Outsourced CIO

STATE STREET GLOBAL ADVISORS

Improving Investment Outcomes through Outsourcing
One Size Doesn't Fit All

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As Cerulli Associates note in their 2018 report[1], the investment landscape remains volatile and unpredictable with continued expectations for a low-return environment. Institutions across the pension and nonprofit spectrum face numerous challenges including stretched budgets, regulatory and accounting rule changes, fee pressures and litigation.

Against this backdrop, the role of the plan sponsor has become increasingly challenging. For plans where staff is limited or those with cost pressures that restrict acquiring adequate monitoring systems, the pressures of increased regulatory, market volatility and extensive oversight responsibilities, the challenges can be compounded. I asked Carrie Peluso, who leads our client engagement team, to take me through how outsourcing can help with these challenges.

NATASHA - Carrie, you worked at a Fortune 10 pension plan prior to joining State Street. Are there things you've learned about outsourcing that could have been applied in your prior role?

CARRIE – Despite having had a relatively large and experienced pension team, I do think there are several elements of outsourcing that might have been useful. In my former role, proposed de-risks had to be taken to two separate boards with formal presentations prior to implementing. This could take time while markets were moving which put the funded status gains at risk. In addition, board members can often be hesitant to go against market trends. It can be difficult to approve reducing equities as the market is rising or add to bonds as rates are rising. Outsourcing the de-risking process allows the plan sponsor to approve the design of the de-risk implementation plan while handing off the execution to be done efficiently and objectively. This helps manage 'regret risk' and operational efficiency at the same time.

Another aspect that comes to mind is oversight of our non-US plans, which was a major pain point. The regulatory and funding requirements, governance structures and even market instruments were often vastly different. As we've staffed State Street's OCIO team, we've kept this in mind. We've hired a diverse team which includes former plan sponsors from several non-US countries. It would have been invaluable to have tapped their expertise as we sought to improve oversight.

[1] The Cerulli Report - U.S. Outsourced CIO Function 2018

NATASHA – We have some clients that have reached out to us to help with sleeves of their portfolio. How does that typically work?

CARRIE – Sometimes clients aren't ready to fully outsource but using State Street as a partner for management of asset class sleeves can make sense. Often there is a lack of resources or expertise in a particular asset class. We've seen this done across multiple asset classes. We recently met with a prospect that had limited staff and some concerns with their equity portfolio. We offered to analyze their portfolio and come back with observations and recommendations. The proposed portfolio had improved active risk, reduced overall fees and simplified the structure. In LDI, we work with clients to determine their objectives and constraints and then develop a hedging liability program which includes a detailed glidepath design. Our manager research team then constructs the portfolio using our open architecture manager platform, often saving the client fees due to our scale. Private Markets is another area in which outsourcing can be particularly beneficial. To invest in these asset classes successfully, it takes extensive resources, experience and solid relationships with partners. Unlike the public markets where people can generally be backfilled, staff turnover or inexperience can be particularly disruptive. It's an illiquid and expensive asset class so it's particularly important that the performance compensates. Outsourcing to a large dedicated team to manage all aspects of investing, administrating and reporting is a sensible solution for such a resource intensive asset class.

The added benefit for using us even for a part of the portfolio is gaining the extension of staff. Once we're working with a client in any capacity, they can leverage our team for projects, strategy work or trustee education among other things.

NATASHA – you worked at pension that had a large staff, but are there areas that all plans struggle with?

CARRIE – The lack of adequate staff is a big problem for many pensions. I've met numerous people that oversee the pension and that is only a portion of their job. Among other things, that person is responsible for meeting regulatory requirements, determining strategy, selecting investments and ensuring proper governance, which is an insurmountable task. With outsourcing, smaller teams can shift their priorities. They can work with us as partners where they can focus on setting strategic allocations, approving glidepath design and reviewing reporting. For them, it becomes more of an oversight role like a committee with an extension to their staff.

Another area smaller plans can struggle with is getting access to certain asset classes. They tend to use less alternative asset classes as well as public asset classes like high yield and emerging markets. Using State Street's scale, they can gain access to diversified allocations which can potentially improve their investment outcomes. Further, as investors, at State Street we use our experience and scale to manage portfolio risk and exposures. For example, where appropriate, we have the ability to utilize more complex instruments, such as currency hedges, equity and fixed income derivative strategies, and other exposure management tools to manage risk and return outcomes more efficiently than can typically be done within a plan.

Glossary

Active risk- segment of risk in an investment portfolio that is due to active management decisions made by the portfolio.

Marketing communication

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