

**January 2021**

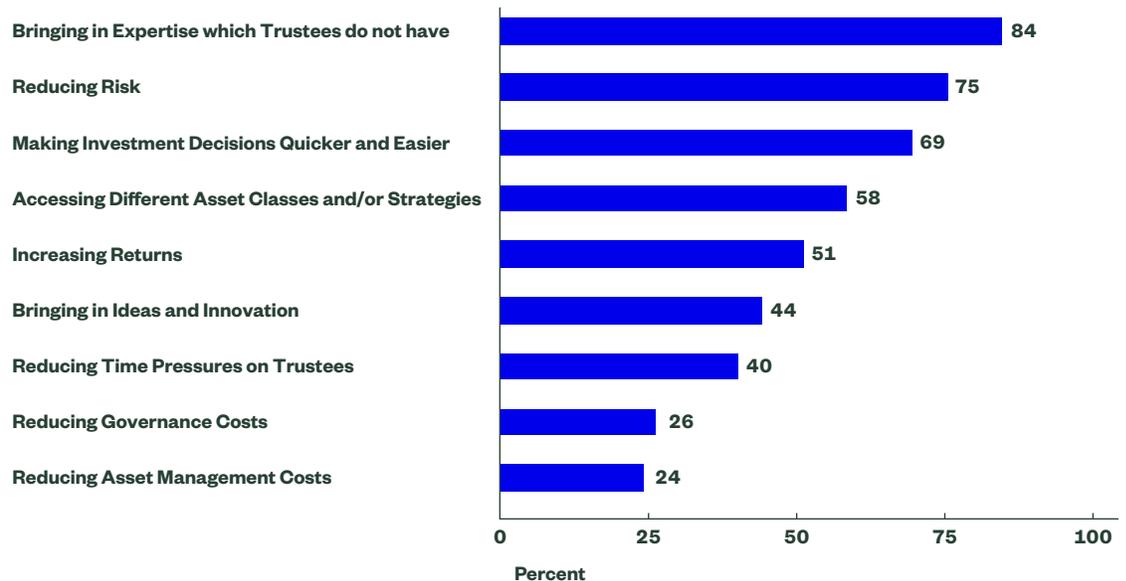
# Selecting an OCIO Manager

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- Investment programs, large and small, have shifted to an outsourcing model to help with increasing investment and resource pressures while improving fiduciary governance and oversight.
- Once a decision to outsource has been made, it's critical to know the right questions to ask to ensure successful partnering so the organization becomes a seamless extension of staff.
- While performance is important, it is only one aspect of outsourcing. Fiduciary and regulatory oversight, robust decision making and minimizing execution risks are also competencies essential to successful outcomes.
- It is important to identify an outsourcing provider whose culture and servicing model is well aligned with that of the client.

Figure 1  
**Top Reasons Plan Sponsors Outsource**



Source: Competition & Markets Authority survey, 2018.

The role of asset owners (e.g. Pension Plans, Endowments and Foundations) has become increasingly difficult. For teams where staff is limited or those with cost pressures that restrict acquiring adequate monitoring systems, the pressures of increased regulatory, market volatility and extensive oversight responsibilities, the challenges compound.

In addition, institutions already stretched from a lack of resources or tools are investing in a wider number of asset classes as they seek better returns. Some of these are quite complex and require more oversight than traditional asset classes. As this becomes apparent, many are considering shifting to an outsourcing model to improve both investment decisions and risk management.

## The Complexities Facing Asset Owners

While all asset mandates have their unique complexities, pensions can be particularly challenging. Pension management differs from traditional investment management in that there are multi-dimensional risks and considerations. Unlike traditional asset portfolios, the assets for a pension are used to offset increases and decreases to the corresponding liability owed to the pensioners. An understanding of the liability, including the interpretation of asset liability studies, is critical prior to setting strategic asset allocation and glide path design. These skills often fall outside of traditional plan sponsor roles, which are typically finance or HR. In these cases, delegating pension responsibilities can free up time to work on core business objectives, while improving fiduciary oversight, which the experts can provide.

Endowments have unique challenges as well. Many have high return targets driven by their desire to deliver on spending commitments, maintaining and ideally growing, the corpus on a real return basis. The return hurdle rate can be particularly challenging in a low return environment. Return objectives, coupled with the longer time horizon of an endowment, often results in a meaningful allocation to private market assets, like private equity and real estate, which require specialized knowledge and expertise to invest effectively. In addition, sophisticated modeling capabilities are required to ensure spending policies can be analyzed to construct a portfolio that will produce optimal risk adjusted returns while meeting liquidity requirements.

