later deciding whether to keep the one they have, can be almost as complicated.

So, what should pension funds be looking for in an external adviser?

The primary consideration for a pension fund when choosing a consultancy should be independence, says Andrea Canavesio of consultancy Mangusta Risk in Rome. Funds should look to make sure that the firm is independent of banks, fund managers, insurance companies and other parties, both in terms of shareownership and relationships.

"Do they offer their services to asset manages as well?" asks Canavesio. "If so, there could be some conflicts."

The staff pension scheme of Banca Nazionale de Lavoro agrees. It awarded a consulting mandate to Mangusta Risk last September. Egone Buricca, the pension fund's manager of financial investment, administration and control, says that the board decided to use an external adviser in 2003 when the scheme switched from being largely DB to predominantly DC. It wanted an adviser to help with strategic asset allocation and to supervise the tactical asset allocation, diversification of asset managers, monitoring and performance measurement, he says.

Before this, the board had simply taken advice from its sole asset manager, BNL Gestioni SGR. But the financial portion of the fund's assets had grown to a size where it had become essential to diversify, says Buricca.

Any adviser the scheme chose had to be independent in terms not only of share ownership but also in its relationships with asset managers. "If 50% of the revenues of my adviser come from services offered to three asset managers, I do not consider the consultant independent," Buricca says.

The organisational and IT structures of the consultancy are also very important, and potential pensions clients should check the firm's data inputting systems, the software, database and the indices it uses, Canavesio adds.

Also important, is the professional expertise of the consultancy's management layers – in the financial markets, financial research and analyses, quantitatively and so on, he says.

Once it has appointed a consultant, the pension fund should make sure it reviews the situation regularly. Canavesio suggests the first review after the appointment of a consultant should be at least two years on, then after that the fund would be well advised to undertake annual reviews.

Canavesio says pension funds are willing to switch consultant if they are not happy with the way the job is being done. "I know of consultants who have lost many clients in the past two years," he says, although he adds that Mangusta Risk has never lost any.

Canavesio: 'consultants should be independent of banks, fund managers and insurers'

Even if a pension fund is perfectly happy with the service being given by their current firm, just the process of putting the mandate out to tender can often throw light on interesting new possibilities that the scheme would not otherwise have considered.

Last September the £1.3bn (€1.9bn) Plumbing & Mechanical Services Industry Pension Scheme in the UK awarded a consulting mandate to Hewitt Associates. The previous consultant to the scheme was Mercer.

Robert Burgon, secretary and pensions manager of the scheme, says the decision was taken to review the consultancy appointment because it has been in place for 10 years.

"We felt it was appropriate and invited a number of organisations to come and present," he says. "We were looking for a firm with the right kind of skills to give advice on the right way for our investments to be managed."

Pension schemes differ widely, he points out, and there is no particular investment model that will fit them all. "We're probably more different than the average, so a good understanding of the type of scheme and the problems we have was important," he says.

Burgon says that he and others at the scheme were looking for innovative solutions – ideas that others may not have come up with – and above all, people who they could get along with. "The change was no real criticism of the previous consultant," he says. "We were generally happy with the advice we were getting.

"But it just happened that there were some innovative thing that we hadn't previously thought of, that would add value," he says.

Before the Plumbing & Mechanical Services scheme had appointed Mercer a decade earlier, there was no external advisory firm helping the scheme. Back then, the fund was much smaller than it is today, with assets of around £400m.

"We felt we needed professional input into the way our investments were managed," he says. Independent consultancies have access to far greater amounts of information than would be available to the fund on its own, he notes.

Trustees have to consider the effectiveness of the advice they are getting, Watson Wyatt noted in a 'What if?' paper in September 2004. It suggested a methodical way of assessing whether the advisers that a pension scheme is using are doing a satisfactory job.

The approach is the 'balanced scorecard' concept, which was created by Robert Kaplan and David Norton as a management tool that probed deeper than traditional measures of financial performance. It involves four quadrants of measurement – the principal target measure, support measures, risk measures and process measures. The key behind the concept, says Watson Wyatt, is to identify the drivers that will lead to success, that can then be measured and managed in the short-term to maximise the likelihood of success in the long-term

Paul Deane-Williams of Watson Wyatt says that there is an annual independent research study of consultants' performance, which the firm thinks is the best guide for assessment of abilities. This study looks at four factors – client satisfaction on quality of service, technical sophistication, knowledge of managers and capability of consultants.

"Clients would be well served by considering these in their decision making," he says. He points out that Watson Wyatt measures itself with the same rigour that it measures investment managers.

Although he says pension funds should review the appointment of a consultant reasonably regularly, Deane-Williams says there is a difference though between formal and continuous review.

Pension funds should talk to their consultancy firm if they feel they are being advised by the wrong adviser or getting inappropriate advice. "The consultancy may just have the wrong person in place," he says. "Many funds that we advise now have a business plan and they will build 'consultant review' into the process – this may be every three years, for example."

Deane-Williams says that these days, pension funds are more willing to review their consultant appointment rather than actually switch.

"After the Myners review there is certainly more activity in this area, which is not to say there has been a lot of change," he says. "It has become best practice to review relationships at regular intervals and to consider investment an actuarial relationships separately. Myners had wanted a more competitive marketplace – he certainly got it."

Psolve asset solutions has had successful year in winning consultancy mandates, including one from the £1.44bn Durham Country Council Superannuation Fund in September and another from the £564m London Borough of Hammersmith and Fulham in October.

"We're finding clients have responded very positively to some new solutions to some well-established challenges," says John Conroy, principal at consultancy Psolve Asset Solutions. The tendering process for consultants is now happening much more frequently than before, he says, and it is akin to the activity of manager selection.

"It's just good governance," he says. "People have it as part of their job to see what is out there. Sometimes they change, and sometimes they don't."

Clients are also looking for value for money from consultants – more than was the case before – but this does not simply mean lower fees, says Conroy. Fees can be linked to results. "It is about how you arrange the client's engagement," he says. "There is still some dissatisfaction with the extent to which consultants are on-the-hook for the advice they give."