



The Role and Functions of an Investment Consultant

Milliman, Inc.
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Today's Agenda

Some questions we will address today

- What is happening in the Investment Consulting industry?
- What are typical functions of an Investment Consultant (“IC”)?
- How does an IC interact with staff, trustees, actuaries, investment managers, custodians, and other vendors?
- What are “Best Practices” for client/consultant relationships?

Industry Trends

Market size/definition

- Our focus is on institutional Investment Consultants, not individual financial planners
- From Pensions & Investments:
 - Investment Consultants advise on over \$36 trillion worldwide
 - US institutional tax-exempt assets over \$18 trillion
 - US tax-exempt public fund client assets over \$10 trillion
 - 83% of Investment Consultants' revenue comes from institutional clients
 - 7% coming from “investment outsourcing”
 - 6% from consulting to other types of clients

Industry Trends

Types of firms and fee arrangements

- Types of Investment Consulting firms include:
 - Independent actuarial/benefits consulting firms
 - Subsidiaries of large financial services (or other types of) firms
 - Specialty boutiques
 - Brokers
- Typical fee arrangements include:
 - Multi-year retainer
 - Project-based
 - Asset-based (usually for OCIO services)

Industry Trends

Where do fund sponsor fees go?

- From Callan Institute 2016 Cost of Doing Business Survey:
 - 93% of fees paid by fund sponsors go to external investment managers
 - 2.5% of fees paid go to other external advisors (actuaries, consultants, auditors, etc.)
 - Median fee paid to “other external advisors” is 3.6bps (vs. 43.6bps for investment managers)
 - Investment Consultant fees average 4.9bps for small plans (<\$1 billion), 2.7bps for medium plans (\$1 billion to \$3 billion), and 0.6bps for large plans (>\$3 billion)
 - Endowments/foundations pay the highest Investment Consultant fees (6.5bps), with corporate plans paying 2.1bps and public funds paying 1.8bps

Industry Trends

What's happening in the industry?

- Consolidation
- Utilization of specialty consultants, particularly for alternative asset classes
- Outsourced Chief Investment Officer (“OCIO”) business growth
 - From Chief Investment Officer magazine: OCIO assets grew 860% from 2007 to 2016
 - However, a slight pause in 2016, as pensions moved into annuities – assets still at \$1.3 trillion
 - Investment Consultants take on responsibility for implementation of investment policy
 - Higher margin business, often with asset-based (instead of project/retainer) fees

Investment Consultant Roles

What is an Investment Consultant?

- Born by the Investment Advisers Act of 1940 – provide advice on securities
- Advisors became more prevalent with the inception of ERISA in the 1970's
 - ERISA not applicable to government pension plans – prudent standard may be incorporated
 - State and local laws may specifically define who is a fiduciary for governmental plans
 - Consultant/Advisor should be experienced in your state and local laws
- Generally two types of advisors/consultants in a fiduciary capacity
 - Non-discretionary Advisor – provides advice and recommendations to the trustees / sponsor
 - Discretionary Advisor – provides advice, has discretion and control over the assets

Investment Consultant Roles

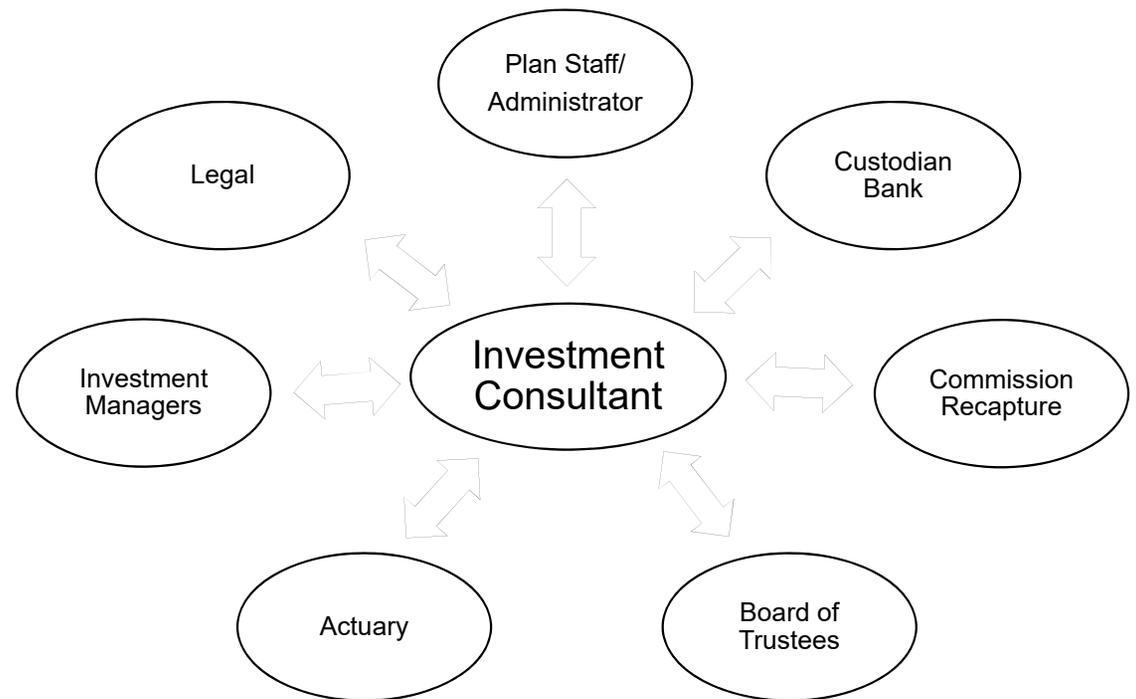
What do Investment Consultants typically assist clients with?

