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TRENDS IN OCIO

roundtable

AON

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From left to right:

William Parry
Partner, Aon

Michele Hirons-Wood
Professional trustee, Capital Cranfield

Michelle Darracott
Trustee executive, Best Trustees

Melanie Cusack
Client director, Zedra Governance

Maria Johannessen
Head of UK investment, Aon

Alan Pickering
President, Best Trustees

Andrew Harrison
Director, LawDeb Pension Trustees

Daniel Peters
Senior partner, global investment practice, Aon

Not in the picture:

Ian Maybury
Independent trustee

DISCUSSION: TRENDS IN OCIO

It's not easy being a pension scheme trustee. They have to comply with regulation, integrate risk management and grow their assets faster than their liabilities. And this is before they've started tackling other critical matters such as sustainability.
The role seems to get more complicated as each year goes by and so many need help. That could come from a professional trustee, greater reliance on investment advisers, or from a fiduciary management provider. Or they could introduce a CIO function through an arrangement known as an OCIO (outsourced chief investment officer).
But what is an OCIO? How are trustees using it? And what are its limitations? *portfolio institutional* chaired a lively debate between those providing the service and those using it.

What is the difference between OCIO and fiduciary management?

Daniel Peters: Fiduciary management is where the high-level goals are set. The keys are handed to a fiduciary manager to implement their clients' mandates in the best way they see fit, to take over most of the investment decision making. An OCIO structure allows the trustee and sponsor to retain more investment discretion over the mandate.
OCIO can mirror the close working relationship in-house teams have with trustees to understand their nuances and needs. Quite literally, this is reflected in the name and the ability to take away the implementation and governance associated with the investment decision-making.

Maria Johannessen: OCIO is an umbrella term that doesn't mean one specific 'thing'. It is a service more than it is a product and as such is tailored to each client situation. Outsourcing the operational aspects of an investment mandate is a natural extension of the professionalisation of trusteeship.
During the liability-driven investment (LDI) turbulence, the risks involved in the operational aspects of the investment process were suddenly in the spotlight. It is therefore natural that trustees stepped back and asked if they could do this better.

Melanie Cusack: The fiduciary management comparison is a bit grey. They both manage the implementation, but the key is where the strategy is decided. If that is retained, you tend to have OCIO. If you rely on the manager to develop a strategy, that is more fiduciary.
I love fiduciary management, but not all of my clients do. Part of it is they think they are losing control of the strategic piece. But they like the idea of someone doing it for them, which is what we are describing. It is already happening without us putting a label on it.
It has moved a bit historically. A lot of trustees love the investment piece. It is the sexy bit of pensions, but they are not skilled enough and want to hand the day-to-day to the experts.

What services can schemes expect from an OCIO provider?

William Parry: OCIO offers a range of services that trustees are obliged to do themselves, such as signing bits of paper to move cash between managers and moving cash across to pay members. And if schemes have illiquids, moving cash across to meet capital calls, and moving cash if you have LDI collateral calls.

On top of this, it offers services that trustees often do not have time to do such as regular rebalancing back to a central benchmark.

All of these operational aspects require a huge amount of trustee time. An OCIO structure removes that burden, freeing trustees to focus on the strategic investment piece so that they can get to their goals more painlessly.

Andrew Harrison: Trustee time is getting squeezed to the extent that we are asking ourselves: are there things where we just get someone to go away and make it happen.

That can be attractive. Regulation is coming at us left, right and centre and is taking up more and more of our time.

Michele Hirons-Wood: I have a slightly different view. I tend to think of traditional fiduciary management being more of an off-the-shelf package, while OCIO is bespoke fiduciary. If you want a certain ESG portfolio, for example, that is where it comes in.

In a nutshell, I like OCIO because I feel that person is looking after my pension scheme. They care about it and will tell me what I need to do if anything happens. They are looking at it from tactical and strategic levels, not just operational.

Peters: Being bespoke and looking out for you is key. If you had your own CIO, that is what they would be doing.

Harrison: It is about who owns the risk. Who is the person you shout at when something goes wrong? It is the individual doing this because it is in your best interest. It is tailored to your specific situation.

