

Getting a second opinion

By AMANDA SILINS

Superannuation funds are utilising more specialised consultancies to help them manage in an increasingly demanding, complex and competitive environment.

The past few years have seen the opening of boutique consultancies in areas like insurance tenders, alternative investments, risk management and compliance. Increasingly, superannuation funds are demanding very specific skill sets and experience from their consultants.

Pauline Vamos, formerly with ASIC, set up Vamos Consulting at the end of March to provide risk management, compliance and corporate governance consulting to the financial services industry, including superannuation funds. She says the increasing diversity in superannuation consulting is being driven by trustees and consultants.

“The main consultant may say we have a particular problem, let’s go and get a specialist – that’s where you can have consultants managing consultants. In particular areas there is very specialist knowledge and I think it’s becoming a lot more professional.”

Mercer chief executive officer (CEO), Simon O’Regan, says his firm is not threatened by the number of boutique consultancies setting up.

“We recognise our clients’ needs are changing and we don’t try to be all things to all people. We’ve never claimed

to be a one-stop shop,” he says, pointing out Mercer has well-established areas of expertise.

Because superannuation funds’ needs are evolving and becoming more sophisticated, what they need from consultants is also changing. These changes are being driven in part by the increasing size of funds due to growth of superannuation and consolidation of corporates.

Increased expectations of members and regulators also play a role, O’Regan says.

Processes determine need for external help

Renee Freedman, associate director of alternative investment adviser Principle Advisory Services, says she thinks superannuation funds are understanding more clearly what they want and their processes are becoming very well defined.

“We’re seeing very sophisticated decision making processes in funds and they are very well informed.”

REST CEO, Neil Cochrane, says his \$6.5 billion fund draws on external advice in a number of areas as the fund continues to get more complex, particularly with compliance requirements. “Our board doesn’t assume it alone has the knowledge base to be able to manage without outside support... The way we go about it is we see our consultants as our partners – they’re

there to assist us – but at the end of the day the board takes full responsibility.”

REST manages its external consultants through board sub-committees. For example, the external advice the fund seeks on business continuity plans and risk assessment is driven by the audit and compliance committee.

“Having sub-committees helps the fund in dealing with external consultants and it means board responsibility is spread and we’re better able to use the skill set of the board.”

REST handles some outsourcing processes in-house – such as the review and appointment of its administrator. But others are handled by consultants. When the fund put out its asset consulting arrangements to tender last year, it used a tender consultant. It also appointed a tender consultant to help review its insurance arrangements.

Cochrane says he expects boutique consultancies will grow but is unsure they’ll be a dominant force in a few years time. “There is the issue, as a board, how do you manage conflicting views? You’ve got to have a clear demarcation between different advisers,” he says.

Ideas for a fresh approach

Military Super uses a number of advisers in its investment approach, as well as seeking second opinions from asset consultants. Charles Kiefel, chair of the board of the \$7.5 billion Military Super



Superannuation funds are increasingly turning to the specialist experience of consultants for help.

fund, says the fund used one asset consultant up until five years ago, when it began seeking an additional fresh view from second consultancies.

“For the last five years every year we’ve had a second opinion and in every case the second opinion has added value to members in terms of improved returns,” he says.

The fund also has four consultants to its investment committee, which meets monthly. Of these consultants, one firm specialises in alternative investments, one reviews international managers and risk budgeting, one acts as a general asset consultant as well as monitoring domestic managers, and the other provides a fund manager perspective in addition to overall strategic review and risk analysis.

“The investment committee acts as a think tank and then we take ideas to the full board for ratification,” Kiefel says. He expects the whole superannuation market will become more proactive in terms of investing – adding that incentive fees should be considered for asset consultants and managers in addition to fixed fees.

Looking ahead, Kiefel expects two of the areas of greatest demand in superannuation consulting will be member communications and financial planning. Jeff Humphreys consults to superannuation funds in two capacities – as director of CHR Consulting which looks after large insurance tenders and design issues, and as director of Actuaries in Super, which consults in areas including defined benefit design

issues and legislative work. He also assists funds with administration tenders and advice on fund mergers and demergers.

Move to master trusts

Humphreys says a key growth area in his consulting has been helping manage the movement from stand-alone funds to master trusts. A lot of consulting jobs are one-off, he says. For example, an employer may want to move from defined benefit to accumulation and go to a master trust. Humphreys helps them through the transition and with master trust selection.

CHR Consulting has developed expertise in trustee liability insurance. Humphreys says, because this type of insurance has become very expensive, funds approach CHR to act like a broker

to source trustee liability insurance for them.