- Investment Policy Statement Development
- Investment Manager Research and Selection
- Performance Monitoring
- Vendor Searches & Oversight
- Documenting / Meeting Minutes
- Specialty Asset Classes – evolving trend – multiple advisor relationship
 - Preqin survey shows typical asset classes where a specialty advisor may be utilized: Private Equity, Hedge Funds, Real Estate and Infrastructure

Board/Trustees and various interactions

How should a consultant work with staff, trustees, and vendors?

- Various reports customized for Board
- Interaction with actuary
- Reconciliation with custodian
- Accounting disclosures
- Setting assumptions
- Implementing investment policy
- Assessing results
- Fiduciary education



Interaction with the plan actuary

How should plan features and the interest rate assumption be set?

- Directive of the Board
 - Administers the plan document, but the city/state creates it by law
- Benefit structure and plan features
- Negotiations with unions and business agents
- Restrictions for plan investments (law, committee, board)
- Setting the expected return/interest rate assumption (law, board, advisor)
- Is the interest rate assumption realistic?
 - Asset allocation vs target return

Interaction with the plan actuary

Update on Funding and Interest Rate Assumptions

- Milliman Public Pension Funding Study (PPFS)
 - Largest 100 public pensions
 - Assets of \$3.24 trillion / Liabilities of \$4.43 trillion
- Aggregate Funding Ratio 69.8%
- Little change in asset allocation (last 5 years)
 - 50% equity / 20%+ P.E. & Real Estate / 30% Fixed Income
- No correlation in allocation vs funded status

MILLIMAN WHITE PAPER
2016 Public Pension Funding Study

Rebecca A. Snelman, FSA



Introduction

The Milliman Public Pension Funding Study annually explores the funded status of the 100 largest U.S. public pension plans. We report the plan sponsor's own assessment of how well funded a plan is. We also recalculate the liability for each plan based on our independent assessment of the expected real return on each plan's investments. This process enables us to independently determine funded status without reflecting any bias or lag that may exist in the plan sponsor's own return expectations.

Highlights

- As of June 30, 2016, the aggregate funded ratio is estimated to be 69.8%, as markets took back some of the gains from 2012 to 2014 and discount rates declined
- Plan sponsors continue to reduce interest rate assumptions in the expectation that returns over the coming decades will be lower
- The difference between the average sponsor-reported assumption of 7.50% and our independently determined assumption of 6.99% is the highest we have seen, indicating that pressure to reduce interest rate assumptions is unlikely to abate

Starting with our 2006 edition of the Milliman Public Pension Funding Study, we have shifted our focus away from the accrued liability figures that are used to determine a plan's funding requirements; rather, our study is now based on the "Total Pension Liability" figures used for financial reporting under Governmental Accounting Standards Board Statements No. 07 and 08 (GASB 07/08), which apply to governmental entities. For many plans, the funding accrued liability and the "Total Pension Liability" are determined in essentially the same way, but the "Total Pension Liability" numbers are more directly comparable from plan to plan. Also, importantly, the financial reporting requirements include some key details that enable us to project the "Total Pension Liability" forward beyond the plan sponsor's fiscal year-end. This permits us to analyze how the funded status of these plans changes over time in response to shifts in the economic climate. Based on the information the plan sponsors reported at their last fiscal year-ends, we project that the plans experienced a median annualized return on assets of just 1.3% in the period between their fiscal year-ends and June 30, 2016. Total plan assets are estimated to have declined from \$3.24 trillion to \$3.20 trillion, while the aggregate "Total Pension Liability" measured using the plan sponsor's discount rates is estimated to have increased from \$4.43 trillion to \$4.48 trillion. The funded ratio is estimated to stand at 69.8% as of June 30, 2016, with an aggregate underfunding of \$1.28 trillion. Look for our funded status updates on a quarterly basis.

