



Trends in pension investment governance

Market survey exploring governance evolution

April 2024



Building a better
working world



Market update

2023 OCIO fee survey

Why is the OCIO model becoming popular with plan sponsors?

- ▶ Resources constraints
 - ▶ Fiduciary risk
 - ▶ Cost/return optimization
-

Is full delegation needed?

What does a leading practice monitoring framework look like?

What can EY US do for you?

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Introduction

The last few years have been eventful in the pension investment governance space. Pension plan sponsors have had to manage the downturn and subsequent recovery of equity markets in the first half of 2021, followed by the tight credit markets and Federal Reserve uncertainty of 2022 and 2023. During this time, investment professionals have had to stay on their toes, ready to rebalance according to their mandates as well as take advantage of market opportunities. Without prudent and reactive dynamic asset management, plan sponsors and their interest rate-sensitive portfolios could have found themselves in unfavorable positions and unable to capitalize on recovering equity markets.

As 2023 is in our rearview mirror, several trends in the pension investment governance space have become apparent, and many of these trends presented themselves in our newly launched Pension Investment Governance Survey. This is our first survey where we will bring our perspectives as a truly independent third party in the pension investment space. We believe we have uniquely positioned ourselves at the intersection of investment governance strategy and consultation, vendor selection and performance benchmarking, having made heavy investment into deep market research.

In its inaugural year, 14 pension outsourced chief investment officer (OCIO) providers participated in our survey, covering more than 1,000 clients and over \$500 billion in fully delegated OCIO assets under management (AUM) as of 31 December 2022. Continuing into 2023, we saw some impressive growth in the book of business of our respondents, notably in the addition of multiple large mandates of at least \$10b in AUM that transitioned from an in-house pension investment operating model to an outsourced one. In just the first six months of 2023, one of our respondents reported a surge in their defined benefit (DB) OCIO AUM of more than 180% due largely to the onboarding of large mandates, while several other respondents saw their own books of business expand with double-digit growth figures in the fully delegated DB OCIO space.

This is our first annual survey where we will bring our perspectives as a truly independent third party in the pension investment space.

\$563b
in AUM as of
31 December 2022

More than
1,000
plan sponsors across various industries

Through the data points shared by our respondent pool, we have compiled valuable insights that we've leveraged in this thought piece to provide insider perspectives into the pension investment market.

This article will delve into multiple areas. First, we'd like to share broad perspectives on the pension investment market and what trends are making themselves evident, in particular, in the OCIO space. Then, we dive into what current market OCIO fees are looking like, and why some plan sponsors are finding that this model is the right one for them. Next, we discuss why some plan sponsors feel the fully delegated OCIO model isn't the one for them and are yielding satisfying results from an in-house model complemented by an investment advisor. Lastly, this publication will cap off with what we believe a leading pension governance monitoring framework should look like, as well as the areas where Ernst & Young LLP (EY US) can provide value to ensure that plan fiduciaries are checking the right boxes when it comes to pension investment fiduciary responsibility.

Before delving into the core of our discussions, we would like to underscore that while certain trends have emerged regarding pension investment operating models, the decision-making process is inherently case-by-case, taking into account the unique circumstances of each plan sponsor. As a player in this space, EY US has extended its expertise in pension investment governance strategy services to plan sponsors who transitioned to an outsourced fully delegated OCIO model, as well as to clients who opted for an insourced investment governance approach, or even a hybrid model somewhere in between. There is no one-size-fits-all solution, and companies should consider their specific circumstances and weigh the costs and benefits of implementing such models.

01

Market update

Trends and growth

Looking at the last several years, the US OCIO market has continued to see strong growth in AUM and number of clients and mandates. Through survey data collected from 2017 to 2022, our respondent pool data cited cumulative growth of 39% in AUM and 23% in number of plan sponsors. In 2023, we saw a continuation of this growth in our respondent pool largely due to the onboarding of large DB mandates.

What we have learned from our discussions with plan sponsors is that they are reacting to the various challenges in the market, which in some situations has led them to consider a transformation in pension investment governance model. This has attributed to the optimistic consensus outlook that our OCIO survey pool has, with the majority of our respondents forecasting similar or more accelerated growth in the near future. OCIO providers have emphasized their understanding of opportunities associated with market volatility, complexity, lack of internal client resources and are making significant investments to support their OCIO infrastructure.

Purely looking at movement in OCIO AUM does not tell the whole story, as assets are directly exposed to market upswings and downturns, as well as pension plan de-risking. We asked our respondent pool about plan termination activity they've experienced in the last few years. What we heard from them was

Figure 1: Demonstration of growth in client count up to 31 December 2022 for our OCIO respondent pool

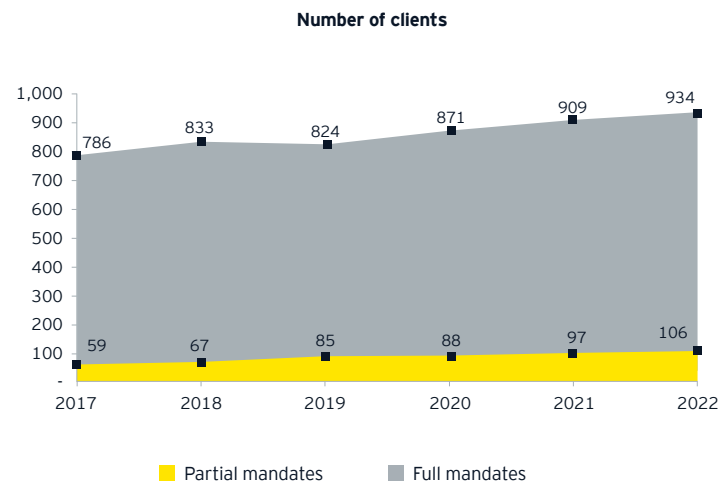
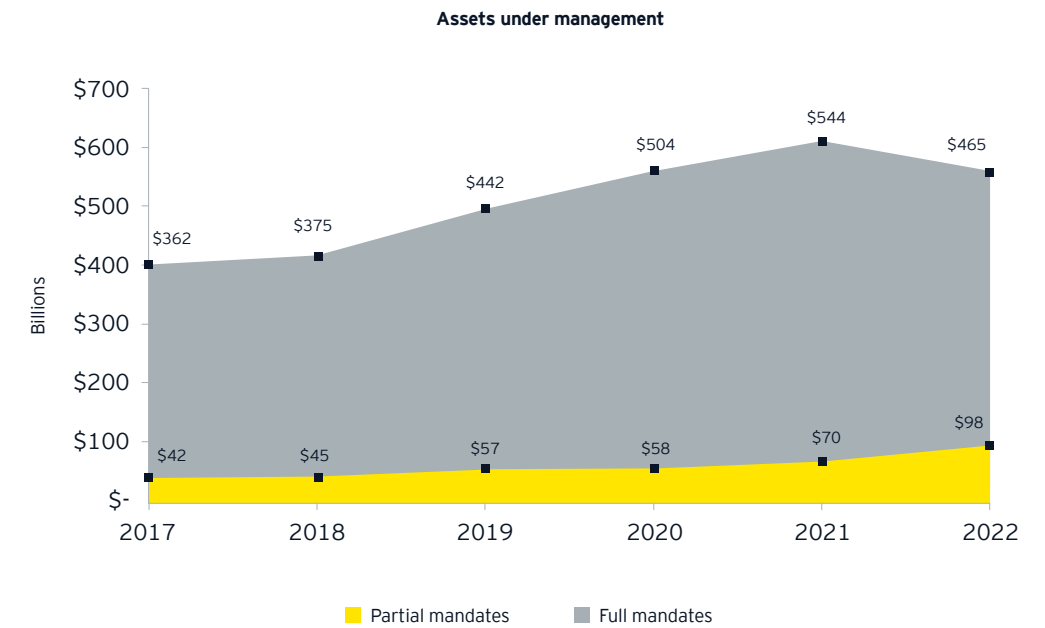