Hirons-Wood: A prime example of that was the LDI crisis last year. At the time I called my LDI manager and the OCIO had already been in touch and worked it out. That is what you want them to do, to look after your money as if it was their own.

Cusack: Trustee boards do not want to check how the admin is calculated, so why do they think they can select a fund manager?

I have challenged a board on how we are going to choose a fund manager. Candidates are put in front of us who have been shortlisted based on the broad ideas of what we want and then we choose one based on their pitch from their sales guy.

We are not meant to be investment experts and should bring in specialists to do that. The trustees can then focus on the areas that make a difference, which is the strategic piece.

Michelle Darracott: The efficiency point is big. A lot of trustees are focused on buy-out, particularly with funding levels improving post the gilt crisis. But to get there a lot needs to be done over and above investment.

Not having to worry about the investment side of things, whilst you are doing the data cleansing and everything else, is super helpful. Take, for example, the selection of investment managers: things can go wrong. Being able to anticipate when to change managers and having a timelier response to market conditions drives efficiencies. This is where having an OCIO can help.

Johannessen: Delegating more of the decision-making such as fund selection is helpful from an adviser's perspective as well.

The best trustee boards have a mix of people who can leverage the skills of their day job to help fulfil the scheme's objective.

Alan Pickering
Best Trustees

> **Outsourcing the operational aspects of an investment mandate is a natural extension of the professionalisation of trusteeship.**
>
> Maria Johannessen
> Aon

From the adviser side, if the professionals can handle the day-to-day tasks such as fund selection behind the scenes, when we speak to our clients, we can spend more time on the important topics and getting to good strategic decisions.

Ian Maybury: Can we take a step back? I do not disagree with anything that has been said, but around 95% of pension funds don't have a CIO. So what are we outsourcing?

Harrison: If they had the resources to afford a CIO, would more of them have one?

Alan Pickering: It is good to hear Maria describe OCIO as an umbrella term to cover a service rather than a product. But in defined benefit land, schemes open to future accrual or where the sponsor does not want to transfer risk due to market conditions need a different service to those which are three or four years away from risk transfer.

In the context of defined benefit schemes near journey's end, the first thing is to change the mindset to appointing project people, rather than consultants with whom you are going to have a long-term relationship. Then you decide what you delegate, to whom and what you call it. As you get close to retirement, risk transfer is more of an operational issue than an investment issue, in making sure your assets are in the right place.

Johannessen: Although capacity has increased in the risk transfer market, not all funds wanting to buyout will be able to. Schemes that are, or nearly, fully funded need a strategy to balance all of the trade-offs to stay buyout ready.

At the start of Covid we had market volatility. We then had inflation, the gas crisis, the invasion of Ukraine and a liquidity crisis. I cannot say what is going to be next, but there will be something out there that means schemes will have to protect themselves if they find themselves at the back of a queue to get things done.

Pickering: I want my actuary to keep giving me a sense test as to what the market is calculating. I want a risk transfer person who will continually survey the market and have the toolkit to transact when I want them to. Then I want an investment person working with them to make sure my position doesn't deteriorate.

I don't know whether that would be a fully-fledged OCIO. It could be my actuary, my investment consultant and a risk transfer deliverer working closely on my behalf. I would happily buy that product.

Parry: This is similar to the point Ian made, in that if most pension schemes do not have a CIO, why do they need to suddenly outsource the role?

We have mentioned "bespoke" a couple of

times. Whether you like the OCIO term or not, it does capture the tasks a CIO would typically oversee which coincides with the administrative burden that trustees are enjoying less and less.

It comes back to schemes needing more support in volatile environments with increased regulation: they could either hire a CIO or outsource the role.

Maybury: We have what I would describe as the old model, which is a typical trustee model with advisers and multiple managers. At the other extreme, we have a fiduciary manager, which I would distinguish from OCIO in that it has some, if not all, of the advice attached. In-between that, you have genuine OCIO.

