

Challenging the consensus on your pension scheme

By Paul McCarvill

To the majority of pension scheme members, retirement is a long way off, and they have much more interesting and immediate preoccupations. This may explain why about two-thirds of those given a range of investment choices end up with the “default” option. This is the investment choice chosen by the trustees for those who do not wish, or do not feel able, to choose for themselves.

By far the most common default option being used is a consensus fund in which large numbers of scheme members are now invested. This article seeks to challenge the pre-eminence of consensus as the default choice in pension schemes.

What is a consensus fund?

Essentially, it is another form of managed fund – it aims to deliver mid-table performance by following the asset distributions of the various managed funds. In each market it seeks to achieve the performance of

the index. Through having a slightly lower fee the consensus fund can be expected to beat the average over time.

The managed funds which consensus funds track generally operate with a commitment to equities (shares) of 60-85 per cent, though the average rarely moves lower than 70 per cent or above 80 per cent, with the residue in bonds, property and cash. Heretofore, there has been little or no investment in any other asset classes with very little use of options or futures.

So what's wrong with managed/consensus funds?

■ Not diversified enough; too conservative

Managed funds became commonplace during the 1980s when the unshakeable belief in equities completely took over. Their average commitment to equities has moved within a relatively narrow range of 67-80 per cent for many years. For one reason or another these funds did not stray very much from what they were doing 15 years ago despite the possibilities which opened up to invest in other as-



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set classes and use new investment instruments.

■ Too much tied up in Irish equities

For many years, holdings of Irish equities have been very high (20 per cent or so) – as a market dominated by banks and with big weightings in individual stocks, this was an accident waiting to happen. Unfortunately, the credit crunch and economic slowdown nobbled the banks, high oil prices hit Ryanair, and Ty-sabri decimated Elan. With the latter comprising 17 per cent of the ISEQ at the end of June, its collapse took about 1 per cent

off the value of consensus funds. The 42 per cent fall in the ISEQ over the last year has hit Irish pension funds very hard.

■ Management by peer group
The fact is that managed funds are managed by reference to the peer group. Good rankings in the performance tables are vital to win and retain business. Managers demonstrate very little willingness to deviate from the average precisely because of the business risks.

Members of defined contribution (DC) pension schemes (who bear all the risk) expect

that fund managers will take more decisive action to earn them a return, particularly when markets are at extremities of strength or weakness.

They would be surprised to learn that fund managers who have lost money, or failed to out-run inflation, may have maxed out on bonus – as indeed they could if positioned well in the performance tables!

The DC scheme member does not take a 20-year view, and is focused on absolute return – if more (or, indeed, any?) thought had been given to what is so different about DC, a quite different type of “managed” fund should or would have been developed.

The performance issue

It would be wrong to write about managed/consensus funds without referring to performance – that, after all, is what people pay for. While excuses are plentiful, the fact is that the last ten years have seen a singular failure to deliver.

Over the last ten years, the Irish Life Consensus Fund has returned 3.2 per cent per annum, ranking it 4th of 14 (Hewitt survey to June 30, 2008). Even though well ahead of the

average managed fund, Consensus did not keep pace with price inflation (3.8 per cent) over that decade.

It must be acknowledged that performance measured over 15 or 20 years would be very acceptable. However, ten years of failing to beat inflation is hard to excuse, and presents a very serious challenge to the whole concept of “mainstream” investing and pension funding.

Are better choices available?

The arrival of “lifestyle” funds has been positive, even though they often have managed/consensus funds embedded within. They at least start by acknowledging that the money belongs to a real person, whose ability to withstand investment risks changes over time.

The more recently-arrived “diversified” funds are definitely a step in the right direction. However, they will struggle to gain acceptance in what is a very conservative market, unless they are endorsed with conviction by the pension consultants.

Within larger DC schemes, the obvious development is to present choice by reference to

risk (this can be over-laid with “lifestyle”) and using lower cost passive vehicles where possible. With each choice no longer associated with a named provider and identifiable in a survey, the extraordinary emphasis on relative (and short-term) performance which has bedevilled the pensions scene should be considerably diluted.

Conclusion

Managed funds, as we know them, should almost certainly never have become so ubiqui-

tous in the DC arena. The derivative consensus carries the same basic flaws, allayed slightly by delivery of mid-table performance. While there may still be a place for consensus as part of the range of choice, superior alternatives exist – and more are emerging for use as the default option.

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