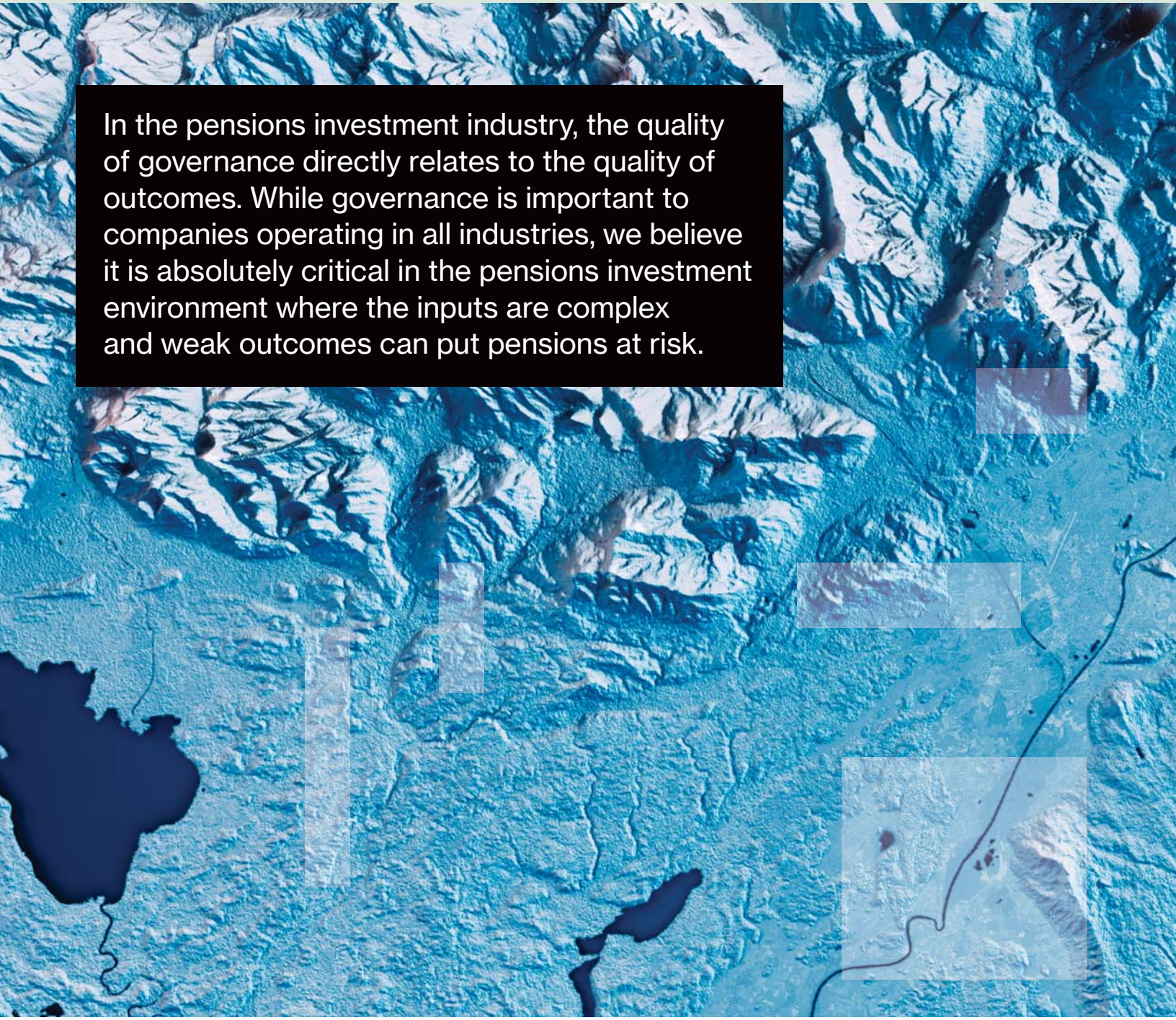
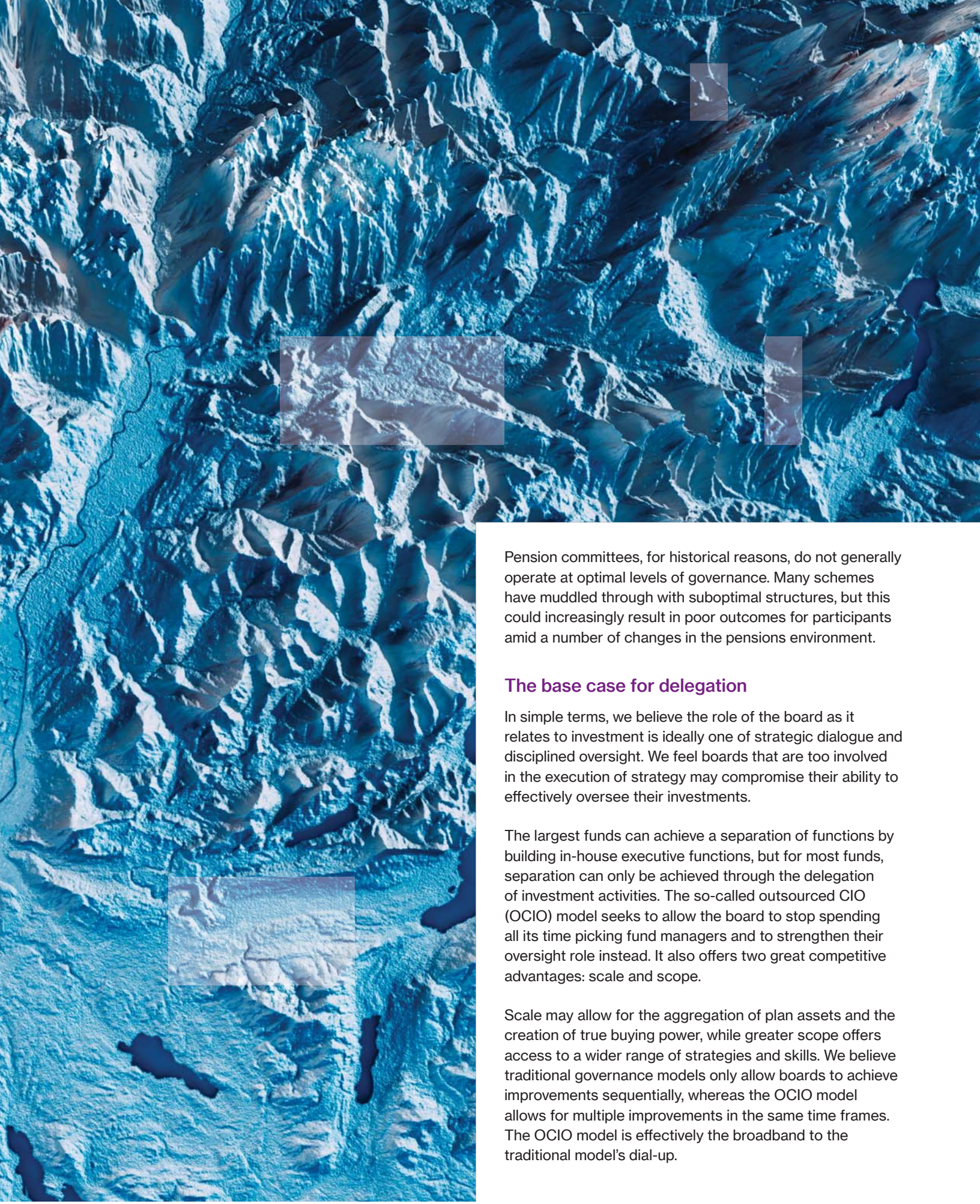
The case for delegation just got stronger