Then you have a whole spectrum of multi-managers, who are not necessarily your OCIO. If you define that as the only option, you have a whole range of asset classes and there are few people who can cover them all. If I appoint two multi managers, who is my CIO? Somebody has to pull them together.

We are seeing in the market lots of OCIO providers offering to do your private markets piece. That is not OCIO. It is becoming like diversified growth funds, which were available in every flavour under the sun, but they were a 21st century version of the 60/40 model. This is just another flavour but with more complicated asset allocation and a lot more tools available. We have complicated the life of trustees, so they need this.

Cusack: I have a few schemes which are well funded with a decent strategy and coped with the LDI crisis. They are trying to get to buy-in.

We have agreed on an investment strategy and a timeframe. Then we want someone to do it. I do not want to have to determine what asset classes we need to invest in to achieve that strategy. I want to focus on the strategic items that are less exciting than selecting managers, but important if we want to get to that endgame. I just want the job to get done.

Harrison: If you have a buy-in target and an approximate timeframe, it is straightforward to say to someone: "I need to get from here to here. There are some controls and constraints around that, but off you go and make it happen."

Maybury: Does that apply to runoff as well? I think it does.

Johannessen: Runoff is just as important. With OCIO, trustees can retain the rebalancing decisions and manager selection or only the strategic part. Once they tell you it is a buy-in or buyout they can ask their OCIO to go away and do it.

Hirons-Wood: Can I be controversial? I work with five fiduciary managers and get that from four of them. We are talking about OCIO like it's new. It's not.

I was having a chat with an OCIO about getting to buyout and at what point we turn our illiquids off. For me, that is what you want. It is fiduciary management with an element of bespoke because we are setting the constraints at a different level.

Cusack: There is a subtle difference with fiduciary. When you buy fiduciary, you are buying the advice piece, whereas Alan was describing having a separate adviser. That is the big difference with OCIO.

Your accountability is different because your OCIO is doing the operational bit. You can choose where your strategic advice is coming from, but that is a standalone arrangement. Fiduciary is where you have both.

Johannessen: At Aon we work with clients in the way they want to work with us. From pure advisory, through OCIO all the way up to fiduciary, where they say: "This is my portfolio. This is the return I need. Now go away and do it."

OCIOs generally manage risk better.

Ian Maybury
Independent trustee

Trustees realise how complex the operational parts are and how much they have to interlink. However, many are not interested in doing that anymore as it takes over their life, so they want a professional to do it.

Harrison: I see this as a spectrum of services. It is unfortunate that there are arbitrary distinctions that describe the different areas along that spectrum. And there are grey areas, there is so much overlap.

Pickering: In the wake of the liquidity crisis, employers and trustees should sit around the table and agree the objective for their scheme. Is it going to be runoff? Is it going to be buy-in? Is the heavy lifting going to be done by investment returns or will the employer write a cheque?

The trustees and the employer will then debate what the hoped for time of arrival is and find project people to deliver that. The projects where I have been involved were seamlessly run by people whose job titles were investment consultant, risk expert and actuary.

The finance director does not need to know who they are and what they do. All they need to know is that here is a team who are, on a scheme-specific basis, going to get me where I want to go, keeping me advised as to how close I am and whether the time is right to sign a cheque to put it to bed.

We have to think of this through the lens of the finance director, who does not want to sell people short, but does not want such a wide bandwidth as to have to grapple with a legacy pension scheme.

Cusack: I'm jealous that you have sponsors who are prepared to commit to timeframes. I sit down with some of mine and ask if we should start looking at this, but they will not commit.

I still have some who don't want to pay a premium to pass this to an insurer and are happy with runoff. When I ask if we can agree an investment strategy, they reply: "No, we are fine."

The trustees carry on getting buyout ready and we are still doing the manager selection exercises and challenging our investment consultant, who has effectively taken the OCIO role although they may not realise that is the case.

Pickering: The gilt crisis was a wakeup call for those employers because they did not realise how much risk they were running. They did not realise all the bureaucratic stuff that was coming down the pipe.

We have reached a position where we are thinking more at the three-to-five-year end than 2040 and the employer is willing to write a cheque if we get within sight of the harbor to make sure they do not go out with the tide.