*Turning to the information reported by the plans as of their most recent fiscal year-ends (see Figure 1), funded ratios dropped by

FIGURE 1: AGGREGATE FUNDED STATUS AS OF MOST RECENT MEASUREMENT DATE (\$ TRILLIONS)

	2013		2014		2015		2016	
	SPONSOR REPORTED	RECAL FIGURES						
MEDIAN DISCOUNT RATE ¹	7.9%	8.2%	7.9%	7.3%	7.0%	7.2%	7.0%	6.9%
PLAN ASSETS ²	\$3.77	\$3.86	\$3.88	\$4.03	\$4.08	\$4.26	\$4.43	\$4.64
FUNDED RATIO	68.5%	66.8%	70.7%	68.2%	70.0%	71.7%	73.3%	69.9%
UNFUNDED LIABILITY	\$1.19	\$1.28	\$1.13	\$1.28	\$1.02	\$1.20	\$1.18	\$1.40

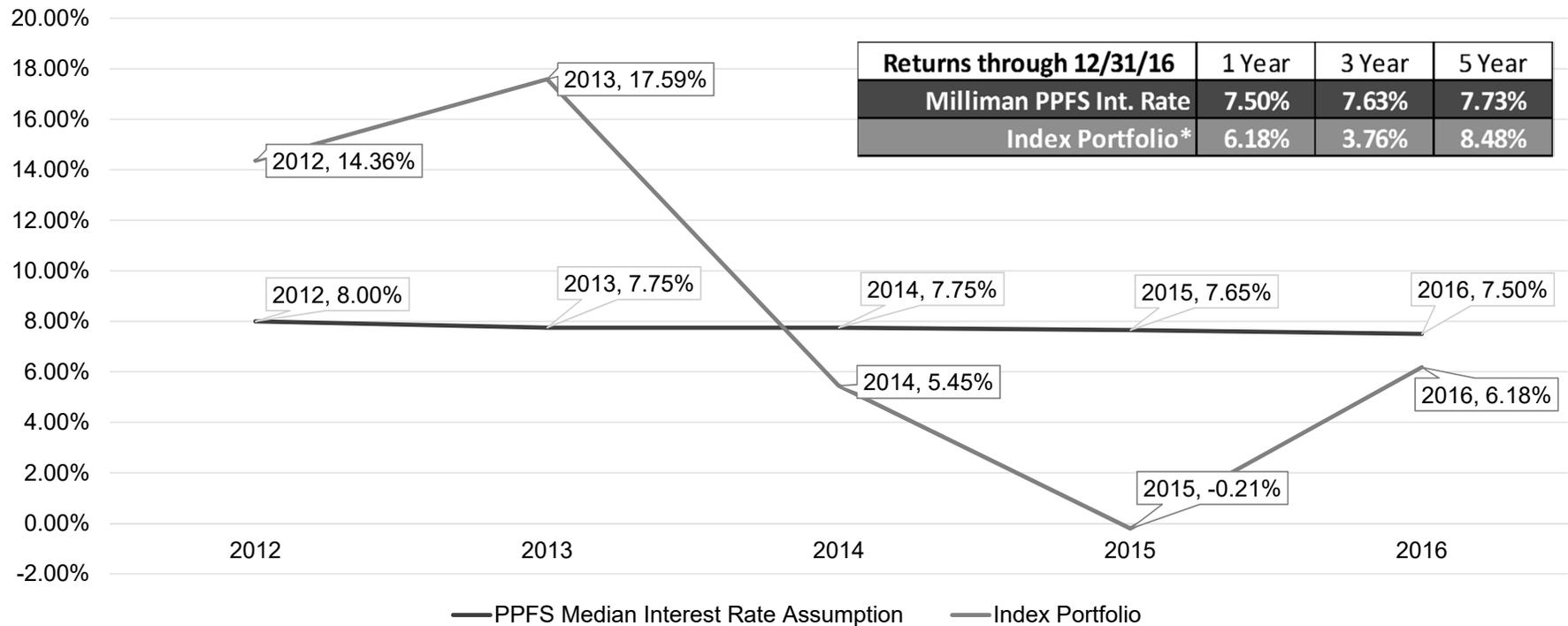
1. Funding interest rate for 2013-2015; GASB 07/08 discount rate for 2016.
2. Assumed liability used for funding for 2013-2015; GASB 07/08 Total Pension Liability for 2016.
3. Market value of assets, referred to as Fiduciary Net Position in GASB 07/08 reporting.