Figure 2: Demonstration of growth in AUM up to 31 December 2022 for our OCIO respondent pool



that the number of plan terminations experienced by their fully discretionary DB OCIO clients increased by 43% from 2021 to 2022, with that trend extending into 2023. As plan sponsors experienced positive pension plan funded statuses due to rising interest rates, consequently, they sought to de-risk their pension liabilities.

This leads right into the risk management conversations that OCIOs are having with new and prospective clients. Our survey respondents told us they are having meaningful conversations with plan sponsors and valid concerns are being raised regarding the difficulties in navigating the challenging risk environment and the stress it may impose on internal client resources. In addition, fee savings are a hot topic of discussion as some plan sponsors are looking to leverage OCIO providers' scale and buying power in the market, to achieve investment management fee optimization.

Another trend that OCIOs are seeing in the market is a plan sponsor shift to an outsourced pension investment model to better manage corporate balance volatility as well as fiduciary risk. For many plan sponsors, the pension plan funded status represents a sizable presence on the corporate balance sheet, thus establishing a risk framework to manage the volatility of interest rate sensitive cash flows is paramount for benefits committees to demonstrate fulfillment of fiduciary responsibilities.

Gone are the days when OCIO services were regarded as a niche asset management service. Out of our respondent pool, 50% operated in the Employee Retirement Income Security Act (ERISA)¹ 3(38) OCIO space prior to the year 2000, with that proportion going up to 86% by 2010. What we can extract from this data, as well as our consistent interactions with OCIO providers, is that the major players in this space now have well-established OCIO operations with mature books of business. Rather than their services viewed as an auxiliary part of their firm, the OCIO offerings are taking center stage in firmwide business operation outlooks.

Our respondent pool ranges from asset managers who have dedicated deep investment expertise and resources to test the OCIO market space, to HR benefits consultancies looking to provide a holistic and comprehensive service to their clients, as well as specialist firms with deep investment knowledge. Regardless of their origins, OCIO providers across the spectrum tell a similar story of growth and investment.

With clients asking us to advise on identifying the right OCIO partnership based on investment beliefs, manager research capabilities, strategic asset allocations and the like, we were interested in how new OCIO appointments were obtained and whether an independent third-party selection advisor was part of the transformation journey. From our responses we noted that in 2021, only 24% of new OCIO mandates involved a third-party selection advisor and in 2022 that number rose only slightly to approximately 34%. It is our understanding, and further supported by these statistics as well as our frequent conversations with OCIO providers, that new DB OCIO engagements largely do not involve a third-party selection advisor. What we are hearing in the market is that many of these engagements are initiated as a result of long-standing relationships with investment consultants that then evolve into an ERISA 3(38) arrangement. This evolution looks and feels natural in the corporate world since a successful track record between a firm and OCIO presents itself as a sufficient basis to convert said OCIO from investment consultant to ERISA 3(38) OCIO provider. However, we would caution plan sponsors that this conversion must be done so in a prudent manner. Is the plan sponsor fulfilling its fiduciary duties with this appointment? Has there been consideration of the wider OCIO market? Has there been sufficient benchmarking of market fees? Does the provider hold the appropriate skill set? These are all important questions the plan sponsor should be asking.

¹ ERISA provides that a plan sponsor can delegate the responsibility of selecting, monitoring and replacing of plan investments to an ERISA 3(38) investment manager fiduciary. An ERISA 3(38) investment manager is largely considered an OCIO.

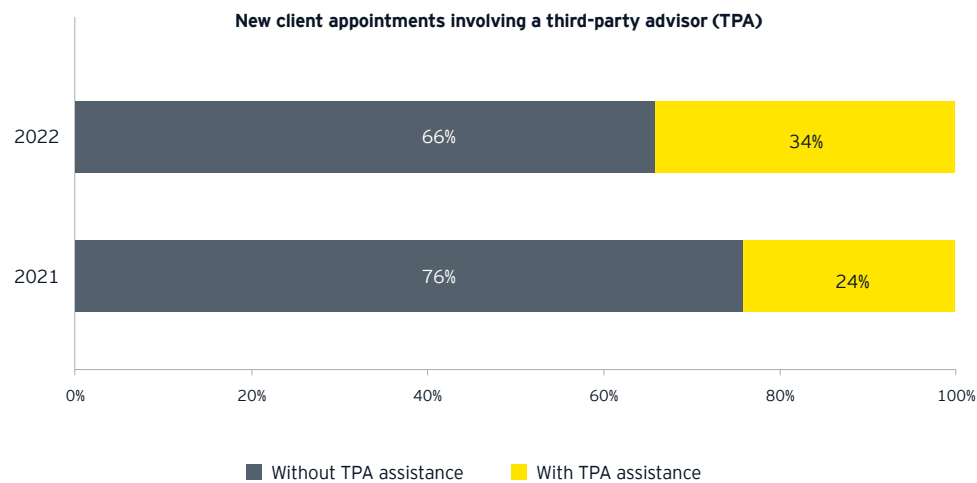


Figure 3: Graph represents new client appointments involving a third-party advisor

