



PlanPILOT

Better Outcomes, Less Risk

# OCIO

**Meeting the Challenges of Effective  
Implementation and Oversight**



# EXECUTIVE SUMMARY

No longer a new concept, the Outsourced Chief Investment Officer (“OCIO”) model has become a way of life to many endowments and foundations globally. What was roughly a \$100 Billion industry prior to the Great Recession of 2008-2009 has now ballooned to nearly \$2 Trillion with hundreds of firm options<sup>1</sup>. The expected growth continues. A 2017 survey by Chief Investment Officer found that 40% of their respondents outsourced or were planning to outsource in the next two years<sup>2</sup>.

Properly implemented, outsourcing an investment program’s oversight can help a not-for-profit organization address a lack of internal resources, risk management challenges, the need for timely decision making, portfolio complexity and on-going pressure of cost reduction. In turn, this will enable the trustees or committee and staff to focus on improving institutional governance and furthering the mission of the institution. We believe an ideal OCIO relationship is a seamless extension of an institution’s fiduciaries and internal staff and complements them with the additional resources needed to steward investments effectively.

Like any process and decision-making to hire and monitor an investment manager, selecting an OCIO provider initially and reviewing the OCIO investment manager regularly is a critical function of institutional governance. While consulting firms can support an institution with this process, some consulting firms act as a search consultant *and* an OCIO provider. We view this as a conflict of interest, which can lead to biased results. As a leader in the non-profit space, PlanPILOT believes in providing unbiased, independent consulting services as described further below that are needed to best meet the governance responsibilities.

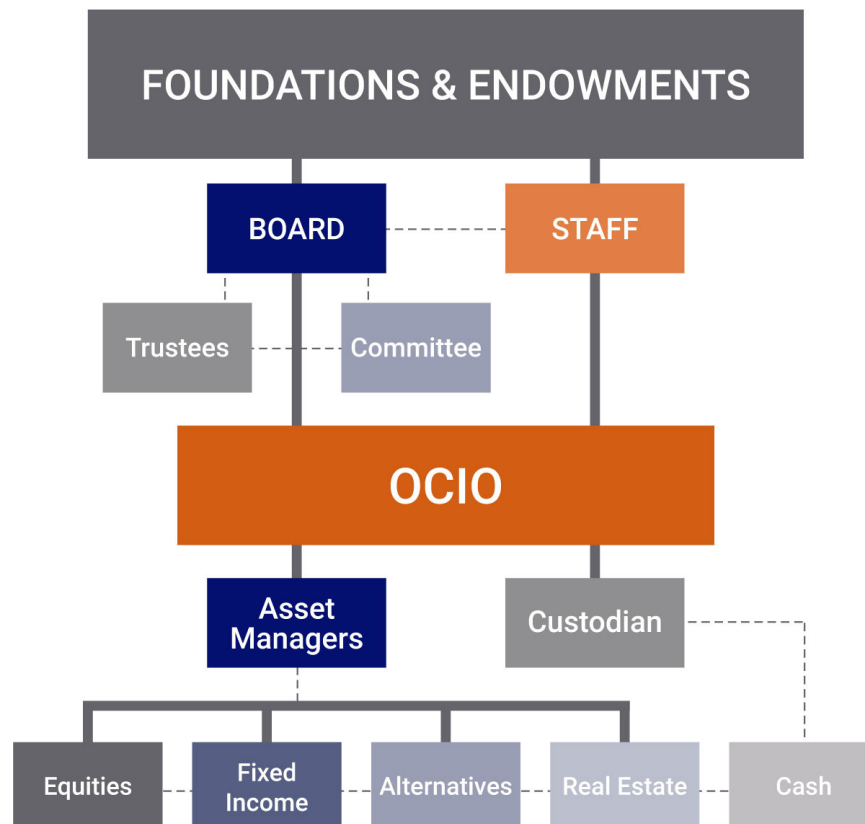
<sup>1</sup> James Comtois, “Complex portfolios spur increased use of outsourced CIOs,” *Pensions & Investments*, <http://www.pionline.com/article/20170626/ONLINE/170629919/complex-portfolios-spur-increased-use-of-outsourced-cios>, June, 2017

<sup>2</sup> *Chief Investment Officer*, “Outsourced Chief Investment Officer Survey,” <https://russellinvestments.com/-/media/files/us/resources/articlereprintciociosurvey.pdf>, February, 2017

