Achieving Better Investment Performance: Time to Delegate?

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The predominant focus in the pensions industry has been on defined benefit (DB) pensions, with defined contribution (DC) often being neglected. However, the same challenges that were seen in DB ten years ago - from the 'equity only' days through to diversified growth funds (DGFs) and more recently fiduciary management - are now being seen in the DC pension space. So now is the time to act.

UK DC pension schemes face an ongoing balancing act between competing priorities. Since the introduction of auto-enrolment in the UK six years ago, employers now need more support than ever. The continued changes in pension legislations place an increased administrative burden on employers. Alongside this, an increasing number of employees need support with their retirement decisions. Additionally, DC pension trustees are faced with growing pressure from regulators with a drive to improve scheme governance and deliver better member outcomes and value.

Trustees' time is a scarce resource that could be better focused on setting scheme strategy and driving member engagement, rather than making investment implementation decisions. In light of these challenges, delegating day-to-day investment management decisions of running a DC pension scheme to a dedicated investment manager is an attractive prospect.

In this paper, we discuss the challenges that are impacting the DC investment market and what it means for schemes. How can trustees address these investment challenges and what does a solution look like?

Investment challenges in the DC market

Product innovation	DC governance	Lower expected investment returns	Transparency and costs	Longevity
Alternative asset classes introduced within DC default strategies such as property, smart beta, active fixed income, illiquid and alternative assets, as well as environmental, social and governance (ESG) factors	Continues to evolve as the challenges for trustees are ever-changing, with ongoing new regulation and uncertain markets	With continued market uncertainty and low interest rates, future investment returns are likely to be lower	Controlling the cost of running a pension scheme remains key	As life expectancy increases, retiree income needs to last longer. People may need to work longer or during retirement
At-retirement products remain in the spotlight, particularly as more retirees take advantage of pension freedoms		Investment strategies will need to evolve and find new opportunities to deliver long-term growth to members	Full disclosure on all scheme costs is being demanded to ensure transparency for trustees and members	The concept of retirement is changing or becoming phased; retirement solutions need to become more flexible, as working lives will typically be longer

What does this mean for DC schemes

As we have discussed there are many challenges facing DC pension schemes today. But, what does this mean for the investment aspects within DC pension schemes, specifically the default strategy, governance and costs?

Default Strategy	Governance	Costs
Keeping the default 'state of the art'	Trustees face increasing risk and pressure	Platform and per member charges
Ensuring the fund continues to evolve as members go beyond retirement age	Increasing burden to efficiently manage investment changes, default structure and provide ongoing oversight	Delivering value for members by understanding costs and how they compare to other options available in the market
More fund options being available	Significant and continuing regulatory change	Charge cap compliant pricing for default strategies
Alternative saving options needed for high earners over tax allowances	Time and resource required to implement investment changes	Consulting costs

New investment horizons

In the new world of political uncertainty and challenging markets, DC schemes have started to explore different asset classes in a bid to enhance returns, diversify their portfolios and guard against volatility. A shift away from the more traditional passive investing approach is starting to be seen to improve members' risk-adjusted returns. This has translated into greater consideration for low cost alternative equity strategies or smart beta options, low-cost dynamic DGFs, active fixed income and demand for more illiquid and alternative assets, as well as an increasing focus on ESG factors.

New approaches can mean more opportunities to better align the investment strategy with the risk and return expectations of members. Having flexibility within the investment strategy design also allows new asset classes or investment approaches to be considered for inclusion, where it makes sense to further diversify the asset mix.

Being well-informed of these new investment approaches and being able to implement investment ideas quickly is crucial to improving returns and the sustainability of the default fund over the long term. To do this effectively trustees need to keep abreast of changes in financial markets, investment trends, regulation and member needs. However, with limited time and resource this can be a difficult task.

Addressing the challenges

Trustees can use their time to research new investment ideas for their portfolios. But why waste valuable time, resources and budget when you can get someone else to do it for you? One option is to delegate the investment strategy and implementation to a third party or fiduciary provider.

