SHAINAL SUKHA

TRENDS IN ASSETS CONSULTING

Shainal Sukha is owner and founder of Sukha and Associates (Pty) Ltd - a black-owned, niche and independent Investment Consulting business based in Cape Town.

Trends in Investment Consulting

Transformation of the South African fund management industry continues to be both a priority and challenge. However, I would argue that transformation of the fund management industry is inextricably linked to transformation of the investment consulting industry. This is because investment consultants, through their advice to retirement fund trustees, play an important and influential role in terms of allocation of retirement fund assets. We therefore cannot expect transformation within the fund management industry to gain further traction until transformation also becomes a priority within the investment consulting industry.

The purpose of this article is to discuss the dual investment consulting model, which is already being tested and applied in the industry. This could be an opportunity to further transformation efforts within the investment consulting industry but as I will argue below, an opportunity to also improve the governance and robustness of investment decisions made by retirement fund trustees.

What is the dual consulting model?

A few of the larger retirement funds in South Africa have adopted a dual consulting model. This involves appointing two investment consultants, who are independent of each other, to provide investment advice.

This helps to facilitate greater debate and discussion of complex investment matters in order to improve overall investment decision making, as well as provide the Board of Trustees with confidence in the decisions that they have taken.

Some retirement funds have used the dual consulting model to facilitate enterprise development and transformation by supporting small consulting or black owned and managed consulting companies. Small businesses play an important role in terms of job creation, which is a national priority. Boutique, black-owned asset managers have created many jobs and allowed the youth to gain valuable experience within the financial services industry. Consider the number of jobs that could be created if similar support was offered to boutique, black-owned consulting firms.

The concept of peer review is also well established in academia, the sciences and the actuarial profession. When applied to complex retirement fund investment decisions, peer review should deliver the same quality of thought process, leading to the delivery of more desired outcomes for all retirement fund stakeholders including members, the regulator and government.

What are the benefits for retirement fund trustees?

Retirement funds pursuing a dual consulting approach tend to have a more comprehensive audit trail of decisions made, which improves transparency to various stakeholders and provides confidence in the decision making process.

The dual consulting model allows investment issues to be prioritized more effectively and assists with managing the Board's governance budget, including time allocation. Trustees may develop greater conviction in decisions in instances where both investment consultants agree.

On the other hand, in instances where the two consultants disagree, trustees may exercise greater caution or allocate more time to investigate the matter further. Investment consultants have different "styles" or methods of operating and different skill sets and experience. Trustees may tap into the collective expertise of both consultants or utilize the strengths of each consultant as it sees fit or as is appropriate to different situations or decisions.

What are the challenges of the existing single consulting model?

As Bruce Cameron puts it, investment consultants are meant to act as "watchdogs" [1] for retirement fund trustees. They should retain some distance from other service providers (rather than receive remuneration from or build business relationships with them) in order to remain as objective as possible. Greater objectivity should "level the playing fields" and create an environment in which asset managers compete on merit.

Investment consultants should only generate fees from providing independent investment advice in order to align themselves completely with the interests of their clients. However, this is a challenging business model and as a result there are only a few truly independent investment consulting companies left in South Africa that fit this mould.

The primary challenge is that investment consulting is a low margin industry. As a result, many investment consulting companies have offered additional services to retirement funds in order to generate additional revenue. There is nothing wrong with this, especially if the additional services add value. However, with each additional service there is a real risk that explicit and implicit conflicts of interest develop between the investment consultant and their retirement fund client, thereby creating a non-alignment of interest and, possibly additional costs, both explicit and implicit.

How does the dual consulting model seek to address these challenges?

Firstly, it allows for better management of conflicts of interest and improved accountability. In instances where one of the investment consultants is conflicted in some way, the other investment consultant provides independent oversight in addition to the retirement fund's established processes in dealing with the conflict of interest.

The dual consulting model is beneficial in situations where one investment consultant is dominant and has a significant information advantage over the trustees. Rob Rusconi referred to the "information inequity" (in his discussion document: "South African Institutional Investments – Whose Money Is It Anyway?")[2] that exists between trustees and service providers and how this is usually to the disadvantage of and sometimes actually exploited to the detriment of trustees and hence the retirement fund. An additional investment expert within the decision making process serves to level the playing field and ensures that the information inequity is not exploited to the detriment of the retirement fund and its members.

> "The dual consulting model offers a greater breadth of ideas and opinions...

All human beings are subject to behavioural biases and investment consultants are not exempt. Investment consultants may be biased in terms of their preferences for certain strategies or service providers. Where two independent experts are applying their minds, it should be easier to recognize and mitigate these biases and their effects. The dual consulting model therefore reduces the risk that these biases feed into final decision making.

The dual consulting model may be a good opportunity to encourage transformation and enterprise development within the investment consulting industry thereby enabling greater diversity of opinion and more robust investment decisions. Diversity is one of the strengths of South Africa and could result in long-term capital allocation decisions being better suited to the needs of South Africa. Support of boutique asset managers and investment consultants should further job creation efforts.

Conclusion

The dual consulting model may be one way of addressing some of the shortcomings of the single investment consulting model as it effectively incorporates an expert alternative opinion at different levels of the investment decision making process at little or no cost. It also offers an opportunity to facilitate transformation and enterprise development within the investment consulting industry. This can only improve outcomes for all retirement fund stakeholders over the long-term.

References

[1] *Cameron B (2012), Savings industry needs a change of course, Personal Finance, September*

[2] *Rusconi R (2008), South African Institutional Investments – Whose Money Is It Anyway? A Discussion Document, January*