Healthcare companies typically have a variety of asset pools and plan types that each have unique goals. This drives the need for expertise across a broad set of asset classes and significant resources to ensure proper governance. In addition, there have been shifts in the market and regulatory environment, which can be challenging to navigate. There has also been substantial merger and acquisition activity in the industry. For companies that are actively involved, this added dimension needs to be incorporated into planning the portfolio's liquidity requirements.

## Outsourcing Models

Once an asset owner is considering the move to an outsourcing model, there are several decisions that they will need to make. One of the first things to determine is the extent that they would like to outsource. Outsourcing comes in a multitude of degrees and they will need to decide what is important for them to retain and where they may need additional help. The chart below is an example showing several of the responsibilities required to manage a pension fund. In the advisory model, the plan sponsor retains much of the ultimate decision making while delegating the work product to an outsourced manager. The full discretion model is at the other end of the spectrum and shifts much of the ultimate decision making to the outsourced manager.

In all cases, the plan sponsor retains ultimate responsibility for approving the strategic asset allocation and investment policy statement, as well as some of the reporting and regulatory monitoring. Asset owners should seek an outsourcing provider that allows them to customize the extent they are willing to delegate. Often this can fall somewhere in between advisory and full discretion. Some investors outsource “sleeves” of their portfolio where they may lack resources or expertise. This can make sense if a team loses a resource or decides to invest in a new asset class or strategy, such as private equity or real estate, which require specialized expertise.

Figure 2  
Scope of Services

Function	Ultimate Owner/Decision Maker ● Work/Product Ownership ■			
	Advisory		Full Discretion	
	Plan Sponsor	SSGA	Plan Sponsor	SSGA
Asset-Liability Analysis	● ■	■	■	● ■
Strategic Asset Allocation	● ■	■	● ■	■
Glide Path Design	● ■	■	■	● ■
Funded Status Monitoring (Pension)	■	● ■	■	● ■
Investment Policy Statement	● ■	■	■	● ■
Investment Management Agreement	● ■	■	■	● ■
Portfolio Construction	● ■	■	■	● ■
Manager Transition	● ■	■	■	● ■
Manager Oversight	■	● ■	■	● ■
Manager Hiring & Termination	● ■	■	■	● ■
Portfolio Rebalancing & Liquidity Management	■	● ■	■	● ■
Tactical Market Positioning	■	● ■	■	● ■
Derivatives Management (As Needed)	● ■	● ■	● ■	● ■
Regulatory & Compliance	● ■	■	● ■	● ■
Performance & Risk	● ■	■	● ■	● ■
Monthly & Quarterly Reporting	● ■	■	■	● ■
Quarterly Board Reporting	● ■	■	■	● ■

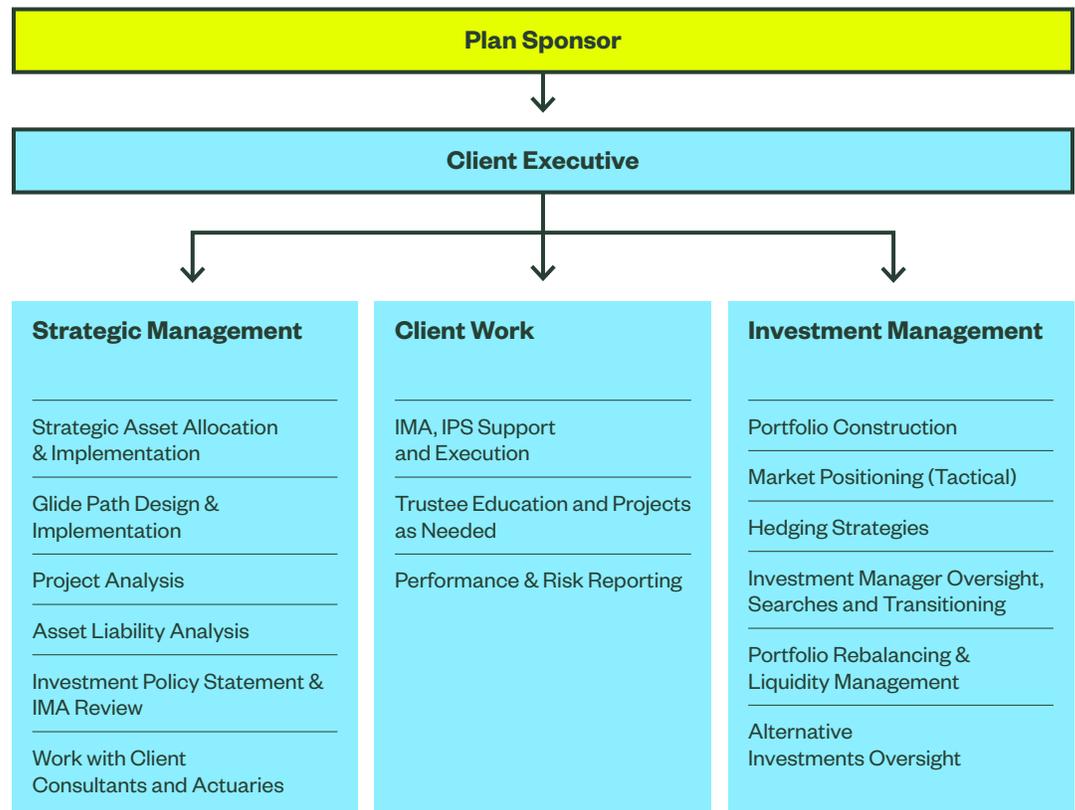
Source: State Street Global Advisors.