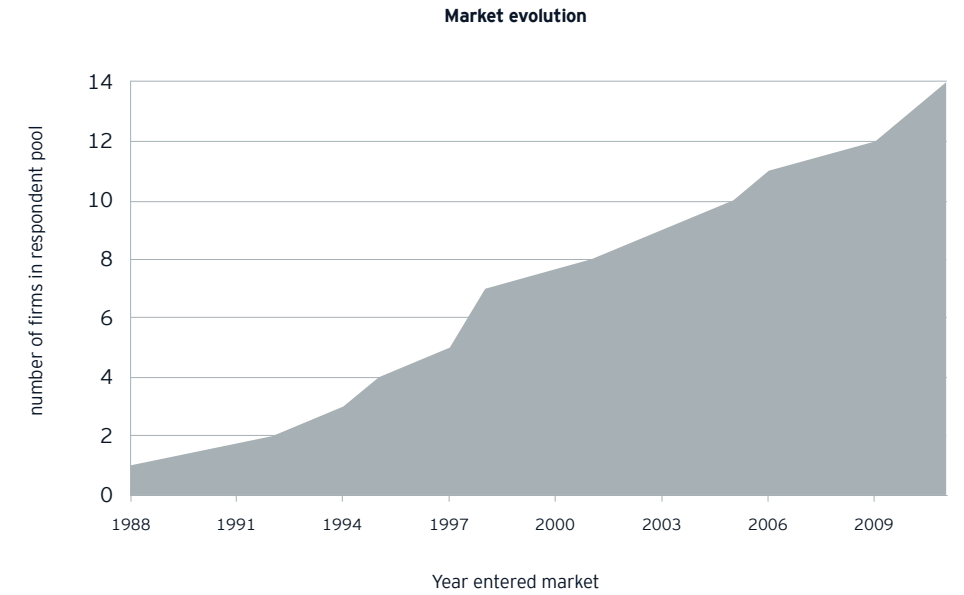


Figure 4: Cumulative demonstration of when our respondent pool moved into the OCIO business

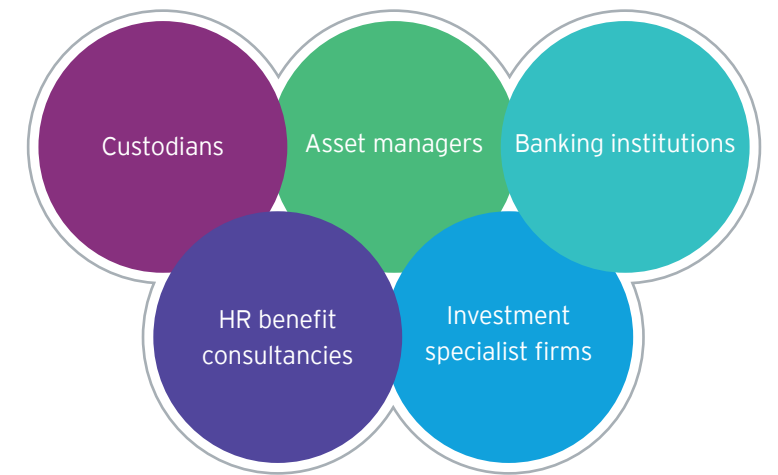


Figure 5: This graphic demonstrates some of the business models under which OCIO providers operate

02

2023 OCIO fee survey



Bringing transparency through our survey and publication allows us to educate plan sponsors on the fee structure and magnitude of such fees in the US OCIO market. Proper fiduciary responsibilities cannot be fulfilled without a thorough assessment of fees.

Introduction

Some of the key data points we sought to gather with our survey were the OCIO base and investment management fees that are involved with appointing a US OCIO provider. Bringing this transparency through our survey and publication allows us to educate plan sponsors on the fee structure and magnitude of such fees in the US OCIO market, which can help in assessing whether an OCIO arrangement provides value in line with expectations.

Our fee survey largely explores details of total investment costs, which include OCIO base fees, investment management fees, and other OCIO-related expenses that would be incurred. Before delving into our graphical representations of fee responses, we ask that you refer to the “How to read our analysis” section following the introduction for a quick demonstration on how our fee analysis is presented.

An OCIO arrangement typically covers a broad range of investment services that a pension fund needs, including advice on investment strategy, implementation of such strategy, risk management, and reporting of performance. As funding statuses for

pension plans improve, a plan sponsor may require advice on settlement solutions and other de-risking strategies. These services may be considered ad hoc and may not be included in the OCIO base fee. A consistent theme across OCIO providers is that fee arrangements between a provider and a plan sponsor can be highly bespoke, so considerations regarding plan characteristics and size should be considered when analyzing the fees presented here.

For the purpose of aligning our responses across firms, we gave the OCIO survey respondents four hypothetical pension plans of various sizes, each with three specific return targets, and left all remaining investment decisions up to the OCIOs (e.g., asset allocation and level of hedging). To allow clean discussion of fee data points, we’ve included in our passage the specific pension fund return target of 6.5%, with the two other scenarios provided in the Appendix.

Components of fees¹

The fees in an OCIO mandate can be separated into three key components.



Outsourced chief investment officer (OCIO) fees

This represents the fee paid directly to the OCIO for strategic advice (including modeling and setting the investment strategy) and implementation of the investment strategy (including manager selection, tactical asset allocation and implementing hedges).

Investment management (IM) fees

Typically, OCIOs implement the chosen investment strategy via underlying investment managers. These fees make up a large part of overall costs and are passed through to the client.