Parry: Things have moved quickly. We are in a difficult environment for many employers and they want to understand what is going on in their pension scheme. There is more pressure on trustees to engage with their sponsor and those conversations can be strained if sponsors can't reach into their pockets and experience has been adverse. This comes back to getting rid of the stuff trustees do not need to do, so they can focus on their journey plan.

When fiduciary first came out a decade or so ago, people did not like the idea that fiduciary responsibility was passed across. The worry was that this label was being used in a way to almost absolve trustees of their responsibilities, whereas over time, as more people have seen how fiduciary works in practice trustees have become more comfortable with what it means.

Equally, more trustees seem open to OCIO now because it is a flexible model. It's not trying to be something they don't want or do anything controversial such as absolve them of any responsibilities.

Being able to anticipate when to change managers and having timelier efficiencies. This is where having an OCIO can help.

Michelle Darracott
Best Trustees

OCIO elevates trustees to the position of CEO and that is where trustee boards need to be.

Daniel Peters
Aon

Maybury: When we have meetings about OCIO they could just as easily be discussions about fiduciary management. So why, given that we had a quite well working fiduciary management model, did we create an OCIO model?

It boils down to a couple of simple things. Since a certain magnate stepped off the back of his boat in 1993, independent advice was the gold standard. Fiduciary management upended that because it is no longer independent as it is bundled with your investment management.

There are many people, either because of scale or legacy, who do not like that lack of independence. Therefore, an OCIO model allows you to separate your advice.

Hirons-Wood: I have one fiduciary client and the rest are OCIO.

It comes down to accountability and the pace of implementation. It is not the narrow: "Come with us and invest in all of our products." That is the small scheme, rigid off-the-peg fiduciary management. I do not invest in that, bar one scheme, which is what I need to hedge my exposures.

Johannessen: Maxwell was mentioned. How much has changed since then in terms of how we live, how we work, how markets are traded, the derivative portfolios available and the invention of LDI?

Over the past 10 to 15 years, as long as you had an LDI mandate, you could invest in almost anything and it would look good. Looking over the next 10 years, we are in a much more volatile space. We are also threatened by operational risk, liquidity risk and risks popping up in unexpected places.

How are you adding accountability into this offering?

Peters: It is at the heart of it because the best outcomes are when people are clear about what each party is accountable for. In terms of where that accountability or responsibility is outsourced and what is retained by the trustee, in an OCIO context, everyone is going to be different in where they want to draw that line.

It comes to the alignment of interest point. In many ways, once that accountability has been passed over there is more of an alignment of interest.

For instance, when I know I am responsible for delivering the mix of investment managers and their performance, I know I am responsible for which managers I use and other aspects such as costs. This takes away the potential conflicts that can exist in the advisory model when trustees move towards the model of taking a single directive recommendation.

OCIO elevates trustees to the position of CEO and that is where trustee boards need to be: making executive-level decisions about journey planning and then handing over the accountability, as a CEO would do, to a CIO to implement.

More trustees seem open to OCIO now because it is a flexible model. It's not trying to be something they don't want.

William Parry
Aon

Maybury: To put the regulatory bit on that, we are not just a CEO, we are supplier-manager as well because we have outsourced something.

We cannot just say we have somebody who reports to us as a CIO. It is a supplier-management relationship.

I rarely see supplier-management skills on a brief for a trustee role. It drives me up the wall because we outsource just about everything. We do not have supplier-management skills on a lot of trustee boards.

How much of a say do trustees have in an OCIO agreement?

Cusack: It's a choice. As part of the procurement process, you agree on what you want to bespoke, such as a certain ESG focus. That would have to feed into the relationship. It is part of the awareness of what you are getting and who is accountable for it.

Hirons-Wood: It is the constraints you put in the investment management agreement at the end of the day. Don't constrain it too much or there will be no point having it.

Pickering: We have scored an own goal by trying to turn salt-of-the-earth people into do-it-yourself actuaries or lawyers. The best trustee boards have a mix of people who can leverage the skills of their day job to help fulfil the scheme's objective.

