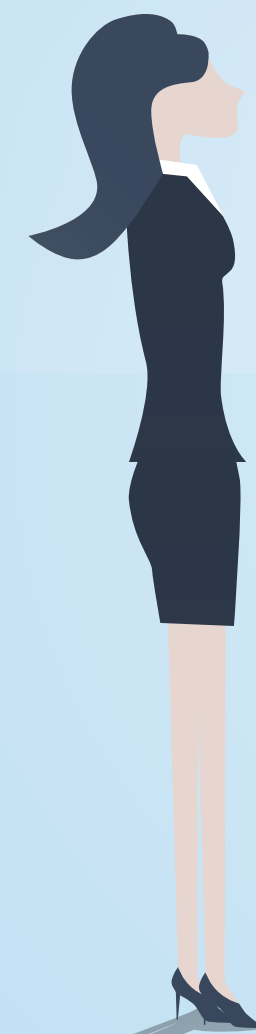


Can OCIO be the answer for your pension scheme?



Recent years have seen significant growth in the OCIO, or “Outsourced Chief Investment Officer” market for pension schemes. Sion Cole, Head of UK OCIO Business, BlackRock, discusses this sector market growth, along with common misconceptions. He also highlights the relevance of OCIO managers as more schemes move to buy-out and his predictions for the future of the market.

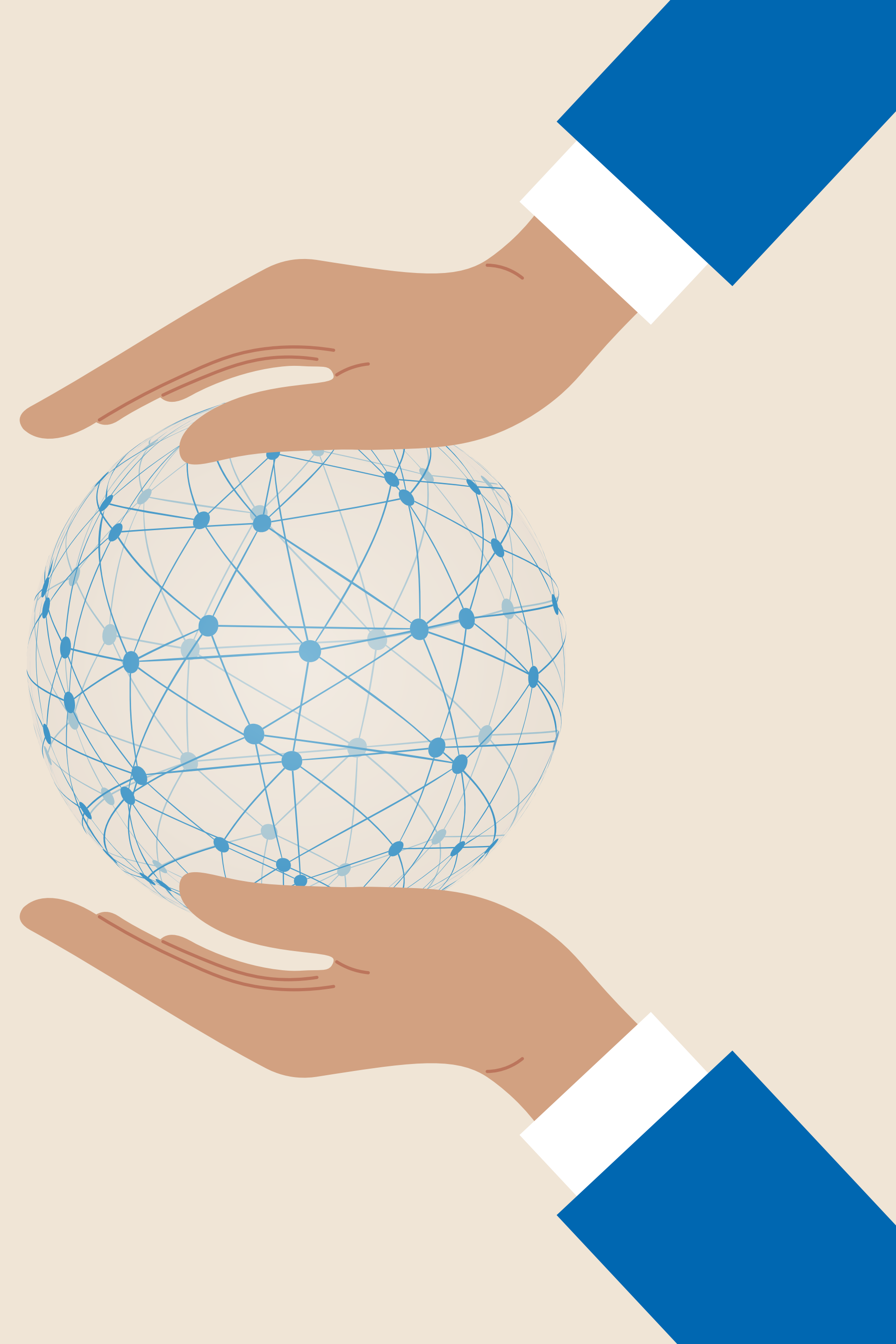
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What are the benefits of OCIO for a pension scheme?