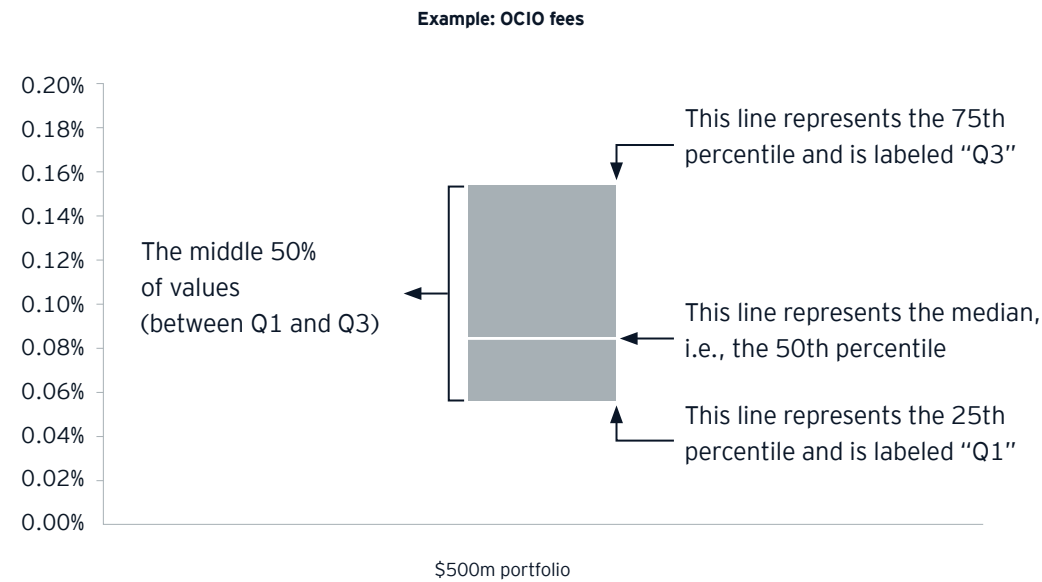
Other expenses

There can be other costs and expenses associated with an OCIO mandate, which can be presented separately from OCIO base and IM fees. Such expenses can include custody fees, fund administrative fees, pooled fund expenses, transition management costs, travel costs, educational materials, and more.

¹ For plan sponsors utilizing an investment model with an in-house investment team and external investment advisor, there may be a desire to compare current fee arrangements with our survey data. Such comparisons can be made by examining our OCIO base fee ranges on the following pages and contrasting with costs incurred by the plan sponsor with employing an in-house investment team as well as any investment advisory fees paid to a third party. These comparisons can be challenging as the total costs of employing an in-house team may be difficult to fully capture. The comparison of IM fees incurred by the plan sponsor and those presented in our survey is more straightforward as these fees are present and observable regardless of whether the sponsor utilizes an in-house or outsourced pension investment model.

How to read our analysis

We have used several box plots throughout this document to illustrate the spread of survey responses. In particular, the box plots show at a glance the inter-quartile range (the middle 50% of values) of responses. An example is below:



OCIO base fees

In the US market, OCIO base fees are typically charged as a percentage of a plan's AUM (e.g., 0.10% or equivalently 10 basis points). Some variations exist, including fixed nominal fees and indexed fees; however, the standard across the industry is a proportion of AUM quoted in basis points.



Figure 6: Range of OCIO base fees under the 6.5% target return scenario

Larger asset bases mean more buying power and economies of scale, which lead to lower OCIO base fees.

What we can observe from our OCIO base fee responses is that our median respondent quoted a base fee of around 8.6 basis points for an asset base of around \$500 million, decreasing down to a median OCIO base fee of 3.5 basis points for a mandate of \$5 billion. Typically, as the asset base associated with these services increases, the fixed basis point fee decreases. This is because the associated OCIO fee is then applied across a larger pool of assets.

Across the three different return target scenarios, we observed that most OCIO providers did not vary their base OCIO fee depending on return target, instead opting to remain consistent across the scenarios. What we did notice in OCIO proposals is a load to OCIO base fees if the mandate includes allocations to alternative assets or actively managed strategies, since the inclusion of these in a client's portfolio would mean the application of specialized knowledge and additional due diligence on the part of the OCIO. For firms that include such loads to OCIO base fees, we saw additional fees between 1 and 3 basis points.

Investment management fees

An analysis of total costs of pension management is incomplete without consideration of investment management fees. Whether a plan sponsor utilizes an in-house or outsourced pension investment model, these costs exist, they make up a large portion of total costs, and are ultimately passed through to the client.

When utilizing an outsourced model, the OCIO will implement the chosen investment strategy via underlying investment managers. OCIOs market themselves as specialists optimizing total pension investment costs by leveraging their buying power to lower investment management fees. From surveying our respondents, we noted that OCIO providers are able to negotiate a discount in IM fees around 25% to 30%, on average.

On the following page is a graph demonstrating the range of IM fees from the model portfolios proposed by our respondent pool.

From surveying our respondents, we noted that OCIO providers are able to negotiate a discount in IM fees of around 25% to 30%, on average.

OCIO investment management fees

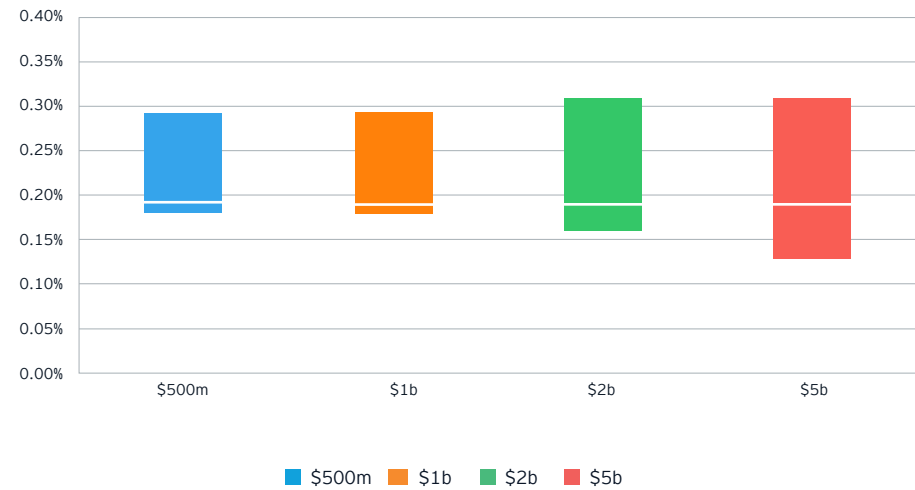


Figure 7: Range of investment management fees under the 6.5% target return scenario

What we observed from the responses is that the median IM fee from the respondents' model portfolios consistently hovered around 19 basis points for all mandate sizes; however, the interquartile range from the 25th to the 75th percentile visibly extends lower for larger mandates compared with smaller. The model portfolios from our respondent pool with a target return of 6.5% and \$5b AUM have a 25th and 75th percentile of 12.9 bps to 30.9 bps, respectively. This is in contrast to the model portfolios with the same target return but AUM of \$500m, which have a 25th percentile and 75th percentile of 18 basis points and 29.3 basis points, respectively. Based on the data, it's evident that economies of scale come into play with investment managers, and a larger mandate in terms of AUM can mean lower IM fees passed onto clients. OCIO providers consistently market themselves as parties who have the ability to negotiate lower IM fees by leveraging long track records with investment managers as well as economies of scale in the ability to pool assets.