These days it is about project management, managing external contractors and communications. It is those skills where trustees can add value rather than thinking they know as much as the actuary.

Peters: That is interesting. Rather than suggest where trustees would like to draw their line, say based on what they find interesting, perhaps they should focus more on when their capability and expertise ends. And at that point they hand over.

Harrison: There is stuff you worry about, stuff you don't worry about and stuff you pay someone else to worry about. Different boards will carve that up in different ways, but once you figure it out there is a solution for that. But it is not necessarily going to be the same for everyone because people want different elements of control.

Cusack: I'm not interested in the actuarial piece, so I pay someone to worry about it. The problem with the trustees and sponsors across some of my boards is that when trying to get them interested in strategic thinking or the journey plan, they prefer to focus on who will deliver the investment piece.

Peters: This issue is prevalent for many schemes. In some schemes I work with, the in-house CIOs will not let the trustees meet any of the managers.

Hirons-Wood: Agreed, engaging with asset managers to talk about benchmark performance is not where trustees should focus their time and energy, unless they have an in-depth understanding of these subjects.

Cusack: It is difficult. I have a scheme which has an in-house CIO who wants to know what we want them to deliver and then to just let them do it. But some board members want to know how they are doing it, where the funds are invested.

Maybury: Some of this is a legacy issue. We have had a generation where the philosophy has been that appointing a diverse best-of-breed set of managers will deliver consistent alpha and therefore you don't need quite as high beta. That is what it boils down to.

Pickering: Paul Myners got it wrong when he said trustees should spend more time with their investment managers. In an hour-and-a-half, an investment manager will say we had a lousy quarter, but it was wonderful last week. That adds no value. They should spend time with their investment consultant thinking strategically.

Johannessen: Alan was talking about skill, not just in picking the right managers, but in enabling good decision making. For instance, when trustee boards are choosing a new investment adviser, how big a factor is price?

I would say that often it is a disproportionately large factor that can distract. Ultimately, this is all about improving outcomes with better frameworks in place and focus on price can be distracting.

Cusack: It is about the value add in challenging us and delivering on the strategy. If we have confidence in the advisory part and it is being delivered well, I will pay more for that knowing that I don't have to worry.

Maybury: I was once asked by some investment bankers: how can we become the McKinsey of pension schemes? The answer is that nobody will pay you the value add for your strategic advice. Therefore, the advisory model is an economies of scale model to deliver more asset and liability management.

With OCIO, we are in a world where economies of scale matter more to us as trustees now than they ever have. Most of our providers are economies of scale businesses, so we are effectively taking their economies of scale away from them. That is a real challenge.

Best-of-breed is still part of the universe, but we are much more about economies of scale. That is why aggregation of mandates works, because the big providers can offer it at scale.

Cusack: For some, but not for all. It comes down to the value add. If strategy is important and you want to outsource its delivery, then you have to pay for that. There is no point having the best strategy in the world and a poor OCIO.

What I do with some of my clients is have an attribution analysis that assesses that part of the performance due to our strategic benchmark in addition to the fund manager's own benchmark. Then there is the advice piece.

There is a strategic benchmark, how has that been delivered, how much of the performance is due to that, rather than just the managers doing what they have been appointed to do.

That is where you see your value added. When you put that in the context of the overall fund you see why you are paying them.

Maybury: That is the other job of trustees. We retain strategy, and maybe delegate as much as we can, but we have to provide oversight on the implementation. Too many of the investment committees I sit on don't do operational oversight. They leave it to the risk and operations committee because it's not sexy and interesting enough.

Hirons-Wood: If you get it wrong, it could be incredibly costly. If it goes wrong in an outsourced model, there is greater accountability. You don't get that in an investment consultancy model.

Johannessen: The difficulty is if you need an adviser for the next 10 years. What is going to come over that time horizon? Is that person going to be innovative? Are they going to challenge me at the right time? Are they going to ask the right questions? It is difficult.

Hirons-Wood: It is, but you have to rely on the pitching process. If you have two people and you believe one is supremely better than the other, then price is secondary.