By Pieter Steyn



In the pensions investment industry, the quality of governance directly relates to the quality of outcomes. While governance is important to companies operating in all industries, we believe it is absolutely critical in the pensions investment environment where the inputs are complex and weak outcomes can put pensions at risk.



Pension committees, for historical reasons, do not generally operate at optimal levels of governance. Many schemes have muddled through with suboptimal structures, but this could increasingly result in poor outcomes for participants amid a number of changes in the pensions environment.

The base case for delegation

In simple terms, we believe the role of the board as it relates to investment is ideally one of strategic dialogue and disciplined oversight. We feel boards that are too involved in the execution of strategy may compromise their ability to effectively oversee their investments.

The largest funds can achieve a separation of functions by building in-house executive functions, but for most funds, separation can only be achieved through the delegation of investment activities. The so-called outsourced CIO (OCIO) model seeks to allow the board to stop spending all its time picking fund managers and to strengthen their oversight role instead. It also offers two great competitive advantages: scale and scope.

Scale may allow for the aggregation of plan assets and the creation of true buying power, while greater scope offers access to a wider range of strategies and skills. We believe traditional governance models only allow boards to achieve improvements sequentially, whereas the OCIO model allows for multiple improvements in the same time frames. The OCIO model is effectively the broadband to the traditional model's dial-up.

Changes to the operating environment

So the rationale for the OCIO model is strong. It has, in our opinion, got even stronger in recent times due numerous important changes to the pensions environment.

1. Market conditions have changed

Equities have delivered outstanding performance over the last decade, but for the next decade and beyond we believe most plans will require a more robust and dynamic portfolio with a greater variety of risk exposures. Diversity is an essential element of this, as is the implementation of extreme risk hedges, which are relevant to all long-term investors.

2. Competition for scarce assets has increased

First-mover advantage is real, and becoming increasingly important. It is now clear to most plans that they are in a competitive environment, particularly for de-risking and return-generating assets. By delegating investment activities, we feel plans become more dynamic and may be in a better position to buy the assets they require before their competitors — and at the prices they seek.