Another observation was the impact on IM fees for portfolios with more aggressive return targets. When analyzing the IM fee responses for a portfolio with a return target of 6.5% compared with a portfolio with a return target of 7.5%, the IM fees in the 7.5% portfolio increased up to 16 basis points. This is a natural outcome considering a portfolio with a more aggressive return target can include more growth-seeking asset classes such as hedge funds, alternative credit, and private equity investments, all of which demand higher IM fees.

It's important to consider the total costs when evaluating an OCIO fee proposal. On the following page we've demonstrated what a fee proposal would look like including the OCIO base fees from the prior section, as well as investment management fees presented above.

OCIO base fees + investment management fees



Figure 8: Range of OCIO base fees plus investment management fees under the 6.5% target return scenario

When considering both OCIO base fees and IM fees, our responses ranged from a low of 11.5 bps for a straightforward, no-frills mandate invested exclusively in developed market equities and US credit, to a high of 103 bps for a dynamic portfolio with active allocations to emerging market equities, property, private equity and hedge funds.

Other expenses

Not all OCIO fee quotes are built alike. As the OCIO industry has evolved, clients have demanded more fee transparency to get a better understanding of the "all-in" cost to be able to effectively compare fee proposals from different vendors. Fee quotes from OCIO providers will typically come in the form of separate OCIO base and IM fees; however, there are other less explicit costs associated with an OCIO arrangement.

When reviewing fee quotes, plan sponsors should scrutinize whether custody fees, fund administrative fees, and pooled fund expenses are included in fee quotes. We observed a fee range from 1 to 10 basis points of AUM for these DB trust-related costs that may not be directly quoted in your OCIO quote.

In addition, fees such as transition management costs, travel costs, and educational materials are costs that many OCIOs are including in their quotes, but it's not standard practice across the industry. Fee transparency is important, and fulfillment of fiduciary responsibility should include a thorough review of proposal fees.

Fee transparency is important, and fulfillment of fiduciary responsibility should include a thorough review of proposed fees.





03

Why is the OCIO model becoming popular with plan sponsors?

Perspectives from our survey respondents:

“

We expect continued growth in the OCIO market due to market volatility and complexity, stress on internal resources, and opportunities for enhanced governance and fee savings.

“

Our OCIO business has doubled in size in the past 14 years and we expect the same trend to continue through this fiscal year as the asset management industry continues to trend toward multi-asset investing.

“

We are committed to providing a strong and robust OCIO infrastructure for our current and prospective clients. In the last five years, demand for our OCIO services has grown, and we expect the trend to continue as more clients consider an outsourced model.

With the current interest rate environment, many plan sponsors are experiencing fully or near fully funded pension plans and are reconsidering their pension investment strategy. These sponsors are at the crossroads of portfolio rebalancing, capitalizing of opportunities, de-risking, pension enhancements, and even re-risking in some situations. Many OCIO providers view themselves at the forefront of pension investment governance strategy and consider themselves a well-equipped partner that could lead plan sponsors into the journey of addressing these challenges. The consensus among our survey respondents is that their firms are committed to growing and improving their practice to transform and evolve the retirement investment governance space.

To get an idea of the specific challenges that OCIO providers are looking to address, we asked our respondents about their recent experiences with plan sponsors and what types of considerations these sponsors had when deciding to implement an OCIO model.

The three consistent themes that rose to the top were resource constraints, fiduciary risk management, and cost and return optimization. We have identified these factors as the primary catalysts for plan sponsor transitions to an OCIO model, and in the following sections, we will explore each of them in greater detail.

OCIO model implementation considerations for plan sponsors:

- ▶ Resource constraints - talent attraction and retention
- ▶ Fiduciary risk management
- ▶ Cost and return optimization
- ▶ Enhanced governance
- ▶ Timely decision-making
- ▶ Improved funded status objectives
- ▶ Broader operational reorganization
- ▶ Investment strategy shift
- ▶ Shrinking investable asset base



Can we continue to attract and retain investment skill sets in-house?

This is a question that plan sponsors are asking themselves as talent retention and attraction continues to be a challenge. We asked our survey respondents the most common reason that corporate clients were shifting to an OCIO model, and talent attraction and retention was consistently one of the main concerns. Corporate clients are acknowledging that not only can recruiting specialized investment talent be challenging, but also compensation structures for such personnel can be difficult to navigate. It's not uncommon for an investment professional to have a portion of compensation structure tied to variable pay based on investment performance and such arrangements could be difficult to manage from an HR perspective as non-investment staff would likely be compensated under a different arrangement.

Facing such challenges, some plan sponsors have found it beneficial to outsource some of their pension investment governance responsibilities to an OCIO provider, which would allow a plan sponsor to focus their efforts on general operations rather than talent and compensation matters.

In our survey, we asked our respondents for the sizes of their teams that are full-time equivalents dedicated to OCIO services. What can be demonstrated with this data presented to the right is that firms offering OCIO services can have tens to hundreds of full-time equivalents on staff ready to provide services. Plan sponsors should consider whether they'd like to maintain internal teams dedicated to pension investment functions or leverage an OCIO and their deep bench of expertise.



Median full-time associates supporting OCIO solutions



Figure 9: Demonstration of the depth of dedicated resources available to OCIO providers. The median total team size of full-time associates for our respondent pool dedicated to manager research, investment advice, implementation, portfolio construction, capital research, risk management, and dedicated ESG is upwards of 164 associates.

Fiduciary risk management - is there an investment operating model that can provide the desired level of fiduciary governance?

What we heard from our survey respondents is that the second most common catalyst driving plan sponsors to an outsourced model are the concerns and considerations of pension plan fiduciary risk. A plan sponsor has the responsibility to provide management and oversight to the pension programs, and a legal obligation exists for the sponsor to act in the best interests of all plan participants. This obligation and the fiduciary risk that accompanies it has many plan sponsors contemplating whether an outsourced pension investment resource could be valuable for the task at hand. The committees overseeing the fiduciary duties of plan sponsors are typically made up of multidisciplinary professionals; however, at times these committees are lacking in practitioners as it relates to the pension investment space. An outsourced investment specialist could enhance these fiduciary bodies by providing an additional layer of fiduciary protection for the pension plans.