We see many benefits of OCIO for pension schemes, their trustees, sponsors, and members.

The first is increased efficiency. We have seen the investment and regulatory landscape constantly changing, creating more work for trustees. Using an OCIO provider considerably reduces this governance burden for trustees and the sponsor. When schemes choose to have everything under one roof, investment decisions become more efficient. We can make real-time decisions, not restricted by trustee meeting cycles. For example, we were able to act swiftly on behalf of our OCIO clients during market volatility in 2022. We act on behalf of the trustees, so they don't need to sign off on day-to-day asset allocation or manager changes.



The second benefit is cost savings. When we look at the portfolio as a whole, as opposed to each asset class in isolation, costs can be significantly reduced. OCIO clients benefit from investment managers' economies of scale through the use of in-house funds and also through using scale to negotiate fees with third party managers. For members, every pound saved is another pound secured for their future. At BlackRock, we use passive and factor-based strategies to achieve cost efficiencies, only using active strategies where we believe paying for them truly makes sense. Otherwise, we use passive and factor-based strategies to achieve cost efficiencies.

Creating customised solutions is another advantage of OCIO. Portfolios are considered in their entirety, with the possibility of incorporating both the sponsor and the scheme's beliefs and preferences. An example of this is the solution we created for our UK OCIO clients to help them access illiquid assets in an efficient, cost-effective way. Illiquids can be valuable for diversification and enhanced returns through the liquidity premium. We worked with experts across BlackRock to design a multi-asset illiquid fund, specifically for our UK OCIO clients, with a focus on providing direct access and cutting out fee layering. It was a low cost and easy way to access private markets. Importantly our clients only invest in this if it is in line with their overall funding objectives and time frames to buy-out.

Finally, if we look at funding level performance, we focus on protecting the funding level volatility in all market environments and seek to act quickly to smooth funding level performance. Again, this means reducing the likelihood of the schemes calling on the sponsor. An OCIO arrangement allows trustees to have a holistic view over the portfolio – sight of risk and control in setting a bespoke governance structure, with the level of delegation and discretion set out clearly in legal documentation. Trustees remain responsible for the high-level decisions, maintaining efficient and clear control of the schemes, whilst delegating day-to-day implementation.

