



Can we
reach better
outcomes by
reimagining
pension
investment and
governance?



The better the question. The better the answer.
The better the world works.



EY

Building a better
working world

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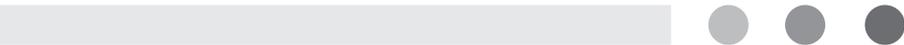


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Executive summary



Aging populations, demographic transformation and responsibility for long-term savings moving from the state to the employer to the employee are three of the most critical megatrends facing today's global economy. Supporting the financial well-being of millions is further elevating the importance of managing pension and retirement assets to maximize investment and benefit outcomes.

Our global research reveals that the required magnitude of necessary financial well-being pension assets may exceed USD 500 trillion. This emphasizes the need for public and private companies, governments, policymakers and other providers to rethink current strategies, challenge established beliefs and work together to build a better retirement world.

Many governments, post-financial crisis, recognize that financial well-being policy promises are the country's single largest long-term financial liability. This is leading to widespread benefit reform pressure and increased public scrutiny on costs, fees, returns and other associated

aspects such as executive remuneration. More stakeholders ask if fiduciaries and policymakers are performing their legal duties as asset owners.

To counter fee pressure and maximize benefits from economies of scale, more pension funds are embarking on insourcing of asset management and assets. Government as well as public and private sector providers and stakeholders are increasingly asking questions, which we have used as a baseline for this investment-focused research. Across the globe, there is a clear distinction between pension, retirement and social security organizations. For simplicity, we broadly refer to this group in our findings under the "pension" umbrella.

We hope this report will shed light on current industry trends and stimulate debate among stakeholders. EY firmly believes that a solvent, sustainable, transparent pension and retirement system is a key pillar to building a better working (and retirement) world.

A young child in a plaid shirt is seen from the back, pointing their right hand towards the horizon. The background is a soft, hazy landscape with a warm, golden light, suggesting a sunrise or sunset. The child's hand is extended, and their index finger points towards the right side of the frame.

Key questions for retirement systems to consider before investing in asset management

1

Are our governance, culture, conduct, leadership, structure and proposition fit for purpose and commensurate to size, complexity and importance?

2

Do we have adequate capacity and capability to deliver expected outcomes?

3

Are we sufficiently transparent to enable awareness and alignment to the risk appetite of all stakeholders (members, beneficiaries, regulators and governments) to retain trust and minimize surprises?

4

How can we convert theoretical benefits from business cases and economies of scale into real benefits?

5

Are our strategies and solutions resilient and sustainable for the new norm, next crisis or forthcoming reform?

6

Have we adequately considered the impact of artificial intelligence, robotics or shifts in customer behavior or preferences?

About the pension asset research

In our third year of research, we focus on how the industry copes with substantial increased growth in pension and retirement assets. We interviewed 50 public and private sector stakeholders, as well as corporate pension and retirement organizations, and asset managers – collectively representing more than USD10 trillion AUM.

For government, public and private sector pension retirement and social security funds and providers (asset owners), we wanted to understand the degree to which they have industrialized their investment governance and operations to drive increased efficiency:

- ▶ How have macro-economic asset management strategies changed in response to pressures?

- ▶ How mature are investment operations: investment risk management, governance, investment operations and technology platforms?
- ▶ How are they adjusting their strategies for insourcing and outsourcing asset management?
- ▶ What are the drivers (e.g., cost, regulatory pressure)?

For asset managers, we wanted to understand their level of readiness:

- ▶ How are they preparing for growth in pension and retirement assets and changing asset owner needs?
- ▶ How are they protecting their revenues as pension funds increasingly insource their investment management (e.g., creating

new types of services to entice pension and retirement fund investors)?

- ▶ How are they working with asset owners to create a more sustainable pension and retirement industry (e.g., annuities, guarantees, assisting with direct to consumer offerings)?

Our detailed quantitative research findings are framed in 10 provocative working hypotheses that are supported by EY analysis and interpretation based on global client experiences. We will discuss these in detail in future thought leadership.

Key findings from our research:

30%



of pension and retirement providers cite investment governance frameworks as lagging behind the increased pools they manage.

42%



of pension funds believe asset growth is pressuring investment operations, resulting in a need to recalibrate operating models.

34%



of providers say that their operational maturity is not aligned with their size and complexity.

Disrupt managing pension assets internally?

Our overall findings challenge some key assumptions and leave some unanswered questions. For public, private and corporate pension and retirement organizations, the maturity of investment management governance, capabilities and capacity is not aligned to the rapidly growing complexity and importance of asset management operations and investment markets.

Pension and retirement providers' investment functions are not homogenous

Our main finding challenges the assumption that participants principally invest in the same markets and asset classes in the same way despite varying benefits, payee and outcome risk carrying structures. Clearly, this is not the case. Cost comparisons of investment, asset ownership and investment returns can be widely misleading without more granularity across beliefs, strategy, operating model,

implementation style, industry, provider and customer levels, as well as member age profile. For example, a defined contribution fund with informed and active members making their own investment choices may have lower returns and higher fees due to smaller mandate sizes. A larger peer may exercise stronger purchasing power to achieve lower fees and higher long-term performance.