SEPTEMBER 2016

Interaction with the plan actuary

Update on Funding and Interest Rate Assumptions

Milliman PPFS Interest Rate Assumption vs Index Portfolio*



Returns through 12/31/16	1 Year	3 Year	5 Year
Milliman PPFS Int. Rate	7.50%	7.63%	7.73%
Index Portfolio*	6.18%	3.76%	8.48%

*Index Portfolio – returns are through 12/31/16 using an allocation index of 1% BB Commodity Index, 20% BB Agg Bond, 30% Russell 3000, 3% BofA ML 91-day Tbill, 20% MSCI EAFE, 6% HFN FoF Agg, 10% S&P Global REIT, 10% Red Rocks Gbl Listed Priv Eq.

Interaction with Investment Managers

What are key factors in researching and deciding which managers to hire?

- Organizational structure/operations and personnel
- Investment process and Portfolio characteristics
- Fees
- Performance
- Fit in the overall portfolio – initial and ongoing
- Client's active risk tolerance (particularly downside)
- Client's understanding of the investment strategy
- Manager's willingness/ability to provide client service
- Issues of importance to the client (NCPERS Code of Conduct, etc.)

Board policy and actions

How active are boards becoming?

- Proxy voting policies
 - Often look to advisors for guidance
- Influencing corporate activities – activist board
 - Attempt to align corporate activities with entity beliefs
 - Executive compensation and benefits
 - ESG – environmental, social and governance
- Transparency on actions / disclosure
 - Publish proxy voting – influence other entities
- May consider a written proxy voting policy

Best Practices for Client/Consultant Relationships

What do the best relationships have in common?

- Collaboration (not competition) between client, managers, consultants, and other service providers
- Objectivity on the part of the consultant, always with the client's best interests foremost
- Document the allocation of fiduciary duties among the board and consultant(s)
- Establishing reasonable expectations, and monitoring fulfillment of them
- Effective use of limited time, focusing on the highest priority issues (which probably aren't individual manager short-term performance records)
- Listening, even to things you don't want to hear

The Role and Functions of an Investment Consultant



Jeff Marzinsky is a Principal and Investment Consultant with the New York office of Milliman. He joined the firm in 1994.

Jeff is responsible for providing investment advisory and retirement plan consulting services to Milliman's clients. He regularly works with retirement plan trustees and investment committees to develop fiduciary procedures, controls and investment policy. He develops investment menus, model investment portfolios and glidepaths for defined contribution plans. For pension and OPEB plans, he conducts asset liability studies and develops liability driven investment strategies. He also conducts manager and vendor searches and assists clients in the review of provider platforms.

He has published and contributed to a variety of articles on pension plan portfolio development, manager selection, fiduciary duty and understanding plan administration expenses. He has been quoted by the New York Times, Money Management Letter, Workforce.com, PlanSponsor Magazine, and the GAO.

Jeff has a B.S. in Finance from Siena College and holds the Certified Investment Management Analyst (CIMA®) and Certified Pension Consultant (CPC) designations.



Jeff Nipp is a Senior Investment Consultant with the San Francisco office of Milliman, which he joined in 2017.

Jeff is a seasoned investment professional with nearly 30 years of experience in constructing and monitoring multi-asset class portfolios. Prior to joining Milliman, he most recently served as the Head of Solutions for Invesco, developing customized portfolios for retail and institutional clients, while also providing objective analysis of Invesco's product offerings. Previously, he spent over 5 years with BlackRock as a Managing Director in the Multi-Asset Client Solutions team, where he designed and implemented manager research/selection and asset allocation input processes and chaired the Manager Research Review Committee. Prior to that, he spent over 20 years as an institutional investment consultant with Towers Perrin and Watson Wyatt, heading investment manager research at each firm.

Jeff earned an MBA degree from Duke University's Fuqua School of Business, and a BBA degree from Mercer University. He is a Chartered Financial Analyst (CFA) charterholder, holds the Chartered Alternative Investment Analyst (CAIA) designation, and is a member of the CFA Society of San Francisco.

Disclaimers

This presentation is for informational purposes only and should not be considered investment advice or tax advice. Past performance is not a guarantee of future results. Please consult an investment or tax professional for advice specific to your entity.



Thank you

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