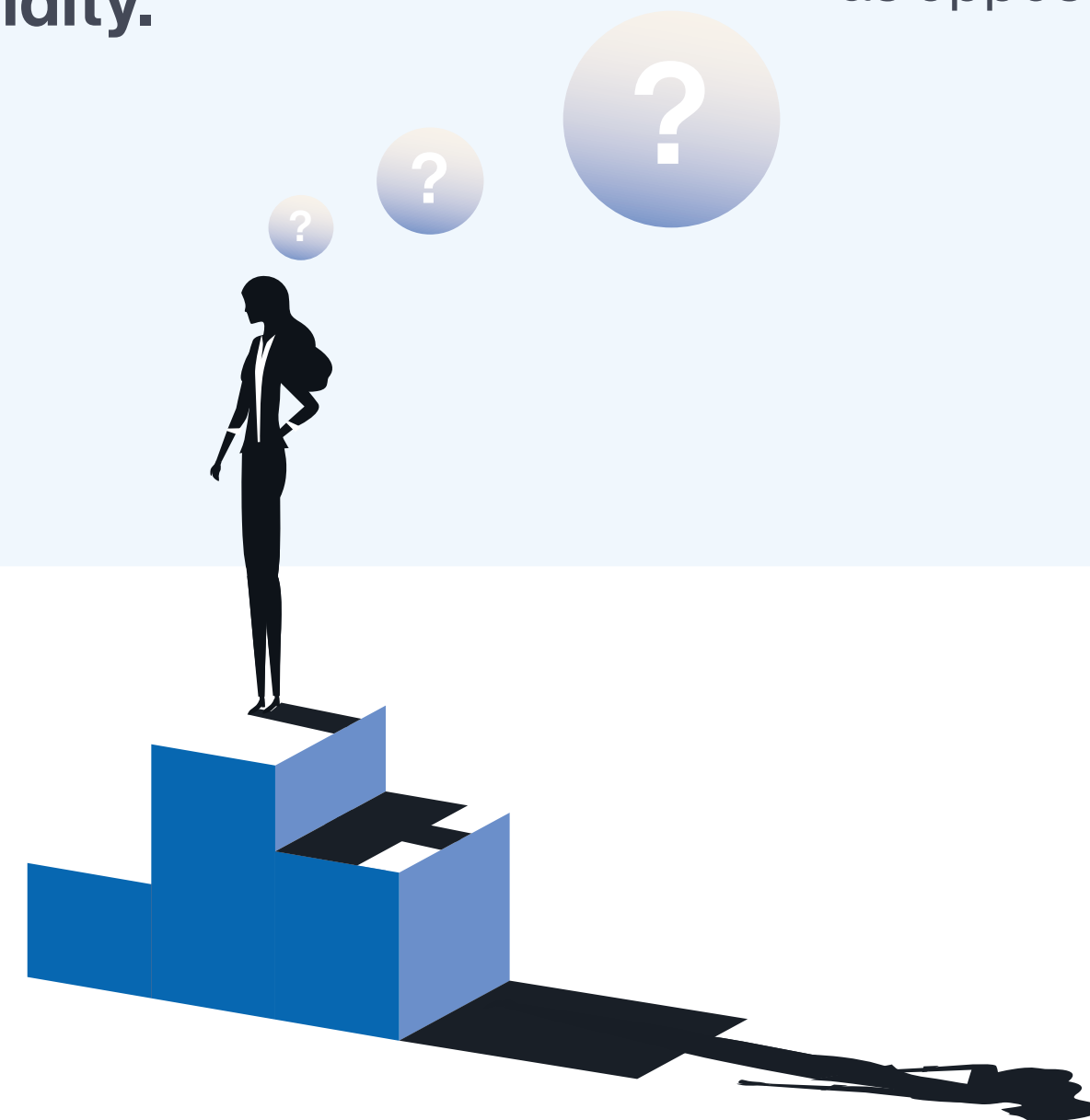


Q: What are the key learnings for OCIO over 2022?

The past year has clearly shown the operational benefits of OCIO arrangements, and the benefits of investment experts making decisions on behalf of clients during volatile environments. Because schemes have outsourced their portfolios to us, they have delegated the authority to make investment changes without seeking permission, within our guidelines. In periods of volatility last year, this was incredibly valuable to our OCIO clients. Holistic oversight of the portfolio allowed us to make proactive decisions on which growth assets to sell and accurately tier assets based on liquidity.

During market turmoil last year our OCIO clients knew exactly who was making the decisions on each aspect of their portfolio. They have one dedicated relationship manager, so they know who to contact with any questions. When it came to their trustee meetings, they were able to explain who was accountable for investment performance.