General agreement on key external challenges to retirement systems and asset owners

Lower investment returns, higher volatility, public scrutiny, regulatory and fee pressure, and demand for improved digital experience are widely acknowledged challenges. Participants that disagreed with those statements have embarked on or completed transformation programs to manage those external challenges. Several leading providers act like professional asset

managers with comparable governance, capabilities and capacity to manage external challenges effectively. With ongoing pressure on investment returns, we see an urgent need for more players to adopt high standards of professionalism. New collaborative models, automation and artificial intelligence will reduce the barriers, but fiduciaries need to act now.

Are your governance, risk and operational capabilities truly fit for purpose?

Responses vary considerably based on whether participants are leaders, acknowledgers (providers driven by strong boards or an informed appreciation of the challenges) or laggards. We encourage all providers to systematically review, challenge and disrupt existing beliefs and identify early-warning signs to comply with their fiduciary duty as pension and retirement asset managers. Government

Key findings from our research:

76% 

think that low investment returns and fees are elevating pressure on the cost to invest.

42% 

agree that public scrutiny is putting pressure on investment fees, leading to an increase in asset management insourcing.

69% 

say that low investment returns and asset growth are driving interest in a new breed of alternative investments.



and regulators must strongly encourage the adoption of adequate governance, management frameworks and integrated enterprise and organizational risk solutions. These must be agile and commensurate to the market, as well as to pension and retirement providers' size, complexity and importance. The highest level of maturity must become the default to promote long-term sustainability and compliance with fiduciary obligations, and to retain public confidence and trust. Apply or explain should become the norm.

New breed of alternative investments will deliver higher-than-expected returns

Most pension providers globally report that over the past decade a new breed of alternative investment classes has outperformed traditional investments. As key parameters change, cost and control pressures are leading pension and retirement providers to seek more cost-effective solutions to invest in alternative asset classes through direct investment, small group management (club deals), separate accounts, joint ventures or alternative investment models. Evolving in this direction emphasizes the importance

of adequate governance, capabilities and capacity to continue delivering long-term investment outcomes.

Universal agreement to shift gears and recognize the value for money

Disruption is pivotal to assist pension providers and retain profitable growth. The industry is dramatically shifting to more customer-centric solutions. As customers become more diverse in their life styles, needs and goals, there is an increasing demand for greater transparency, public scrutiny and value for money. Most asset managers' largest client group – pension and retirement providers – are dictating the rules. As the balance of pension assets shifts from defined benefit to defined contribution, the transition from a traditional B2B to a B2B2C or B2C takes effect. The outcome will be painful: a necessary transition from “manufacturing” investment returns to servicing clients and their investment outcome needs.

Disruption or hype?

Pension and retirement assets face evolving changes in volatility, asset class priorities, capabilities, infrastructures and

expected outcomes. Stakeholder response and provider investment success vary considerably. In an industry whose role is based on anticipating trends and taking risks, it is easy to overestimate the short-term and underestimate the long-term implications of change.

While fiduciaries are responsible for maximizing the financial well-being outcome for millions, one stakeholder group has been largely forgotten: beneficiaries. In most modern pension and retirement systems, beneficiaries ultimately bear the consequences either directly or indirectly for poor investment decisions. In the right system, they have the right to a more transparent approach to how investment, infrastructure and partner decisions are made.

EY research reveals 10 hypotheses

Quantitative findings, analysis and interpretation are based on our client work globally:

1

Governance structures are not aligned with size and complexity

2

Operational maturity is not aligned with size and complexity

3

Investment governance and operations are lagging

4

Investment risk, governance and solutions are not aligned

5

Investment operations and operating models need recalibration

6

Member and public scrutiny and fee pressure are driving insourcing

7

Low returns and fees elevate pressure on cost to invest

8

Lower returns are driving more investment into alternative asset classes

9

Scrutiny challenges, partner and outcome management

10

Technology is creating organizational challenges for providers

Asset managers must reinvent themselves and rethink their value proposition

Pension and retirement asset growth offers tremendous opportunity for professional asset managers to assist pension and retirement providers globally in delivering improved investment outcomes. All asset managers acknowledge the importance of pension and retirement providers. But, a common provider perception of poor value for money is fueled by lower investment returns, conflicting outperformance promises and a self-imposed commoditization in relation to fees and returns.

Asset managers appear to underestimate the long-term implications of shifts in asset allocation, mandates or insourcing. Some

believe that operating models may not be aligned sufficiently between distribution and manufacturing. The transition to move asset management in-house is just around the corner and offers tremendous opportunities for disruption, innovation, collaboration and servicing models through artificial intelligence, robotics, blockchain and digital enablement.

Our research shows universal agreement that asset managers must rethink their business and value propositions. While successfully responding to disruption is pivotal for profitable growth, subpar investment governance among providers creates a false sense of security.

EY point of view

Customer centricity, efficiency, well-articulated value propositions and margins that align to cost of capital and value creation will become the norm and drive improved trust across the industry. Asset managers should continuously stress-test their business model and strategy, as well as analyze existing client relationships to understand shifts in asset growth and better align their operating models.



