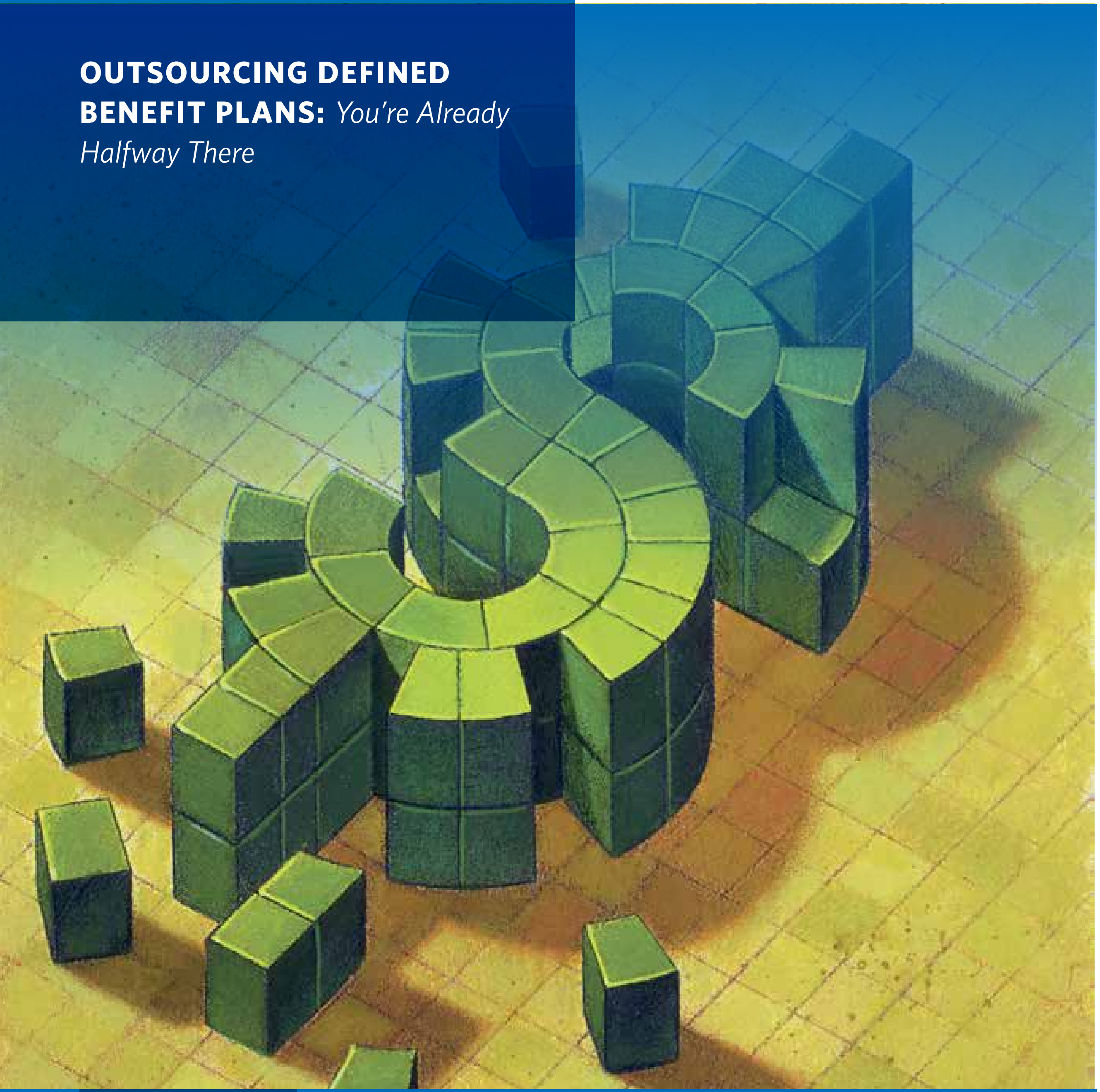
OUTSOURCING DEFINED BENEFIT PLANS: *You're Already Halfway There*



Strategic Investment Group®

Fiduciary Insights

OVER THE PAST TWO DECADES, PLAN SPONSORS HAVE ACCEPTED THE OUTSOURCING OF DEFINED CONTRIBUTION PLAN FUNCTIONS AS THE BEST WAY TO MANAGE SUCH PLANS. In fact, few organizations today would consider not outsourcing their defined contribution plans. They have learned that outsourcing plan functions can add flexibility, functionality, and expertise while decreasing administrative and management costs. Defined benefit plans can be outsourced as well, and there are several ways to do so.