Consistency of reporting also helped our OCIO clients during this period. We deliver quarterly reports on their whole portfolio and report performance for each asset class in one document. This consistent information means trustees can easily compare and track performance across asset classes, as opposed to receiving multiple data points from each individual manager.



Q: What are the common misconceptions of OCIO?

Firstly, the blurring of roles and responsibilities between trustees and the OCIO provider, with the former taking a back seat. In my experience, trustees don't take a back seat with OCIO, they just have more time to focus on the big picture – so we are still in regular conversation and communication with our clients, but about the big picture issues, and trustees are very active in these conversations.

Secondly, some may think it takes a lot of work to get an OCIO provider on board. When you appoint an OCIO provider, you do so with a long-time horizon in mind. It is a big decision, and it is a partnership. What I will say though, is that the market has matured and where OCIO may have had the reputation for being onerous at onboarding in the past, clearly with more and more experience we've seen a real simplification in that onboarding. At BlackRock we have an experienced transitions team and have an appointed project manager to handle the process, so that burden doesn't fall on the trustees.



Thirdly, higher fees and whether these are justified. It's very important to state this – it isn't always higher fees. Like for like, fees can be a lot lower. OCIO cuts out layers and inefficiencies. The Competitive Markets Authority (CMA) orders in 2019 focused on value for money rather than low charges. It is an important distinction. Very low charges and poor outcomes is clearly not the right route for pension schemes, so a focus on value for money is important. However, what is great for trustees in the OCIO market is that after we saw the enforced CMA retendering, this really helped to drive competition in the market and has led to lower charges. What is interesting is that in many cases, OCIO arrangements are lower cost than the traditional setup and is often more transparent, as there is greater regulation around disclosure of cost.

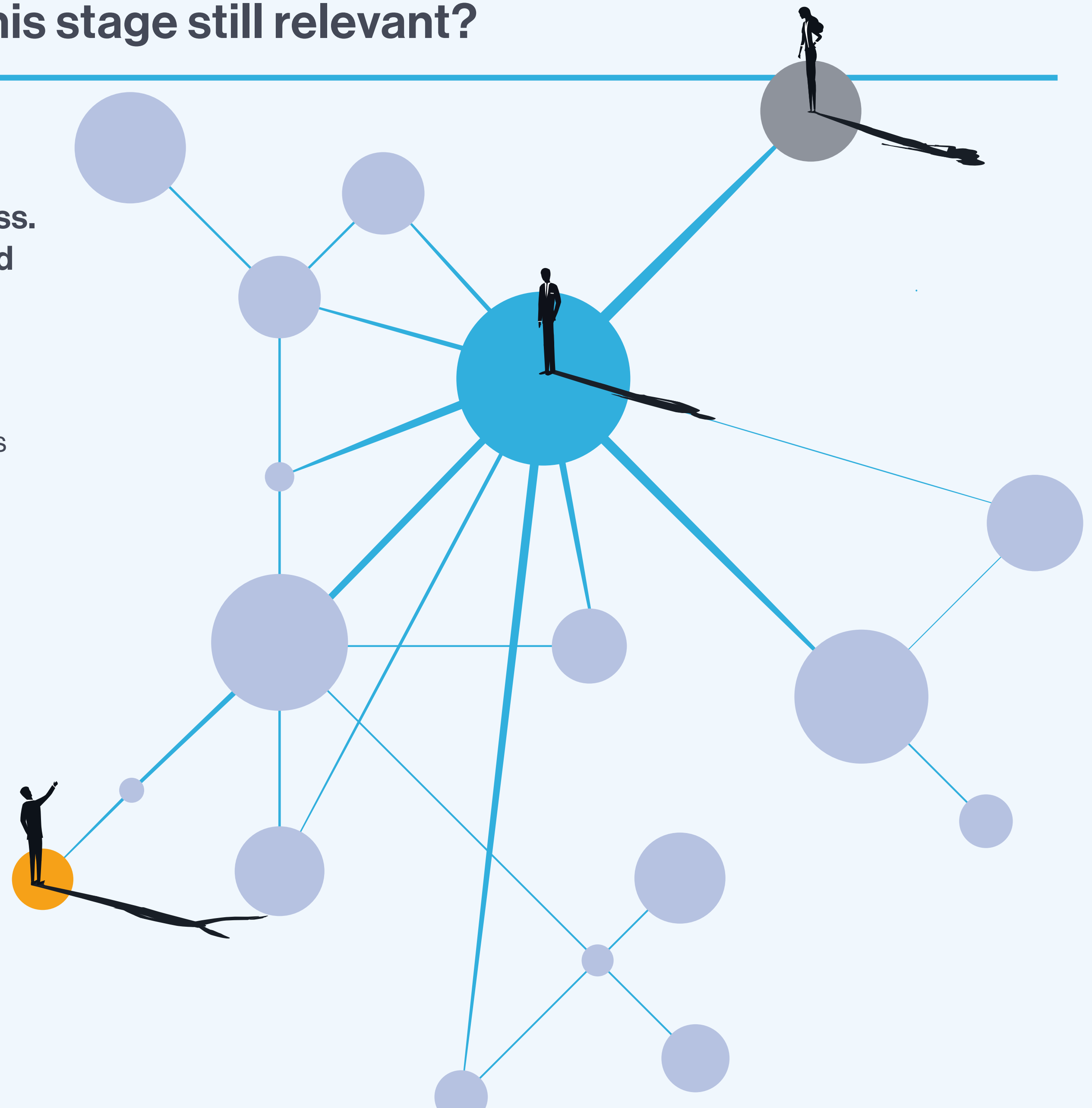
Another misconception is lack of oversight. This has increased over the years and we think the trend will continue. It is also something we encourage. We think trustees should be able to independently evaluate us so that they can identify where we are doing well, and also so that we can keep evolving as a business. There are now many firms with a lot of experience and knowledge of the OCIO market. Some ask, "how easy is it to challenge your OCIO in real detail?" Actually, in some ways, it is easier to challenge your OCIO than your investment consultant. There is full accountability – our clients set us a very clear target and we either deliver that or we don't. There's nowhere to hide. We aim to report in a way that is clear enough to allow trustees to ask the right questions and challenge us.