# PART 1

# OCIO

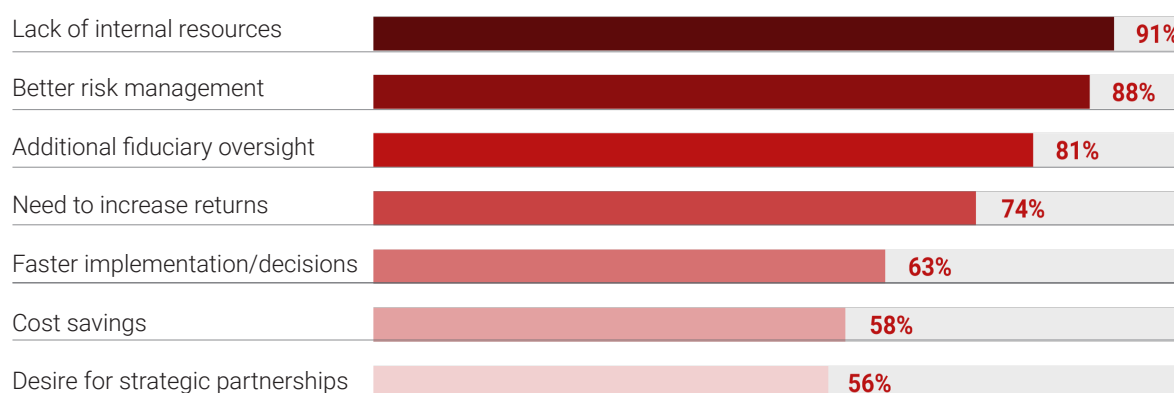
## The What & Why



As depicted here, outsourcing the investment oversight of a pool of assets is a decision made by the trustees or committee that is responsible for them to transition the oversight to an external provider. The OCIO manager will then have authority over the details such as setting the asset allocation, the selection and monitoring of the investment managers and custodian, portfolio rebalancing, voting proxies, risk management and reporting. The OCIO provider will execute its discretion within the guidelines established in the Investment Policy Statement (“IPS”) by the institution.

## Benefits and Objectives of Outsourcing

In its 2017 OCIO Buyers Guide, AON Hewitt’s study identified the following as the critical or important reasons cited why an institution implements OCIO<sup>3</sup>:



The Chief Investment Officer survey previously referenced added these additional reasons:

- Increased litigation concerns
- Desire for customized solutions
- Dedicated investment expertise (such as alternatives and environmental, social and governance (“ESG”) capabilities).<sup>4</sup>

Notice the top reasons involve improving risk management and fiduciary governance, and a smaller weight is given to the investment decisions themselves, each of which supplements and expands what the institution can undertake internally.

<sup>3</sup> AON Hewitt, “Outsourced CIO,” [http://www.ncpers.org/files/Conference%20Docs/Annual%20Conference/2017/PPTs/Janice%20Gonzalez\\_Monday.pdf](http://www.ncpers.org/files/Conference%20Docs/Annual%20Conference/2017/PPTs/Janice%20Gonzalez_Monday.pdf),

<sup>4</sup> Chief Investment Officer, “Outsourced Chief Investment Officer Survey,” <https://russellinvestments.com/-/media/files/us/resources/articlereprintciociosurvey.pdf>, February, 2017

## Unique Aspects of Not-for-Profit Investment Oversight

For effective investment program oversight, the standard metrics utilized for measuring investment performance are not entirely sufficient for endowments and foundations.

Endowments and foundations have a longer-term time horizon to determine the effectiveness of the investment decisions. This typically allows for the inclusion of alternative assets as an un-correlated asset that should dampen the volatility and provide higher returns longer-term. Frequently though, alternative assets are illiquid investments and come with much higher fees than most other asset classes. Our research has determined that many of these investments do not deliver the returns and risk mitigation results as promised. Therefore, it is critical to identify an OCIO provider that has demonstrated expertise in this field, and has a track record of identifying potential top performers.

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Additionally, many endowments and foundations often place an emphasis on ESG goals that are often in alignment with the institution's mission. While these goals historically focused on exclusion and produced spotty return outcomes, current styles emphasize the inclusion of these goals into the investment program more directly and the criteria to select the firms to invest in. Identifying the optimal ESG policy is of significance for alignment with the goals of the institution and the results of the investment program.

Further, an endowment and foundation is likely more focused on meeting the on-going spending goals and policy of the institution than other types of institutional investors. We assert that the impact on the ability of the investment program to meet the short- and long- term funding requirements of the institution is crucial. This increases the need to carefully measure the return and risk characteristics of the program and its specific components in light of this overall solutions target.

## PART 2 OCIO The How

Like any process and decision-making to hire and monitor an investment manager, selecting an OCIO provider initially and reviewing the OCIO investment manager regularly is a critical function of institutional governance. As quoted in CIO, the head of Multi-Manager Solutions at Northern Trust states, “We’re also seeing greater involvement by third-party overseers in the search process and periodic independent oversight after the relationship begins.”<sup>5</sup>

Consulting firms can effectively support an institution with the OCIO process. Some consulting firms act as a search consultant and an OCIO provider though, which we view as a conflict of interest, which can lead to biased results. As a leader in the non-profit space, PlanPILOT believes in providing unbiased, independent consulting services as the optimal approach to supporting the trustees or committee and staff to best meet their governance responsibilities.

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<sup>5</sup> Chief Investment Officer, “Outsourced Chief Investment Officer Survey,” <https://russellinvestments.com/-/media/files/us/resources/articlereprintciociosurvey.pdf>, February, 2017

## Trustee / Committee Education & Support

An effective OCIO program focuses on assisting fiduciaries fulfill their wide-ranging and complex responsibilities. A focus on providing effective education for the trustees and/or committee will support their ongoing need to review the landscape of options available to managing these important investment pools. Key educational support includes:

- Overview and updates on the landscape of the varying approaches to supporting the oversight of endowments and foundations
- Determination of broader goals necessary to address the impact of a range of potential investment outcomes
- Review and discussion of program governance and the necessary time commitments required for the varying OCIO approaches
- Development of socially responsible investing ESG policies fitting with the institution's mission
- On-line and on-site educational events that provide a wealth of timely topics to trustees.