Cusack: A question I ask advisers is: what would you do if you could de-risk and still easily achieve the return objective? Would you talk to us about that first?

One particular adviser said they would automatically de-risk because, "obviously, you have to de-risk". But surely, if they are our valued advisers, they will talk to us first as we might be happy with the level of risk. That is more important than price.

Johannessen: That is my point. As an aside, there are areas where price is a massive issue. For example, in master trusts; it is more important than the underlying strategy, which I struggle with.

Pickering: In defined contribution, you won't get in the room if your price is uncompetitive. My worry is that the authorities are going to say that price trumps value. It doesn't. The members want to know that the data is in safe hands, that the investments are being looked after and so is the admin. It is hard to measure that value on a cost basis.

You can do your best to make sure you are appointing someone who is resilient, but in pensions value is much more important than cost and some of the value is intangible. The drive towards value for money worries me.

Cusack: Michelle, you are a trustee with an investment background, how would you judge that selection process?

Darracott: Price comes into it, but communication with the OCIO is important. When things go wrong and you pick up the phone, how does that conversation go? What does the scenario planning look like? The confidence that is instilled through having an experienced professional on the other side of the table is key. We have had 1987, 2008, the dotcom crash, the Asian financial crisis and the LDI crisis – being able to talk through some of those situations could help you respond to a crisis in the right way. This is where having an experienced investment professional on your side can help.

Communications are arguably more important in DC because from an investment strategy perspective most members go into the default fund.

There is no point having the best strategy in the world and a poor OCIO.

Melanie Cusack
Zedra Governance

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In a nutshell, I like OCIO because I feel that person is looking after my pension scheme. They care about it and will tell me what I need to do if anything happens.

Michele Hirons-Wood
Capital Cranfield

That can't just be about price. To get new ideas coming through, and to keep on top of what we want to do from an ESG perspective, requires a lot of hands-on effort that the trustees cannot do by themselves. There is a huge amount to be done, but for me communication and scenario planning are important.

Parry: Investment is the area requiring the greatest amount of judgement. For example, making assessments for future investment performance, which is uncertain even at the asset class level.

This isn't like the actuary who can discount their projections and quantify today the impact that will have in the future.

When talking about costs, I regularly hear the value-trumps-cost argument. Importantly though, what is changing due to recent turmoil, is people are looking at something else they can value: their experience. This is the communication point.

They are not looking for cheaper, they are thinking about how their strategic partner will help them through the bad times so that they're not working seven till seven, seven days a week.

We are starting to see that differentiation whereby value does trump cost in practice, mostly due to the experience of the journey becoming increasingly important.

Maybury: That is a facet of a big global paradigm shift. We spent a generation making supply chains as efficient as we could and what did we discover? There were multiple points of failure, multiple handoffs and they are not resilient.

We now need to build something better, which is going to cost us a bit more. I'm in the middle of three LDI re-pitches and even the incumbent managers are charging more because they are recognising that their model wasn't resilient.

Cusack: Quite a few of our investment consulting mandates have a fixed fee. A lot of this is operational: the monitoring, the reporting, the accountability and the research.

Then there is the consulting piece, which is the bit we have to pay for and value.

It is needed to agree the journey plan, to review strategy, to check the accountability.

It is a competitive market, so how are OCIO providers differentiating themselves?

Parry: As a consultant, you naturally understand your client's situation which feeds into how to plan if you want to change something. At the other extreme, it is looking at OCIO purely through an asset management lens, which is more of a product model that you can get at a better cost.

The key qeustions to ask are: is this being driven by a need to outsource a set of functions for a fixed fee and low cost? Or, is it more important to have someone who thinks and plans how decisions made today will impact your longer plan. Thinking about what your next three valuations will look like and what the journey through those will be. This doesn't need to be providing advice per se, it's more an understanding that each decision made will have ripples in future which need to be considered.

Johannessen: We are fortunate to be part of a global business with more than 60,000 people and our insights are shared across the world. This wider group helped our investment practice enormously during the LDI turbulence.