In DC you can delegate all or part of your scheme's DC investment strategy including both the default strategy and wider range of self-select options. This approach can be used to and through retirement providing a consistent framework. Under a delegated approach the default strategy is continually updated with the latest ideas for DC investing at each stage of a member's savings journey.

Areas that can be delegated

Investment strategy	Investment implementation
Glide path design	Manager selection and replacement
Strategic asset allocation	Ongoing manager monitoring
Portfolio construction	Dynamic asset allocation
Range of available funds	Risk management
Choice of platform	Performance monitoring
	Oversight of platform
	Fee negotiation
	Implementation of changes

A delegated investment approach provides schemes of all shapes and sizes with professional portfolio construction and execution improving a scheme's ability to improve returns, while freeing up time for strategic decision making and oversight.

Key reasons schemes adopt a delegated approach	
1	Improves timeliness in implementing investment strategy changes
2	Provides resources to deal with the increasing complexity of investment strategies
3	Gives a higher level of diversification both at the asset class and manager level
4	Automatically delivers asset mix changes needed to reflect medium-term opportunities in the markets, new investment ideas and regulatory developments
5	Outsources manager selection and implementation changes
6	Transparent pricing and cost savings

A delegated approach, also known as fiduciary management, can help schemes to meet their objectives by supporting efficient investment decisions and delivering timely implementation techniques. This approach also enables schemes to be better positioned for shifts in the markets and agile in responding to regulatory change.

Evolving your DC scheme

There are a range of delegated solutions available for DC schemes with different levels of delegation. While many delegated solutions focus solely on the default option, approaches are now available for self-select funds, often an area where the challenges around keeping the options up to date are overlooked. Below we highlight some investment areas that can be delegated:

- **Strategy or glide path design**

  Historically, most trustees have maintained responsibility for the design of the glide path or asset allocation underlying the default option. Solutions such as target date funds or providers of 'off the shelf' lifestyle strategies can manage this aspect for trustees.

  Some providers offer a pre-selected range of alternative fund choices or self-select options; effectively allowing trustees to delegate the choice of a wider fund range.

- **Portfolio construction and implementation**

  The choice of the underlying asset classes and investment managers/funds can be delegated, with the fiduciary manager responsible for making changes over time. Traditionally this has only been available for the default strategy but solutions for the self-select funds are now available.

- **Oversight**

  Oversight of the performance, underlying managers and the platform used are all aspects that can be delegated.

An important first step in evolving your scheme is for trustees to consider which of these areas they are comfortable delegating and the level of ongoing involvement they would prefer.

Maximising time for better outcomes

Scheme sponsors and trustees continue to face uncertainty in the markets, evolving government regulation and changing member needs - which result in significant challenges in managing the investments in their pension schemes. This means less time and resources are available to ensure that risk is managed efficiently and member outcomes are maximised.

A delegated solution provides professionally managed DC specific portfolios and effective execution, enabling pension schemes to employ investment strategies that are more appropriate for today's evolving pension landscape.

The delegation of investment decision-making has the potential to significantly increase the effectiveness of your DC investment strategy. Regardless of the shape and size of your DC pension scheme outsourcing investment decisions is well worth considering.

Contact us

Contact our dedicated DC Solutions team to discuss the ways we can add value to your DC pension scheme and its members.

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Working in partnership with our clients

At Aon we believe in working closely with our clients from the very outset to understand the challenges they face and their individual needs. Working in partnership with the sponsors and trustees, we create solutions to help address these issues and help them to meet their long term goals.

To talk to us about any of the points we have raised in this paper or to find out more information about our delegated offering, please do not hesitate to contact your Aon Consultant or Sion Cole, Senior Partner and Head of European Distribution, Delegated Consulting Services, on **+44 (0)20 7086 9432** or at **sion.cole.2@aon.com**

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