# Outsourced Chief Investment Officer Trends and Best Practices

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## With Crises, Institutions Switch to OCIO

As capital markets become increasingly complex, many institutional investors, including endowments, foundations, and other non-profit organizations, have turned to the services of a discretionary outsourced chief investment officer (OCIO) to deliver a more nimble and proactive approach to investment and risk management. This need has been heightened during the COVID-19 crisis, as it was in the aftermath of 2008. As a result, assets entrusted to discretionary OCIOs have grown markedly, from $90.8 billion in 2007 to $2.4 trillion in 2019.[1] We believe this growth stems from an investor desire to:

- Leverage deeper expertise and research capabilities available at OCIOs
- Optimize risk management
- Achieve improved performance outcomes
- Increase fiduciary oversight

While most consulting models may offer investors access to intellectual capital from various investment professionals without having to bear the full burden of that cost, a significant advantage of the OCIO model is the ability to receive and implement advice in a more timely, efficient and proactive manner. Partnering with a co-fiduciary also brings an advanced level of oversight, as well as a higher standard of duty, loyalty and care. While the OCIO model may not be for everyone, it is best suited for organizations that prefer more real-time decisions, greater consultant accountability for performance, as well as having a co-fiduciary to objectively balance out varying degrees of investment expertise on the board.

## Finding the Ideal OCIO

While the demand for OCIO has risen, so has the number of providers that offer a variety of these services. To determine the optimal OCIO provider, institutional investors need to effectively evaluate and measure those providers, as well as their services. But first, it is critical to perform a self-assessment to identify the organization's challenges, objectives, and resulting needs. The primary objectives of the investor must align with the leading attributes of the selected OCIO firm. Fundamentally, when analyzing OCIO providers, investors should:

- [ ] Thoroughly define the investment objectives, strategic liquidity and return hurdles, Investment Committee and organizational needs, and hot-button priorities.
- [ ] Recognize the resources the provider has committed to OCIO. Specifically:
    - The designated team of client service and investment professionals
    - How the provider will manage your expectations
    - The breadth of OCIO solutions, from customized portfolios to model portfolios
    - Experience with similar investors

1 Chief Investment Officer Magazine.

- [ ] Understand and be comfortable with the ownership structure and primary revenue sources of the OCIO firm to align interests and avoid potential conflicts of interest.
- [ ] Clarify the level of engagement and ability to access key investment professionals.
- [ ] Know the OCIO's investment philosophy and process.
  Key focal points include:
  - Investment and research team dedicated to OCIO clients only
  - Product offerings including proprietary and open architecture, active versus passive vehicles, and access to alternative investments or ESG (if needed)
  - Differentiators in manager research process
  - Transparent and competitive fees relative to value-added, including underlying managers
- [ ] Consider the OCIO's ability to work with independent custody banks per industry transparency and fraud-protection best practices.
- [ ] Be able to provide robust, timely and customized reporting that includes: attribution analysis, peer group comparisons and portfolio aggregation.
- [ ] Confirm that the OCIO has a sufficient history of providing services over a full market cycle, and that performance composites presented are GIPS® compliant.
- [ ] Determine the OCIO's familiarity with applicable statutes and ability to provide valuable thought leadership and educational content for the benefit of board members

It is also important to note that there needs to be a baseline level of understanding investments so that one may effectively assess an OCIO provider. If this expertise is not available either on staff or within the organization's board, it would be prudent to hire an OCIO search firm to guide the process.

## Ongoing Oversight

Given PFM's OCIO experience, we have compiled a list of "best practice" initiatives that should be completed periodically:

REVISIT THE PORTFOLIO'S RETURN HURDLE (SPENDING + INFLATION + ADMINISTRATIVE COSTS) AND LIQUIDITY NEEDS:

- [ ] Does the spending policy and methodology still make sense?
- [ ] What are the fundraising campaigns and expectations?
- [ ] Will the portfolio support near-term strategic initiatives that require a high degree of liquidity?

REVIEW AND UPDATE THE INVESTMENT POLICY:

- [ ] Is the asset allocation appropriate given return objectives and liquidity needs?
- [ ] Are the benchmarks defined appropriately?
- [ ] Discuss ways to adjust the portfolio for a better risk/return relationship (e.g. the addition of alternatives)

ASSESS INVESTMENT PERFORMANCE VERSUS OBJECTIVES AND PEERS:

- [ ] Are portfolio returns meeting long-term goals?
- [ ] How do returns and expenses compare versus peers?
- [ ] How is the portfolio currently being evaluated and is this method still a relevant measure?
- [ ] Is portfolio performance GIPS® compliant for fair representation and added credibility?

EVALUATE THE INVESTMENT COMMITTEE'S GOVERNANCE STRUCTURE:

- ☐ What is the tenure of committee members, and do they have the necessary breadth, depth and time availability to fulfill their roles effectively?
- ☐ What is the process and criteria to elect new committee members?
- ☐ How long is each term and can members be re-elected?
- ☐ Has the organization adopted a staggered process to add new committee members to allow for the transfer of institutional knowledge?
- ☐ Has the board considered conducting an independent review of your investment process over the past five years?

LEARN ABOUT NEW INVESTMENT TOPICS AND TRENDS:

- ☐ What conferences/seminars should board members and stakeholders attend to facilitate continued education and the exchange of ideas amongst peers?
- ☐ What topics would the board like to learn more about?

MINIMIZE CONFLICTS OF INTEREST:

- ☐ Is there a separation of duties between the OCIO provider and the custodian?
- ☐ Does the OCIO provider profit from any underlying products used?

## Parting Thoughts

Only after a thorough assessment of an organization's specific needs is it possible to evaluate OCIO providers properly. Overall, the evaluation process can be quite arduous, and it will likely take a considerable amount of time to analyze all the pertinent information sufficiently. At the end of the day, an OCIO provider can help achieve both short and long-term goals. Choosing an OCIO that is a good fit for your organization is also important. Furthermore, providers offering breadth, depth, tenure and flexibility may be the best equipped to help investors navigate the unknown. The ideas and steps outlined above serve as a baseline to help institutional investors assess either their current or future OCIO provider.

**Please consult your PFM representative for any further questions or concerns.**