## Client Engagement Model

Client servicing models vary widely across different providers. Prior to outsourcing, consideration should be given to the level of service the asset owners as clients will expect. For those that want a high touch solution, it is important to ensure that aligns with the provider's business model. Noting the average number of accounts per relationship manager is a good first step. In addition, becoming familiar with the background of the specific team members assigned to your account is useful in determining the success of the partnering model. In a successful engagement, the client relationship person should be the direct link to the rest of the outsourcing team and ultimately feel like an extension of staff. It's key that they understand both the objectives and constraints of the client as well as the inner workings of the entire outsourcing organization. It is often beneficial if the relationship manager has worked at plan sponsor, endowment or foundation so they can better relate to the issues and constraints of their clients. Their experience as practitioners can be applied to today's problems to navigate towards better solutions.

In addition to traditional investment responsibilities, there are typically a multitude of projects that are done periodically. Trustees and boards often need education to get up to speed on investment frameworks or asset classes. For corporate pension plans, mergers and divestitures can be particularly complex when private market assets are involved. There are also typically ad hoc questions from boards. At the onset, it is important to know if your provider will be willing to perform these services and at what cost. Many providers only include basic services in their fees and bill on a project basis thereafter. Using a provider that includes all services in their fees, ensures the outsourcing team is used as an extension of staff without further consideration.

Figure 3  
Client Engagement Model



Source: State Street Global Advisors.

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## Outsourcing Providers

When searching for an outsourcing partner, asset owners will find there are different provider types with varying benefits to each. One notable difference is between consultant model and asset manager model. Most are familiar with consultants and may have used them for advisory services, so it could seem logical to use them when shifting towards a delegated solution. However, there are a few things to consider before doing so. Asset managers, as investors managing the portfolio in real time, can potentially save client's money by providing services that a consultant might have to outsource. Transition management, liability interest rate hedging overlays or tactical asset allocation can all be part of the delegated relationship which can save the client investment management fees. Asset managers also have the capabilities to take advantage of market dislocations or make adjustments to risk positions to reduce risk to the sponsors' portfolio, like applying currency hedges or equity overlay strategies to mitigate downside risk. Having the ability to tilt the strategic asset allocation can also provide an additional source of alpha, which is often diversifying to the excess returns of tradition asset managers.

Outsourcing partners can also have expertise outside of the United States. Large multi-national corporations increasingly use these services to help with the complex regulatory and governance issues across their non-US plans. This can result in a significant improvement of fiduciary oversight as regional experts help navigate through the complexity. Despite the unique attributes each country may have, outsourcing can also bring a relatively consistent investment oversight framework across geographies.

Regardless of model or expertise, outsourcing providers should have strong risk management and governance embedded in their process. It should be clear how decisions are made and show consistency across clients. They should demonstrate fully integrated risk management systems to highlight the risks across the portfolio and demonstrate their ability to respond quickly to changing market conditions.

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## Conclusion

The investment landscape is challenging and requires a significant amount of resources and expertise to manage effectively. Outsourcing, fully or partially, can often help ease this burden, while improving outcomes in a cost efficient manner. It's important to ask the right questions up front, to ensure a solid and successful working relationship.

### Expertise

- What is the background and experience of the team I'm hiring?
- How long have they been offering outsourcing services?
- Can they handle changing regulatory and compliance oversight?
- Have they worked with non-US clients?
- Will they meet my service requirements?

### Investing

- Will they limit my investment options?
- Can they adapt to changes in market conditions?
- Is there private markets expertise?
- How will they measure success?

### Cost

- Are the fees reasonable?
- Will they include all services?
- Is there transparency?
- Will I benefit from scale?

The breadth of outsourcing services can vary greatly, from simplistic to more sophisticated investment structures and approaches. With the wide range of offerings and different types of firms providing delegated investment services, it is critical to find a provider that can help achieve objectives with fees you can trust and understand. Finding the right outsourcing provider can entail some legwork, but results in the benefit of professional oversight with improved governance. Clients who use an outsourcing partner essentially expand the breadth and expertise of their team while freeing themselves up to focus on their core business objectives.

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