He notes there are a lot more checks and balances in superannuation consulting than there used to be. For example, when a fund changes its insurance policy it may get the consultant to sign off, the lawyer to sign off, the insurer to sign off, as well as doing its own in-house signoff.

Vamos expects to see increasing use of tender consultants by superannuation funds. "Professional tendering is a very good idea because it puts consultants under scrutiny. You've got to get value for money from your consultants."

She adds that compliance and risk management are strong growth areas in superannuation consulting – driven by Financial Services Reform legislation and by licensing requirements.

Funds seek specialist advice

In the area of investments, some funds are seeking more specialist advice – particularly as they look to bolster returns in light of poor traditional equity market performance. Principle Advisory Services (PAS) has been asked by some superannuation funds how to start investing in the private equity area. Although the firm primarily works with fund managers, it does some consulting work with superannuation funds, providing information on various ways to consider private equity investing.

As for why a superannuation fund would come to PAS rather than a traditional asset consultant, Freedman says PAS is able to provide a deep view of private equity from a manager perspective and an understanding of fund-of-funds and the way asset consultants operate. PAS does not offer manager selection or advice on asset allocation.

BT Financial Group offers a specialist investment consulting service to superannuation funds through its Governance Advisory Service (GAS), headed by Erik Mather. This service focuses on reducing investment and business risk by engaging with clients' investee companies to improve their governance and social and environmental sustainability practices to maintain long-term share price performance.

Controlling governance risk

Mather says looking at external

governance risks in an investment portfolio and using proactive engagement to mitigate risk can have a tangible effect on the bottom line. He explains BT's GAS acts on an annual retainer with superannuation fund clients, putting in place an annual governance plan and reporting monthly to this plan as well as an annual review.

"We submit a dialogue action plan which is either wholly agreed to, rejected or amended by the client. The fund and their executive do the review work and they retain control."

Mather says the BT service is unique in that it looks at governance as a risk, whereas typically consultants look at corporate governance and sustainability separately. He points out that GAS is a trustee-driven initiative, sparked by the Public Sector and Commonwealth Sector Superannuation Schemes approaching the market looking for a proactive approach to identifying particular governance risk.

Vamos describes her compliance consulting as a very different thought process from auditing. While the audit process will establish whether a fund is or is not complying, the compliance process works out how a fund can comply. Vamos links compliance with risk.

She says some of her superannuation consulting involves high level strategic work – for example a fund without its own compliance manager may want to know if it has the right framework in place. For other clients, Vamos provides an ongoing service such as setting up a risk management framework and reviewing the fund's risk management process with trustees on a quarterly or half yearly basis.

Accountability remains with funds

Having the time to manage consultants can be challenging for superannuation funds, she says. Trustees can get consultants in as much as they want but they are ultimately responsible and they need to make the decisions.

"Fundamental with consulting is your role as a coach – you need to teach trustees what to do because it's their responsibility ultimately and always."

Trustees need to learn outsource management, she says – adding there should be a clear brief and accountability.

What can happen is the trustee gets a consultant but does not manage them or brief them properly. As a result, the fund does not get what it wants from the consultant, then seeks a second opinion, and then things get confusing, Vamos says.

While some funds seek second opinions to confirm their consultant's recommendations, this is generally not common practice. As Mercer's O'Regan says, if a fund chooses a consultant, they are choosing expertise, a very good knowledge of the market and someone that is going to do a good job, so why would they need a second opinion?

He says the choice between a large multinational consulting firm or a small dedicated consultancy depends on the needs of the fund and the topic. Some topics may require specialist consultants. According to Humphreys, superannuation funds should look for independence from their consultants.

"We sell independence. We don't sell product, we only sell advice. We have no conflicts and some funds really like that."

He says firms that sell product and advice can get caught up on what their role is. For example, if you are running a tender and on the list is your own product or service provider, inevitably there will be a conflict, he says. If an asset consultant recommends its own product things start to get messy.

O'Regan says Mercer makes a distinction between advice and product. Where it offers both, it makes sure clients are fully aware of that. He says the key is disclosure and putting clients' interests first. Humphreys says another consideration in consultant selection is the experience of the principal: "You need to know the principal will be heavily involved and not just sitting there waiting to sign the report."

Vamos shares a similar view: "I find a lot of people want to speak to the actual people that have the knowledge – as a consultant, you're transferring knowledge. They're looking for specialist advice and want to learn. Trustees realise it is not just straight outsourcing anymore."

"No matter who the consultant is you have to do your research. Big or small isn't necessarily better." ■