3. Plans are approaching the "end game"

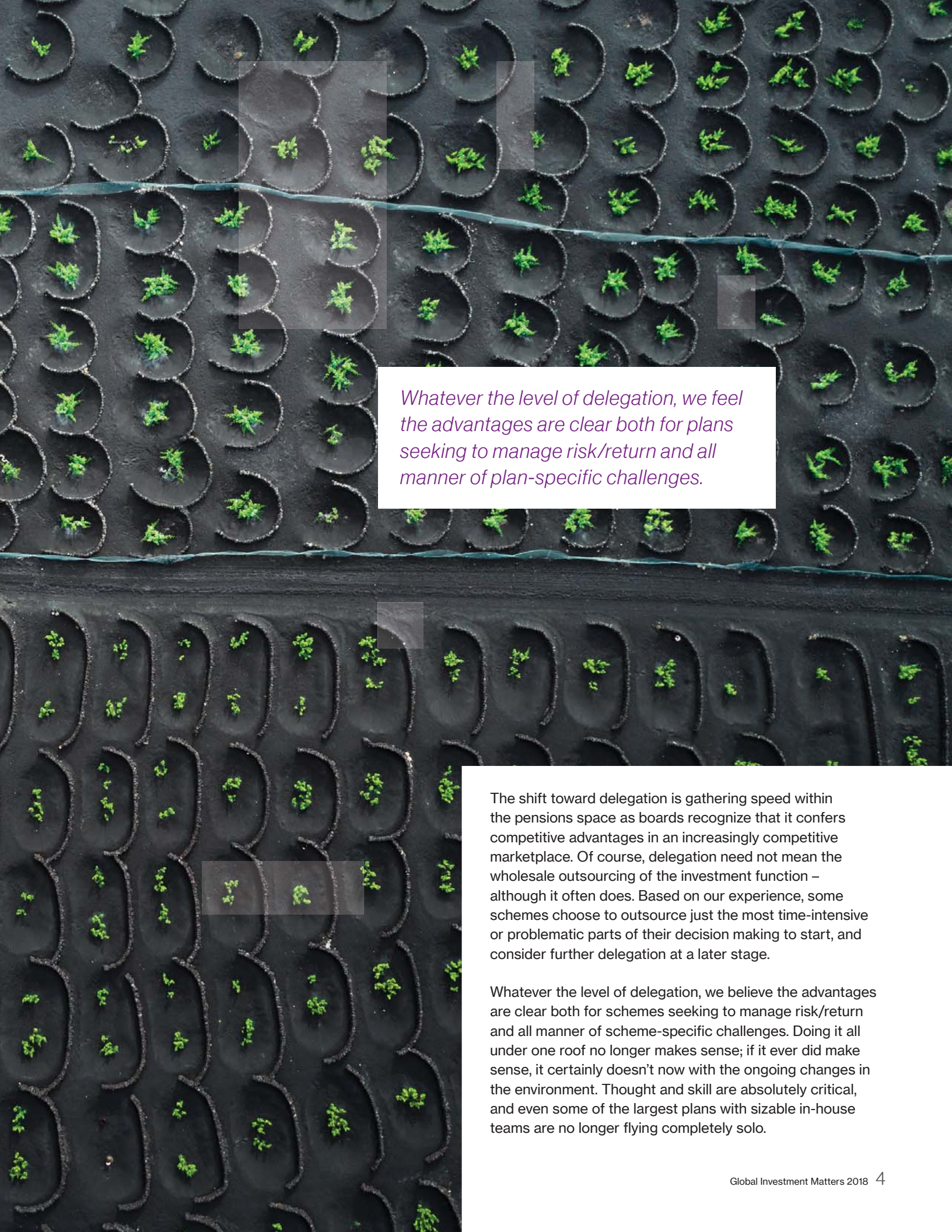
Many pension funds, notably in the U.K., are reaching the end of their life cycles. Many funds must go into insurance mode, converting assets into streams of income. This requires deep understanding and skilled execution of new liability hedging instruments and longevity hedging techniques, as well as the ability to source secure-income assets while continuing to generate some growth. Importantly, these complex activities must be undertaken at the lowest cost possible. We believe this requires a completely different set of skills and scale of operations than what exists in most pension plans today.

4. The search for sustainability

Plan liabilities can stretch deep into the future, whether or not they are in run off. Even mature plans may need to manage assets over the long term due to insufficient capacity in the insurance market to absorb all pension assets. Given the very long-term time horizons, sustainability becomes important both to add return and to reduce risk. But sustainability is neither easy to define or implement, and we believe many plans will benefit from implementing ESG under the OCIO umbrella.

5. Further legislation has increased the trustee burden

The constant drip-drip of regulation is taking its toll on plan resources. MIFID II, which took effect on January 3, is leading to an increased workload on boards. Economies of scope in the OCIO model look to ensure there is bandwidth to deal with the challenging regulatory environment.



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The shift toward delegation is gathering speed within the pensions space as boards recognize that it confers competitive advantages in an increasingly competitive marketplace. Of course, delegation need not mean the wholesale outsourcing of the investment function – although it often does. Based on our experience, some schemes choose to outsource just the most time-intensive or problematic parts of their decision making to start, and consider further delegation at a later stage.

Whatever the level of delegation, we believe the advantages are clear both for schemes seeking to manage risk/return and all manner of scheme-specific challenges. Doing it all under one roof no longer makes sense; if it ever did make sense, it certainly doesn't now with the ongoing changes in the environment. Thought and skill are absolutely critical, and even some of the largest plans with sizable in-house teams are no longer flying completely solo.