Why Outsource Defined Benefit Plans?

The reasons to outsource defined benefit plans include seeking enhanced performance, cutting costs, maintaining management continuity and reducing emphasis on non-core businesses. Outsourcing enables the plan sponsor to focus on its core business. Peripheral functions that do not directly add to an organization's competitiveness can profitably be outsourced.

Outsourcing, as a way to maintain continuity in investment management, often becomes appealing after a significant staff reduction.

Downsized plan sponsor staffs may be hard-pressed to handle their accounting and benefit-related responsibilities, to say nothing of the more critical investment functions of asset allocation, manager selection and reporting. To provide adequate plan oversight in the midst of staff streamlining, plan sponsors can turn to an outsourcing organization to carry out the necessary day-to-day management and administrative duties while the sponsor itself continues in the role of plan fiduciary, providing oversight of the plan assets. The arrangement can compensate for the loss of staff experience and continuity that occurs in the aftermath of a downsizing or other staff turnover.

Cost savings are another benefit of outsourcing. Plans too small to take advantage of the economies of scale available to large plans can use outsourcing to achieve cost reductions in investment manager fees, custody, accounting oversight, research, and daily administration. Pension plan outsourcing providers cut costs by spreading them across many clients, offering operational economies that cannot be matched internally by many small and mid-sized plans. Outsourcing providers "buy in bulk" and can pass savings along to clients.

Ways To Outsource

Funds of Funds

Outsourcing services come in a wide variety of formats. Perhaps the most common is a fund of funds, which provides a turn-key investment solution to plan sponsors by combining several managers or funds in one vehicle. These structures offer expert manager selection and supervision combined with reporting, record keeping, manager analytics and custody.

Funds of funds are considered ideal for smaller plans and are sometimes used by larger plans to gain exposure to new asset classes or management styles. Many funds of funds are limited in the breadth of manager or asset class structures offered, while others provide a hub-and-spoke menu of investment options for diversification.

Although the fund-of-funds approach works well in some cases, it can be hampered by inflexibility or limited offerings, particularly in alternative asset classes such as hedge funds and private equity. Providers are generally unable to handle more complex strategies, such as those involving portable alpha. Since funds of funds are usually prepackaged commingled vehicles, they cannot be customized. Generally, funds of funds offer a low-cost, straightforward outsourcing solution for investors with uncomplicated investment needs.

Investment Consultants

Another common approach to outsourcing is the use of an investment consultant. Through their asset allocation, plan design, asset class research and manager selection services, consultants provide many of the key elements of fund management to plan sponsors of all sizes. In addition, the reporting, analytical and research services provided by full-service consulting organizations represent a good value plan sponsors faced with the alternative of performing these tasks internally.

> *Peripheral functions that do not directly add to an organization's competitiveness can profitably be outsourced.*

> *Generally, funds of funds offer a low-cost, straightforward outsourcing solution for investors with uncomplicated investment needs.*

Using a consultant creates an accountability issue.

Unlike many funds of funds and consultants, the full-service adviser shares fiduciary responsibility and plan performance accountability.

In addition to these advantages, consultants bring the experience of working with many clients over long periods of time and across many asset classes and manager relationships.

Other key benefits include staff and philosophical continuity and a historical perspective that is very useful for organizations regularly experiencing turnover due to changing staff roles and the regular rotation of investment committee members.

By definition consultants are advisers, not decision-makers. The governing body still bears the ultimate fiduciary responsibility for making virtually all decisions. This disconnect between advice and responsibility can introduce governance problems, as administrative details divert the governing body's time from more critical policy deliberations. Moreover, using a consultant can create an accountability issue. Plan sponsors often find it difficult to measure the value added by a consultant's advice, or even to identify which results were attributable to the consultant's recommendations and which to the plan sponsor's own decisions. However, for those sponsors desiring to maintain full and sole discretion, but needing additional expertise and resources, investment consultants offer a sound solution.