## Provider Review and Selection Process

It is fairly common for trustees to select an approach for their endowment and foundation investment oversight and only revisit this decision if a significant event occurs (e.g. prolonged investment underperformance or an unexpected decline in the asset value) or if there are changes to key investment savvy trustees' participation on the board. We advocate a more proactive, forward thinking approach that addresses potential risks of not reviewing your current approach and educating trustees on the changing landscape. This provides a more thoughtful and measured approach of determining what is the best interest of your institution and reduces your risk posture.

PlanPILOT recommends a periodic review of your current approach by following a process that either will validate your current oversight approach or lead you towards a change. Supporting the institution with addressing OCIO manager selection and oversight includes such services as:

- Review current governance and investment structure and determine appropriateness
- Screen a database and create appropriate short list of firms to receive a Request for Proposal ("RFP")
- Summarize RFP responses with written analysis of each provider's proposed services, expenses and business operations
- Conduct finalist presentations at your location
- Understand potential bias apparent in the investment process due to providers stance on investment structure/asset classes
- Finalize negotiations with incumbent/new provider and provide transition planning as needed.

Significant areas of focus in the review includes items that are difficult to benchmark in a RFP. These include potential conflicts of interest or investment biases that may result from key relationships or affiliations. The capital structure and compensation practices for partners and other personnel are an important consideration as it will influence the evolution of the firm, and ultimately the resources that are deployed on your behalf.



## Items to Consider in Evaluating an Optimal OCIO Provider

The process of evaluating, selecting and monitoring the OCIO provider involves a number of specific considerations. These items should be tailored to meet the specific goals and needs of the institution. Some of the more common criteria include:

- Breadth and depth of the provider’s capabilities
- Experience in managing programs of similar size and nature
- Strength of the management team
- Qualifications of the servicing team
- Capital structure
- Alignment culturally with the institution
- Capability to support the spending goals and policy of the institution
- Asset allocation methodology
- Strength of portfolio construction and manager research
- Ability to customize
- Scope of expertise in alternatives and ESG
- Thought leadership
- Risk management capabilities
- Compliance procedures and history of violations
- Related entities (e.g. broker-dealer) that may also be involved
- Use of proprietary products
- Frequency and form of communications
- Service quality
- Fees, including performance-based fees.

Fees is a particularly important issue from a regulatory and potential litigation standpoint as there can be layers of fees for the oversight function in addition to the management of the underlying investments which can possibly both be paid to the OCIO provider. There can also be an incentive fee based on achieving certain performance goals, and different fee levels based on the type of investment vehicles utilized (e.g. alternatives and private placements). According to the 2017 Commonfund Institute white paper, fees paid to OCIO providers typically run in the range of 30-40 basis points.<sup>6</sup>

*There can be layers of fees for the oversight function in addition to the management of the underlying investments.*

Another key consideration is the degree of control the OCIO provider has in relationship to the institution. Granting full discretion within the parameters of the IPS to the OCIO provider is the norm, but some institutions may want to retain some control over asset allocation and manager selection decisions. The institution may choose to adopt a hybrid approach and have an independent consultant provide some assistance, such as preparing the IPS.<sup>7</sup>

The process of implementing the OCIO decision is obviously complex and multi-faceted. Having adequate internal or external resources with the right expertise is a must to meet the needs of the institution and its fiduciaries and staff.

<sup>6</sup> Commonfund Institute, "Outsourced Investment Management – An Overview for Institutional Decision Makers," <https://www.commonfund.org/wp-content/uploads/2016/01/2013-1106-Outsourcing-White-Paper-Jarvis.pdf>, August, 2017

<sup>7</sup> Commonfund Institute, "Outsourced Investment Management – An Overview for Institutional Decision Makers," <https://www.commonfund.org/wp-content/uploads/2016/01/2013-1106-Outsourcing-White-Paper-Jarvis.pdf>, August, 2017

## CONCLUSION

Properly implemented, outsourcing an investment program's oversight can help a not-for-profit organization address a lack of internal resources, risk management challenges, the need for timely decision making, portfolio complexity and on-going pressure of cost reduction. In turn, this will enable the trustees or committee and staff to focus on improving institutional governance and furthering the mission of the institution. An ideal OCIO relationship is a seamless extension of an institution's fiduciaries and internal staff and complements them with the additional resources needed to steward investments effectively.

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As a leader in the non-profit space, PlanPILOT believes in providing unbiased, independent consulting services. PlanPILOT will provide you the objective advisory services you need to best meet your governance responsibilities in effective OCIO implementation and oversight. Contact us if you would like more information or guidance on OCIO consulting services.

# Take the next step.

Call (312) 973-4911 for more information or visit us at [www.planpilot.com](http://www.planpilot.com)



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