Shape up or ship out

Consultants are having to raise their game to keep up with client demand

By Daniel Shane

While the present low interest regimes seen among the world's top central banks may be posing a headache for pension funds and other institutional investors, it is creating new opportunities for the region's consultants.

The low yield investment environment has encouraged more institutions to further diversify their portfolios to include bigger allocations to non-traditional (and often higher yielding) asset classes. Increasing liabilities, in part exacerbated by ageing demographics across the region, has also encouraged pension funds in particular to streamline and better cost manage operations. In both cases, consultants are providing a helping hand.

"We still see significant demand for building effective alternatives exposure in a cost-effective manner, and this has been a major part of our work for a while," explains Naomi Denning, managing director of investment services for Asia Pacific at Towers Watson. "Funds are challenged by the lower return environment for most assets, while they still face a reasonable amount of inflation in their liabilities. This has put a keen focus on improving net returns."

One target area for bolstering these returns has been the fixed-income markets, according to Ms. Denning, who believes that pension funds have generally been "disappointed with the traditional global aggregate approach, which tends to overweight the most indebted countries". This, she says, has led to extensive bond portfolio restructuring at some funds, although the potential for this is sometimes limited by restraints on investing outside of investment-grade credit assets.

"Many clients [are] incorporating an emerging market debt portfolio, [while] others have gone further and restructured their sovereign portfolio to address the structural biases by capping individual countries and regions," Ms. Denning explains. "Many funds are still restricted to investment grade bonds, but for those with more flexibility, there is growing interest in high yield and some of the less traditional bond instruments such as loan portfolios and distressed debt. It remains a challenging time for the industry to achieve high returns, wherever an investor sits, so choosing wisely where to take risk is essential."

Ms. Denning says that amid the present low-yield environment, building exposure to alternative assets has become of rising prevalence among institutional investors; with this subsequently being an area that consultants are focussing more on. However, the methods through which institutions are gaining exposure to these assets are also evolving, partly because they have not always been cost effective. "Initially, funds tended to hire funds-of-funds for private equity and hedge funds, but there is a growing dissatisfaction with the high levels of fees embedded within the industry," she reckons. "The larger pension funds, especially the sovereigns with big teams, have started to invest only in direct funds and building diversified portfolios."

She says that the manner in which Towers Watson assists institutions with these allocations is two-fold: for larger investors, the firm will assist with investment ideas and due diligence, while for smaller funds the consultant says it can leverage its scale to negotiate more competitive fee structures with product providers.

It is not just the investment climate that is helping to determine opportunities for Asia's consultants. Pension frameworks across the region are also increasingly changing, be it the transitioning from defined benefit (DB) to defined contribution (DC) plans, or the introduction of new default or core funds in markets such as Hong Kong's Mandatory Provident Fund (MPF).

"Region-wide the growth of DC will continue and we see a huge need for building better DC frameworks, default strategies and post-retirement solutions in order achieve better outcomes for the individual members – this is a key focus for Towers Watson," Ms. Denning insists. "Although at different stages, most countries in Asia are challenged by how to deal with an increasing array of complex assets and strategies which may help to improve their returns and diversity within their portfolios; we see significant scope for helping clients navigate this effectively."

In terms of Towers Watson's client markets in the region, she describes Japan, home to the world's largest public pension fund, but also facing a severe demographic crunch, as "critical". Ms. Denning says that China also remains "an interesting challenge" for the firm, as domestic investors increasingly seek to diversify internationally, particular as RMB appreciation is no longer a sure bet.

In-depth and hands-on

Singapore-based Stradegi was established in 2013 by several former senior investment management professionals in the region, including ex-Russell Investments chief executive officer (Singapore), Trevor Persaud. The firm specialises in addressing front-, middle-, and back-office services including advisory and consulting, bespoke application development, third-party product implementation, and managed services. In terms of addressing these requirements, Stradegi claims that there is something of a deficit in the current availability of these services in the region.

"Although some other consultancies exist in this space, we found they lacked the in-depth and hands-on experience of having faced and solved such problems, and so could only provide generic and often cost-ineffective solutions rather than meaningful, customised and targeted advice that was actually relevant and needed," Mr. Persaud observes.

The firm says its clients include asset managers, sovereign wealth funds, pen-

Naomi Denning

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sion funds, and insurance companies. For these entities it has provided services including organisational realignment, strategy development, and assisting in making technological architecture more scalable as assets grow.

"The changing landscape of investment management, especially with regard to the increased regulatory scrutiny and the client's need for transparency in the risk/return trade-off, presents a huge opportunity for Stradegi to add significant value," Mr. Persaud explains. He adds that while many such institutions in the West have invested significant resources into developing the aforementioned processes, Asia has lagged behind. Part of the reason for this is what Stradegi perceives as a shortage of experienced talent in the region. "If you look at the more mature investment managers in the West, we can see that they have spent time, money and effort to build and implement processes that are now accepted as industry best practices," Mr. Persaud adds.

In terms of market geographies, Mr. Persaud says that the focus for Stradegi is currently on Singapore, Hong Kong and Malaysia, while there are plans in the pipeline to expand elsewhere in Asia eventually.

Complex needs

Like Towers Watson, the firm has also picked up on new business opportunities amid the low yield investment climate, particularly in regard to rising allocations to alternative assets. "The diversification into alternative and uncorrelated assets has significant impact on the back and middle office as there are unique data, valuation, pricing, performance measurement and risk management requirements," Mr. Persaud explains. "Most traditional investment management systems do not support these requirements in the alternative space. While fund-servicing providers can partially fill this void, increasingly clients are asking for customised processes and solutions. Stradegi is currently helping a couple of our clients to develop bespoke solutions in this space and we see this trend increasing."

Continuing on the theme of new investment horizons, Deborah Bannon, investment solutions leader for Asia ex-Japan at Mercer Investments, agrees that non-traditional asset classes and foreign allocations are becoming de rigour among institutions in the region.

"Clients in general across Asia and in different segments have more complex needs and are increasingly having to revisit how their portfolio is structured in order to generate returns and/or match their longer term liabilities," she explains. "We continue to see increasing allocations to both non-domestic markets and, in particular, to the alternative space, mostly in the area of private markets, infrastructure and real estate assets."

"Our comprehensive and in-depth understanding of all the relevant alternative asset classes extends to first-hand experience directly investing in real assets, as well as extensive manager research and third-party mandate establishment expertise, as well as implementation," she adds.

One challenge going forward for the region's consultants could be a trend that is seeing more institutions increasingly 'insource' functions that were traditionally handled by third parties. According to Ms. Bannon, services such as manager selection and monitoring are more-and-more being performed by internal expertise within institutional investors, rather than by consultants. As a result, she says, Asia's consultants are being made to up their game, such as by developing capabilities in alternative assets and other traditionally unfamiliar markets.

"Many larger Asian institutions have strengthened, and continue to develop, their in-house capabilities and are undertaking several functions that they possibly used to outsource to consultants, for example manager selection and monitoring – this is a continual challenge for consultants that have not evolved from a more traditional advisory model," Ms. Bannon notes. "However, most still appreciate the value added from independent third-party advice, especially as these institutions look to invest more into markets and asset classes that they are less familiar with and/or the complexity of their portfolio increases."