Q: Let's look at the buy-out process. As more and more schemes get closer to buy-out, is the role of an OCIO provider at this stage still relevant?

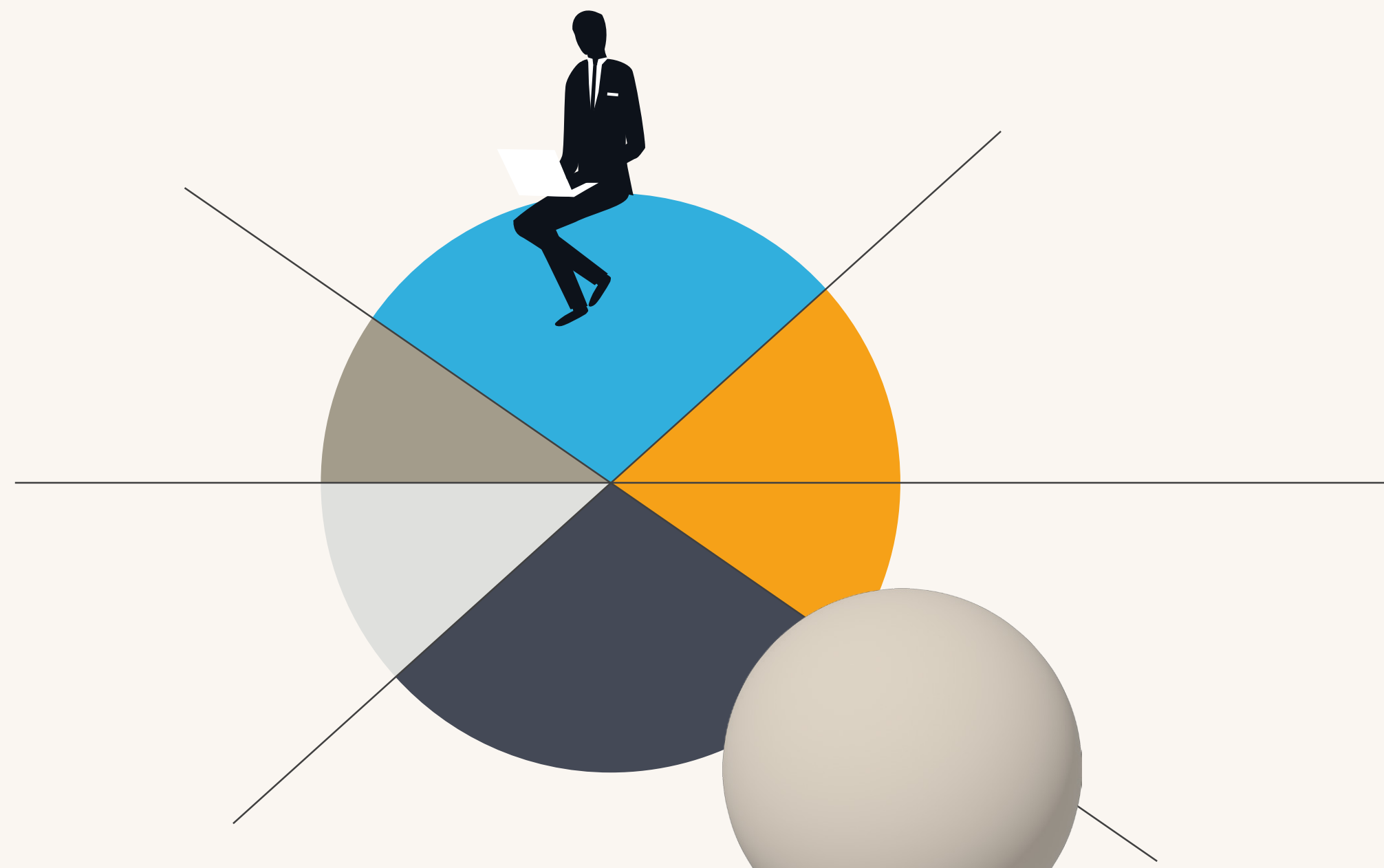
The reason an OCIO framework works in the run up to, and during, a buy-out is because it is such a time and resource intensive process. You need to move quickly, there are lots of assets moving, you need to be joined up and coordinated, and there are huge benefits to having your assets on a single platform.

It ultimately reduces the stress and burden on trustees in what is an intensive time for a pension scheme. The final year, the final months, of a pension schemes life before it gets to buy-out are very important. You can't afford to get it wrong. You have to be able to move quickly to be in a position to take opportunities, but then on the flipside if you aren't in a position to move quickly and miss it, the regret risk can be very high.



Q: A core part of being “buy-out ready” is admin and data. Can OCIO help here?

Yes. Hugely. OCIO is a real advantage to our clients here. BlackRock will work with actuaries to recut client liabilities and load new data. We can then swiftly ensure changes are captured, meaning the latest strategic positions are reflected across assets and liabilities. To do this we work closely with actuaries. We can provide cash flows in the format that they need and can convert cashflows into the right format. Importantly, this is all included within the BlackRock OCIO management fee, keeping things simple and compressing costs.



Q: What is the future for OCIO?

I am expecting this area to continue to grow. I believe there are clear benefits of OCIO for pension schemes, large and small, and as more schemes see these benefits in practice, we think they will consider this type of arrangement. We've considered this and so we're continually expanding our capacity in this space. Our OCIO business is a strategic priority for BlackRock and over the past two years, our UK OCIO team has expanded by over 25% and we have experience across the whole spectrum of client sizes. I think OCIO is a great model for all scheme sizes. It saves costs, increases efficiency, and ultimately may help trustees and members reach their objectives with more stability. As time goes on, we may see more DB schemes move towards buy-out. We're excited about this for our clients. For us, it's the sign of a 'job well done'. We proudly took two clients to buy-out in 2022 and we're continuously building out our buy-out capabilities to support this trend.

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