In situations where a plan sponsor decides to work with an outsourced pension investment professional, this does not mean full relinquishment of responsibilities for pension plan investments. As a matter of fact, according to ERISA, a plan sponsor cannot fully relieve themselves of fiduciary responsibility; however, it is possible to delegate much of the responsibilities to an OCIO provider with the plan sponsor maintaining the responsibility of prudent selection and ongoing monitoring.

Cost and return optimization - has the context changed?

The balancing act of costs and investment returns and how such relationship can be optimized is something that plan sponsors are continuing to discuss. With the current market environment, many plan sponsors are faced with fresh objectives with improved funded statuses, which has led to de-risking strategies that include frozen liabilities or exit strategies such as lump sums and buyouts. The relinquishment of large proportions of the plan liability results in an asset base that may not be nearly the magnitude it was only a few years ago. With an improved funded status and smaller investable asset base, plan sponsors should be rethinking their investment governance model and whether it is still appropriate considering new circumstances. Is the pension plan still one that demands the same level of skilled in-house investment professionals as it did previously? Could budgets be optimized by shifting costs to an outsourced arrangement where costs are more clearly defined as trust payable? Should there be a revisiting of investment management fees? Does the firm have the buying power to do so? Can return targets still be achieved? These are questions that plan sponsors should be asking themselves.

Discretionary OCIO providers consistently market themselves as institutions that have the buying power and capability to negotiate lower investment fees on behalf of their

clients. Such negotiations have come about through long track records with specific managers, as well as economies of scale in the ability to pool assets of various clients.

If cost optimization is a goal for plan sponsors, then the area of IM fees is not an immaterial component to be overlooked.

Costs tell one side of the story, but not all. An open and accruing pension plan will still maintain an asset allocation toward return-seeking assets. Does the plan sponsor have the investment talent in-house to implement the tactical and dynamic asset allocations that are desired? To manage such strategies, dedicated and skilled resources are needed. As a result, we are hearing that plan sponsors are re-evaluating their operating model to ensure they have access to day-to-day investment professionals who can help optimize return across the portfolio by leveraging deep industry knowledge and the ability to think and act quickly when new market information arises.



04

Is full delegation needed?

ERISA 3(38) fully delegated OCIOs are not the only investment practitioners that can provide value to pension plan sponsors. As a matter of fact, a common investment governance model utilized among US-based pension plan sponsors includes an ERISA 3(21) fiduciary arrangement in addition to an in-house investment team.

We asked the major players in the pension investment governance space about their defined benefit clientele, and for those that operate as both an ERISA 3(21) and ERISA 3(38), the data shows that the fully delegated OCIO business represents about 20% of their book of business on an AUM basis, with the remaining 80% represented by the 3(21) advisory model.

ERISA defines the 3(21) advisory framework as one where the third-party investment professional provides guidance and recommendations to the plan sponsor; however, the sponsor has final authority on investment decisions to be made with the trust. This can be an open and collaborative arrangement where the 3(21) fiduciary slots in as an extension of the plan sponsor's internal investment team.

Under this arrangement, both the investment advisor and the plan trustees share the fiduciary responsibility for the investment decisions. The fine line between this arrangement and a fully delegated 3(38) OCIO lies with discretion and implementation. A plan sponsor may not want to fully hand over the reins to a 3(38) OCIO, which would include discretionary investment decision-making, and may instead opt for a 3(21) advisor that will supplement their own in-house investment team, and not act in a discretionary manner regarding investment manager selection and implementation.

Though these models have some differences, overlap exists when it comes to plan objective setting and prudent monitoring of service providers. ERISA does not allow plan sponsors to delegate these tasks away, so fulfillment of these responsibilities is essential to fiduciary oversight.

Case study 1:

EY US was recently engaged with a large US manufacturer that migrated from an ERISA 3(38) model to an ERISA 3(21) advisory model. The fact pattern that supported its decision was scale, transparency, and flexibility to explore non-traditional investment strategies. As a sponsor of a multi-billion-dollar pension, the firmwide capabilities and resources were sufficient to maintain an in-house investment team that could utilize a 3(21) advisor as an extension of the team. The firm's large pension asset base allowed the team the ability to effectively go to market to negotiate lower investment management fees. In addition, having a dedicated team on site allowed full transparency of processes and decision-making, which was an added layer of oversight that was valuable to the investment committee.

Case study 2:

EY US was recently engaged with a large corporate plan sponsor that shifted from an in-house operating model supported by an ERISA 3(21) investment advisor, to an ERISA 3(38) model. As the sponsor of multi-billion-dollar defined benefit and defined contribution plans, the company was undergoing a spin-off from its parent entity and considered it a fitting occasion to evaluate the governance of their existing model. This led to its decision to explore the market for an ERISA 3(38) OCIO, rather than build in-house investment expertise. With assistance from EY US, the firm effectively conducted a thorough selection process that involved examining OCIO solutions, corporate governance, and associated fees. Following several rounds of interviews, assessments, and documentation, the plan sponsor was able to secure OCIO partners at competitive market rates. Additionally, the company leveraged the vendors' dedicated transition management teams to guarantee a seamless transition.

05

What does a leading practice monitoring framework look like?



Under ERISA, pension plan sponsors are required to act in the best interest of plan participants and beneficiaries. As a fiduciary, one of the responsibilities of a pension plan sponsor is to monitor the performance and fees associated with their implemented investment operating model.

The expansion of the pension investment market has provided pension plan sponsors with more data points for benchmarking

purposes that were previously inaccessible. This increased availability of data allows plan sponsors, regardless of their chosen investment model, to monitor the fees and performance of their investment teams, advisors, or OCIOs not only against benchmarks and expectations but also in comparison to the broader pension investment market.

Benchmarking areas of interest

Investment performance

In-house investment team, investment advisor, or OCIO performance relative to investment objectives and benchmarks, as well as relative to other similarly situated portfolios

Value added through delegated authority

Review of the value added via the decisions made using their delegated authority (e.g., asset allocation, investment manager selection)

Risk management

Review of the diversification of the return-seeking portfolio, effectiveness of liability hedging programs and other risk management techniques

Fee competitiveness

How do fees paid compare with the wider pension investment market?

Quality of service provided

Review of the quality of advice provided and reporting capabilities compared with the wider market

An in-depth assessment of the above areas will allow a plan sponsor to review performance, costs, and governance to determine whether the current model is appropriate and effective, or whether any adjustments are necessary to achieve best-in-class performance.