Will you be disrupted and ignore signs from key clients?

Our research reveals that few asset managers are taking changes from their largest client group seriously enough to act swiftly. Few assessed their clients' focus on insourcing or fees, regulatory or public scrutiny as long-term threats or catalysts for change.

The global asset management industry is diverse. Geographic and client priorities, as well as business and operating models, vary considerably. Consequently, asset managers experience market, client, regulatory and business pressures differently, creating varying levels of urgency to respond to change.

EY point of view

We recommend that asset managers challenge their industry, client and operating model beliefs and strategies now. Money is in motion and the business impact is likely to be fundamental. All signs globally point in the same direction: industrialization of the professional asset management industry – albeit at varying speeds. Rapid commoditization and the shift to customer centricity will create digitally-enabled mass-customization of investment products and outcomes.

Will alternative asset classes save the day for asset managers?

Our research shows overwhelming support for alternative asset classes as a substantial growth opportunity. This aligns with pension and retirement providers' view and actions to increase their alternative asset class exposure. Surprisingly, the market for well-established alternative asset managers is well developed in specialized areas such as farm land or illiquid credit; many providers are replicating an in-house asset management model for alternative asset classes; and public and fee scrutiny may fundamentally challenge traditional asset managers' business and operating models.

EY point of view

Alternative asset classes offer a tremendous opportunity for growth, but the market is already established at the core. All asset managers must have a compelling proposition as asset demand and manager supply are evolving. We recommend all asset managers that act or plan to act in the alternative space rethink their proposition to reflect increasing competition for attractive assets and clients' higher levels of fee and regulatory scrutiny.

Conclusion

Pension and retirement providers face tremendous challenges in delivering sustainable and attractive investment outcomes. But the rules have changed and all stakeholders must adapt and take responsibility to restore trust and confidence.

All pension and retirement providers – whether private, public or government – deliver a social service as part of a broader social contract. This comes with higher fiduciary obligation. For providers, particularly in mandatory systems, this translates to governance maturity which is commensurate to size, complexity and importance. But, governance is multi-faceted and must cascade down from board or trustee to operational levels to be adequate and effective. Governments and policymakers must set and monitor expectations to protect the ultimate obligation: delivering financial well-being and retirement outcomes for millions.

EY is committed to partnering with all key constituents in the pension and retirement system – policymakers, public and private sector funds and providers, employers, retirees, and employees alike – to carefully examine the major challenges in pension and retirement management and develop working solutions to enhance financial well-being security and improve outcomes.

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EY is known for its deep insights and pension and retirement knowledge, relationships with the industry's key stakeholders and strong global capabilities. Clients see us as the most globally connected organization among the Big Four. We can assemble a team that combines deep industry knowledge with experience resolving the issues you are facing to provide advice tailored to your local market. Our Global Pension and Retirement network is dedicated to offering industry insights and coordinating a network of professionals who are ready to develop practical approaches to the assurance, advisory, tax and transactions issues you face.

- ▶ We work with the leading clients in the pension and retirement industry, providing advisory, assurance, transactions and tax services to clients at the national, regional and municipal level across both mature and emerging markets. This broad and deep exposure means we understand the dynamics of the sector and the underlying drivers of the leading actors. We can help our clients translate issues, challenges and proposed recommendations into meaningful stakeholder language.
- ▶ Our team combines former industry practitioners and deep technical subject-matter resources capable of providing integrated pension and retirement services across the whole value chain. We make it our business to understand your business and to keep our advice relevant to your needs. Identifying issues, developing integrated approaches and seeing unintended consequences increase outcome predictability and long-term stakeholder confidence.
- ▶ We are a truly global organization with geographical presence and deep local relationships. We navigate global complexity and provide leading-practice insights in pensions and retirement. The combination of global and local insights helps our clients to stay ahead of the curve and enhance outcomes while raising relevance of recommendations and sustainability.
- ▶ We are committed to providing industry insight that can help create value. We connect our pension and retirement professionals worldwide and share industry-focused knowledge to help you succeed in a changing world. We provide large-scale transformation capabilities as the pension industry seeks to "industrialize," helping you anticipate the pitfalls and lock in the results on which your future depends.

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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About EY's Global Pension and Retirement Services

Pension and retirement challenges pose a complex array of issues for governments, public and private sector organizations and their stakeholders. These challenges include social, economic, financial and delivery-related dimensions. They take the form of: a short-term focus, uneven political and economic realities and the globally widespread threat of defaulting on past fiduciary obligations. All serve to create a new need for a shared long-term vision, mission and strategy – as well as an efficient operating model.

At EY we serve public and private pension funds, pension providers in the insurance and asset management sectors, government policy makers, regulators and service providers. We focus on what we believe are the four key pension challenges: financial adequacy, investment performance and efficiency, financial sustainability and effectiveness of operations. We turn data and information into insights – to support improved predictability and outcomes.

Our cross-functional teams deploy domestic knowledge and overseas experience to address these issues. They help restore confidence that supports a better working world today for all stakeholders – and a more secure retirement for millions tomorrow.

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