Full-Service Fiduciary Advisers

A third type of outsourcing vendor used by large and small plans alike is the full-service fiduciary adviser. These organizations operate as the investment office for plan sponsors who want to minimize the amount of plan management that is done internally.

In practice, a full-service fiduciary can be a stand-alone organization, part of a larger investment management organization, or a separately incorporated subsidiary of a plan sponsor organization that stands ready to manage assets for other plan sponsors. Unlike many funds of funds and consultants, the full-service adviser shares fiduciary responsibility and plan performance accountability.

As a ready-made "plan sponsor for hire," the full-service fiduciary performs all of the investment services required by the plan sponsor. These organizations can recommend and implement asset allocation (both strategically and tactically), hire and fire managers, negotiate fees and contracts, provide research services and manage daily investment and liquidity flows. At their best, they possess the investment expertise spanning all public and alternative asset classes, coupled with risk management analytics, which enable them to construct, manage, and monitor a sophisticated, multi-asset class portfolio customized to meet the client's needs.

In this structure, the plan sponsor is relieved of virtually all day-to-day duties of manager and asset class administration and therefore can focus on more important issues such as plan design or asset-liability issues.

Strengthening a plan's governance is a key benefit of hiring a full-service fiduciary adviser. These organizations bring coherent structure, experience, and well-developed systems to the task of overseeing plan assets. Since good governance is often a precursor to superior performance, the organizational improvements introduced by the full-service fiduciary adviser can foster improved net-of-fee performance.

The full-service fiduciary may not have a set group of managers or funds. Instead, these organizations can work with the sponsor's existing manager roster, making changes gradually, to lower costs or enhance performance. In fact, the manager roster of one client may be completely different from that of a second client, even with similar investment objectives, because of differing initial manager structures and sensitivity to avoiding turnover costs. Over time, the fiduciary may decide to consolidate managers or to switch to managers used by the fiduciary's other clients.

The full-service fiduciary combines the broad client-oriented experience of the consultant with the market expertise of the investment manager. In addition, because of its focused client base, the full-service fiduciary adviser can easily customize reporting, performance presentation, and meetings to fit client needs. The fee arrangements can be flexible, because clients can tailor fee structures to their specific service needs.

Outsourcing: A Growing Trend

Firms today are well aware of the many efficiencies that flow from outsourcing their defined contribution plans and they will find similar advantages in hiring others to manage their defined benefit plans. Several well-established ways exist for organizations to use outsourcing to cut costs, improve performance, sharpen focus on core businesses, and ensure management continuity. Many plan sponsors should consider extending their use of outsourcing to their defined benefit plan. If you have a bundled defined contribution plan, you are already halfway there.

Strengthening a plan's governance is a key benefit of hiring a full-service fiduciary adviser.

Strategic Investment Group

Strategic, a pioneer in dedicated Outsourced CIO (OCIO) solutions since 1987, offers a comprehensive service platform for managing customized portfolios for institutional and private investors. Our proprietary process combines active portfolio management, rigorous risk management, and open architecture manager selection.

Strategic functions as our clients' investment partner and co-fiduciary, effectively becoming an extension of their resources. Clients are then free to focus on their core businesses, while we focus on providing the highly specialized portfolio management expertise that clients need to meet their investment goals. Depending on a client's needs and preferences, Strategic can orchestrate the management of an entire portfolio comprising multiple asset classes, focus on specific asset classes, such as alternatives (e.g., hedge funds, real estate, and/or private equity) or international investments, or manage strategies with high potential for adding value (e.g., portable alpha through investor-friendly turnkey structures). Customized liability-driven investing (LDI) solutions, whether through an integrated total portfolio approach or a targeted long-duration strategy, are also available, as are solutions that address mission-related investment objectives.

We strive to build enduring partnerships with our clients by strengthening their investment programs through a dynamic, value-enhancing investment process, sound governance framework, and world class client service. Our mission is to empower investors through experience, innovation, and excellence.

For more information, please email us at inquiries@strategicgroup.com.

Strategic Investment Group®

1001 Nineteenth Street North
16th Floor
Arlington, VA 22209 USA

+1 703.243.4433 TEL
+1 703.243.2266 FAX

strategicgroup.com