With the right partner, plan sponsors can conduct thorough evaluations of their pension investment governance, putting them on the path to prudent fiduciary management of their DB plan.

Why EY US?

1 Market research and thought leadership to help improve clarity and transparency in the market

2 Regular meeting with OCIO providers, building in-depth understanding of their offering, including investment philosophy, end-game capabilities, manager selection, operational due diligence, etc.

3 Research data collected from each OCIO, allowing us to benchmark clients' performance against the wider market and offer insights

>\$35m+

In annual fees savings experienced by our global clients over the last three years

25+

Number of global clients that utilize EY ongoing OCIO monitoring services

1,600+

Hours spent on OCIO research in the last year

06

What can EY US do for you?



There is no one-size-fits-all investment operating model. In an increasingly complex investment environment, a growing number of plan sponsors are looking to assess and improve their investment governance strategy.

EY US has significant experience in providing objective investment governance assessments for pension trusts, endowments and sponsoring companies. We have experience in recommending solutions at different points of the journey, for trusts with assets ranging from less than \$10m to over \$40b.

Governance review and strategic advisor

While we are seeing an increase in sponsors giving consideration to a full or partial OCIO relationship, given an expansion of providers, the OCIO model may not be the best fit for many programs. We have worked with our clients to evaluate the “best fit” given their unique facts and circumstances, pension program objectives and overall business strategy.

Has there been an assessment of team member roles and responsibilities? We help clients assess the responsibilities assigned to each position, and comment on opportunities for driving efficiency and improving risk management.

Are objectives aligned across C-suite, pension members, investment committee and team? We can help clients identify any disconnects and develop a solution for full buy-in across stakeholders.

Has there been an assessment of team structure given investment objectives? We help clients identify weaknesses in their operating model and where additional resources could be dedicated to support fulfillment of objectives.

With a thorough governance review, EY US can help identify strengths and weaknesses of current arrangements and any gaps where improvements and efficiencies can be made.

Vendor selection

Has the plan sponsor determined that an ERISA 3(21) investment advisor or ERISA 3(38) OCIO is right for them? EY US can help facilitate an efficient and comprehensive vendor search.

Working with a third-party selection advisor allows a plan sponsor to leverage deep investment and actuarial skill sets to complete a thorough vendor search that goes beyond a procurement exercise. EY US is in the pension investment market every day, having spent thousands of hours on investment governance research to ensure the right perspectives and insights are being delivered to our clients. We market ourselves on being able to provide comprehensive vendor searches that can be documented by investment committees with full confidence that the selection process has been conducted in a prudent manner.

When assisting our clients with ERISA 3(21) or 3(38) RFPs, we are helping them understand how vendor investment philosophies differ, summarizing the strengths and weaknesses of proposed solutions, assessing investment manager diversification, and more. A solid understanding of these items can be an important step in prudent fiduciary management, and EY US has a proven track record of providing such insights to our clients.

Investment performance and fee assessment

How confident are plan sponsors that their current operating model is performing as expected? Do these assessments go beyond measurement of investment performance versus benchmark? Plan sponsors should revisit performance analysis and whether a true assessment of investment services is being performed.

It can be highly beneficial for plan sponsors to have an independent third party with deep knowledge of leading-edge market capabilities and a robust data set to assist in performing these assessments. Establishing a monitoring framework helps drive accountability and capitalize on opportunities to negotiate more competitive fees with service providers.

EY US gathers quarterly performance and fee information from the major OCIO providers in the US and can perform a robust monitoring exercise that includes an assessment of investment performance and fees compared with the wider market and similarly situated portfolios.

With deep industry knowledge across pensions and investments, EY US strives to provide clients with truly comprehensive services that facilitate prudent processes and robust risk management.

07

Appendix

Fee survey methodology

OCIO providers typically cover the full range of investment services that a pension fund needs. This includes provision of advice on the investment strategy, implementation of the investment strategy and reporting of performance. As pension plan funding levels improve and they get closer to their end-game, the nature of OCIO offerings are expanding to cover advice on settlement solutions, and managing run-off portfolios. The fee arrangement that each pension fund has with its OCIO, therefore, needs to take account of the plan sponsors specific requirements including any constraints on the portfolio.

There is a lot of variety across different OCIO offerings in terms of services provided, the underlying investment beliefs and philosophies, and the portfolio construction process, to name a few. To create some comparisons, for the purpose of our survey we gave the OCIO providers a scenario for four hypothetical pension plans with specific return targets, and left all remaining decisions (e.g., level of hedging and asset allocation) up to the OCIOs.

Participants

The survey results presented are based on the responses we received from 14 of the more established OCIO providers operating in the US market, with data as of 31 December 2022.

Hypothetical portfolios

There are a number of providers of OCIO services whose solutions can also differ depending on pension plan size and objectives. To obtain comparable results across the providers, and for consistency going forward with future surveys, we based our requested scenarios on the following hypothetical DB pension funds:

Hypothetical DB portfolios (AUM):



In all cases, the plan sponsors require the OCIO to manage 100% of their assets and the full range of advisory, implementation and communication services as part of their service offering.

We requested hypothetical pension fund portfolios with the following return targets to measure fees with consideration of portfolios with higher allocations to return-seeking asset classes:



Hypothetical 5.5% target return portfolio fees

OCIO base fees

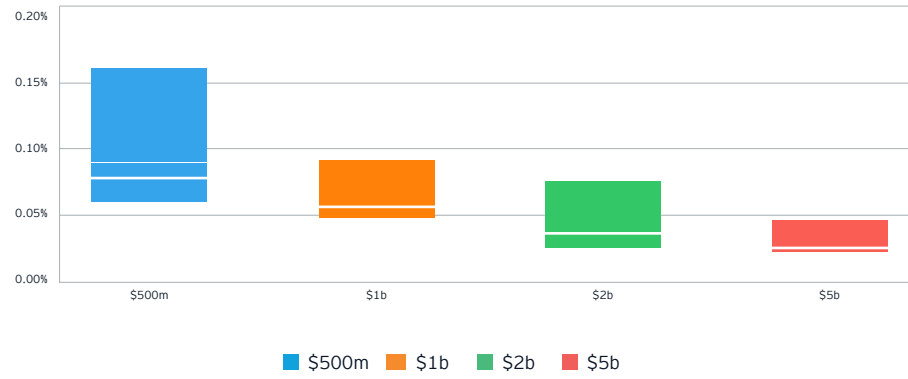


Figure 10: Range of OCIO fees under the 5.5% target return scenario

OCIO investment management fees

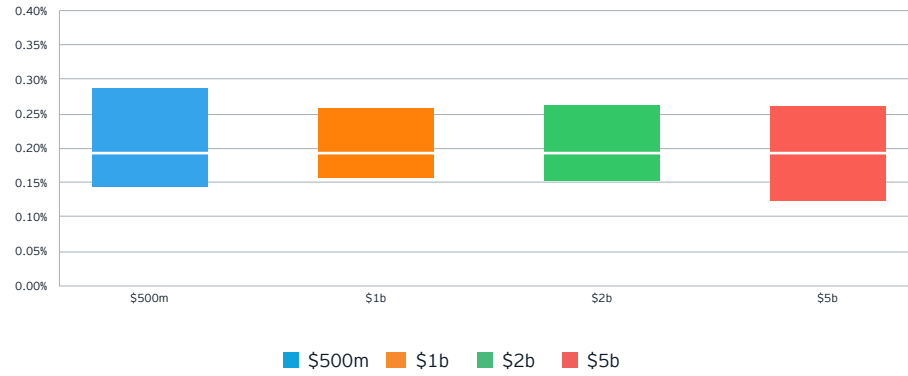


Figure 11: Range of investment management fees under the 5.5% target return scenario

OCIO base fees + investment management fees

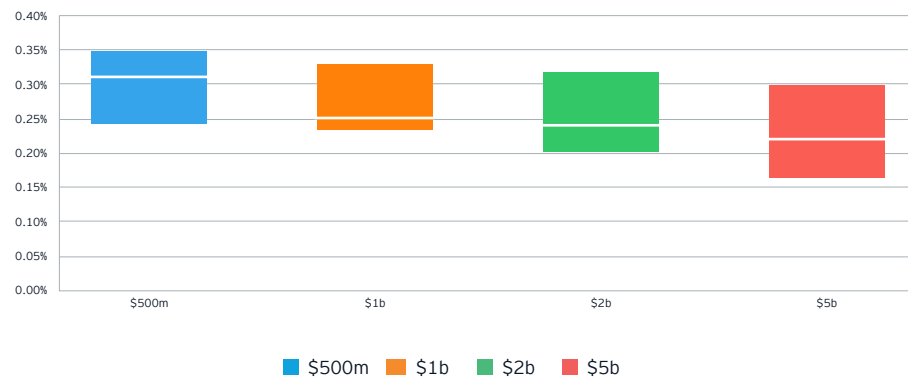


Figure 12: Range of OCIO base fees plus investment management fees under the 5.5% return scenario

Hypothetical 7.5% target return portfolio fees

OCIO base fees

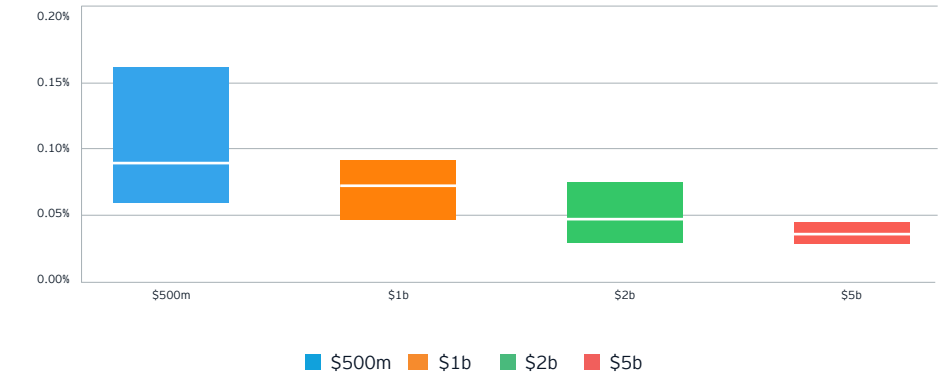


Figure 13: Range of OCIO fees under the 7.5% target return scenario

OCIO investment management fees

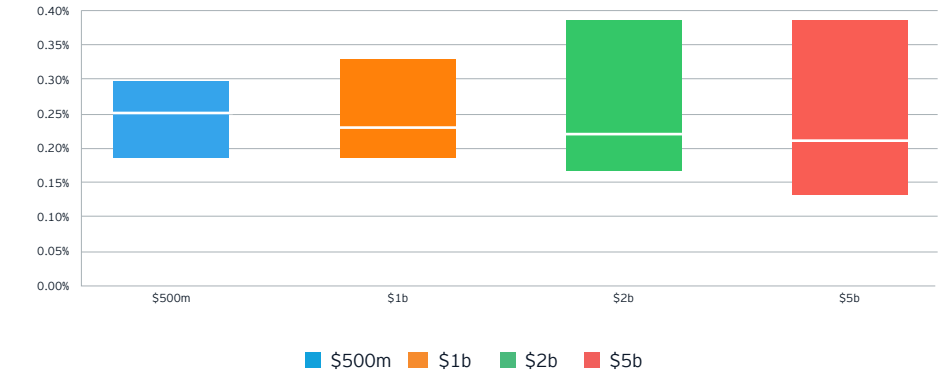


Figure 14: Range of investment management fees under the 7.5% target return scenario

OCIO base fees + investment management fees

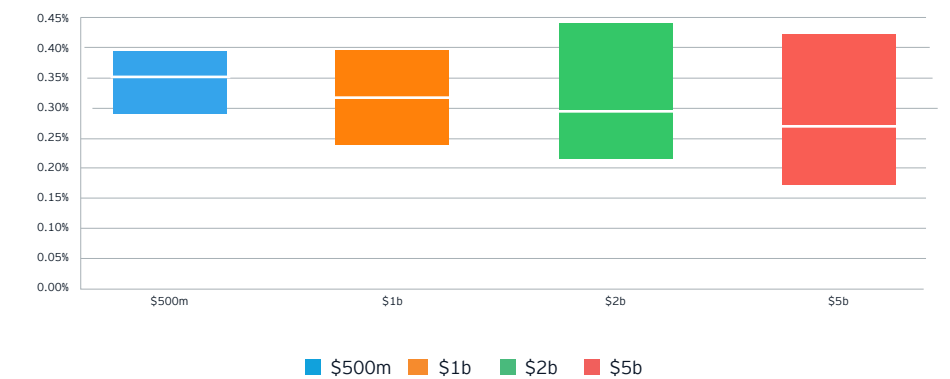


Figure 15: Range of OCIO base fees plus investment management fees under the 7.5% return scenario

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