Whilst the majority of our clients had a stressful time, they got through it because

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> Andrew Harrison
> LawDeb Pension Trustees

we went into execution mode. We focused on them and freed up consultants to speak with them. We had the support of the wider business: compliance, legal and project managers. In a time of turbulence that makes a huge difference.

Hirons-Wood: The big asset managers do implementation only, but one of my schemes has a separate investment consultant, who gives me an independent overview.

Cusack: The key for me when I have a fiduciary model is to have a clear advisory piece. I want my advice to come from an investment consultant.

For one client, Aon does this and has a team that implements the strategy, but they are not the same. They have both come to meetings: one is there as the adviser and the other as the fiduciary manager.

I want to see both of them. One is talking about the performance of the funds and the other is giving advice on whether we should be de-risking.

Parry: But equally, just as many will want a single person to be responsible for everything. People tend to pick advisers rather than houses, whereas for asset management you might pick a house as opposed to a particular adviser.

The strength of picking a consultant is that you will gravitate towards people who understand what you are after and will fit with the model you want.

They could then build something a bit different for this particular person, as opposed to when an asset management house is chosen, which will naturally find it much harder to tailor in the same way.

Hirons-Wood: It is important to understand your scope when deciding what you want. How you want to work will influence the range of people you can work with. Understanding your governance structure is going to be key as you go through the process.

Cusack: Every trustee board has its own idiosyncrasies. Changing one person at the table can change the dynamics. That is the challenge. It goes back to being a good communicator and having a good relationship where you can have a conversation to get the trustees to the right place.

Peters: That is the value of professional trusteeship. Having that relationship with the trustees to understand what the board needs and then help to define the scope when they are looking to appoint someone.

Hirons-Wood: Boards change. Sometimes you need to revisit appointments because you have a completely different collection of people whose needs and requirements have changed.

Cusack: Going back to the advisory piece, if you have a fiduciary manager, the advisory piece and the delivery is part of the mandate. If you separate those you have your OCIO giving a bit of challenge and having strategy discussions. If you don't have them separate, you need an oversight manager.

In theory, you are always going to have two best practice investment people at the table. You need that challenge; not why did you choose that specific investment manager?

Hirons-Wood: The question should not be, what happened in the last quarter. The question should be about what's the market outlook for the next 12 months and how are we positioned for it? It is changing the level of conversation on the trustee board.

Cusack: That is the accountability point. When the managers deliver their target, has that target delivered to the overall fund objective and has that objective delivered what we need for our journey?

Johannessen: I like Michele's focus on "forward looking". The journey planning is good, but who is going to say that in 10 years' time your scheme can buyout?

This is where you need flexibility and foresight from your investment adviser. Whatever the actuary tells you will change; do plans ever progress exactly as predicted?

Cusack: No, they will guarantee that their assumptions will be wrong. You say there is a journey plan and we should look forward, but if you are not on track, you need to call it out and ask: what do we need to do?

We have covered a lot of ground, so does anyone have any final comments on this topic?

Darracott: When everything is going right, most models are probably okay. When things go wrong, this is when these OCIO services come into their own.

What I want to be sure of as a trustee, whether I'm working with an OCIO or a fiduciary manager, is the depth of resources that could be drawn on in turbulent times. Whatever we forecast, all we know that life is going to be different to what the actuary, investment consultant or asset manager says, so how do I deal with that situation when it arises?

Maybury: Why am I a big fan of OCIO? Whether it is an OCIO offering or embedded in fiduciary management, it removes key-man risk, gives me economies of scale and manages risk.

OCIOs generally manage risk better. Schemes are going through a huge regime shift because they are maturing and their funding has improved. We are moving to a new paradigm and need to keep it simple. Historically, we have not been good at that. The future is about simplification, which is going to manage risk more than anything else.

Pickering: If we get DC wrong, ordinary men and women miss out. It is important, therefore, that delegation and default rule the day.

I don't want independence to override outcomes, so I am happy to have a delegated model in DC as long as the trustees and strategist are open to somebody coming along and kicking the tyres.

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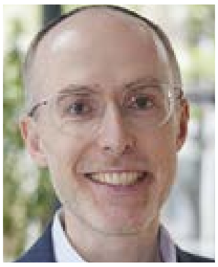

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NAVIGATING VOLATILITY: THE VITAL ROLE OF OCIO FOR PENSION SCHEMES

Cast your mind back over the past three years: the Covid-19 pandemic, uncertainty with US presidential elections, geopolitical tensions and conflicts, the gilt market turmoil in late 2022, high inflation and the sharp tightening in monetary policy – all have meant that pension scheme trustees have had a lot to contend with and a lot of investment decisions to make. Gone is the 'golden decade' of investing in a low interest rate environment – volatility looks set to continue and the next decade could be trickier still for trustees and sponsors.

What is OCIO?

OCIO is one way to better navigate this environment of volatility and uncertainty. It allows trustees to delegate certain investment-related tasks, meaning they can focus their time and efforts on their priorities: making executive investment decisions. But don't all trustees have different priorities? Yes. And this is where OCIO can play a vital role as at its heart is the ability to deliver flexibilty and investment arrangements to respond to these different priorities.

Is OCIO the same as fiduciary? The terms are often used interchangeably, but the key difference is that fiduciary involves passing across all decision making, apart from the high-level strategic goals. OCIO, however, covers a range of different approaches and tends to be for schemes looking to retain some strategic control within an arrangement tailored to meet their goals.

The value of OCIO – flexible and customised support

As a result of recent market turmoil, trustees have never needed (or wanted) support more. A huge burden can be lifted from trustees' shoulders when they no longer have to deal with the day-to-day investment decisions. For a long time, fiduciary management has been the answer to this challenge, but with more and more trustees and sponsors now wanting help, the demand is increasing for solutions with greater flexibility to fit into their decision-making frameworks.

This flexibility along with the speed of implementation, will be pivotal to taking advantage of market movements. The increase in interest rate volatility, will probably mean more frequent changes in circumstances and funding level. It is now critical to ensure your portfolio can cope with movement in your liabilities, by building your framework with a partner who has a lens on assets and liabilities.

AT AON, OUR OCIO SOLUTION FOCUSES ON:

– Providing flexibility to cater for differing client needs and at different stages of their journey
– Unlocking trustee time and removing the operational headaches they face to focus more on strategic investment decisions
– Assessing assets and liabilities together and looking holistically across both to build a bespoke model for our clients.

Case study

Understanding the client need

In Q1 2015, we started working with a client in an OCIO arrangement, having worked with them previosuly on an advisory basis.

The client was keen to remove the operational burden but retain control of their strategic allocation.

Aon's Solution

The client assets are invested entirely with Aon. We work with the trustees to set their investment objective. The trustees, with support from us, then determine their target asset allocation and set interest rate and inflation hedging targets along with a target exposure for the synthetic credit mandate.

Our portfolio manager is then responsible for managing their assets to these targets, rebalancing whenever appropriate.

Measurement and impact

The client values the partnership we have with them. They maintained control over what they invest in given their strategic asset allocation, hedging and synthetic credit target exposures. But we take the operational burden away from them, allowing them the time to focus on their strategic decisions.

During the 2022 gilt market turmoil, the client did not lose hedging. This was due to the portfolio manager being able to act quickly in this period. Following this, the client was impressed we got their asset allocation quickly back in line with their target.

Why now?

There is no doubt, 2022 was a remarkable year. Schemes faced multi-year journeys (the highs and the lows) within just 12 months. The schemes that took it alone, with no operational support, found an unprecedented level of time and effort was required.

The only constant is change. Despite the uncertain future, one thing remains clear: now is the time for trustees and sponsors to review how they get from investment ideas to getting the cash in the right place and managing this through the ups and downs of financial markets.

Conclusion

In an environment of uncertainty, an OCIO can act as a strategic ally, allowing pension schemes to thrive in an ever-evolving financial environment.

The next decade is expected to be different to the last. Finding the right OCIO partner for the next stage of your journey will significantly impact your ability to keep moving forward.