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OCIO or No CIO?

Getting the most from your investment provider

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Institutional investors of all types and sizes have most likely heard the term "outsourced chief investment officer," or OCIO. It essentially refers to firms that are hired by institutions to take on investment management responsibility on behalf of that organization. For decades, institutions with pools of capital—such as endowments, foundations, pensions, defined contribution plans, insurance funds, and even corporate business entities—have engaged investment firms to either assist or fully manage their pools of capital.

As its name suggests, an OCIO is hired to replicate the duties of an internal chief investment officer and investment office staff. In many cases, particularly for institutions with less than $1 billion assets under management, an OCIO may be the only investment management resource for an organization. For this reason, we believe that vetting and hiring an OCIO is just as critical for small- and mid-size institutions as building out an investment office is for their larger counterparts. Realistically, however, it is no mean feat for these leaner, more capacity- or investment expertise-constrained organizations to sift through myriad candidates to find a qualified, skilled, and trustworthy OCIO partner.

In our view, the proliferation of institutions seeking these services and investment firms willing to grow their business has led to a wide disparity in the types of services that are provided and a lack of clarity on the value an OCIO can provide. Let's take a closer look.

At a glance: responsibilities of an OCIO

- Learn about the institutional asset owner's financial objectives, including any return objective or liabilities, to help develop the strategic asset allocation and investment policy statement (IPS) for the portfolio
- Provide advice for investment and value-add resources beyond investing, implementing appropriate solutions to achieve the clients' goals
- Act as a fiduciary, putting clients' best interests first when acting as an investment advisor
- Perform spending policy/ liabilities analysis, investment policy development, portfolio construction, and ongoing portfolio management*

* "Exposure Draft Guidance Statement for OCIO Strategies," CFA Institute.

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Unfortunately, many institutions have engaged investment advisors thinking they hired and paid for an architect but later learn they have instead hired a contractor at architect fees.

An architect for your institution

First and foremost, an archictect meets with clients to understand their needs, goals, and constraints. Then, he helps construct a vision, builds a plan, and oversees the execution of both. This will require knowledge in "local building codes and safety regulations," so to speak, to ensure they comply with local laws—as well as broad knowledge of related providers in order to hire the best contractors and subcontractors for your specific job. This typically places the architect in a better position than their clients to negotiate lower fees from contractors and suppliers. Furthermore, they should have the ability to oversee the project through to completion, course correcting for unforeseen issues, and delivering the result that was discussed during the planning stages.

Unfortunately, our experience has shown us that many institutions engaged investment advisors thinking they paid for an architect, only to later learn they actually hired a contractor at architect fees. This can leave the institution's leadership frustrated, exposed to fiduciary risk, and in the position of having to take on more work than they expected or are capable of completing. All of this can lead to suboptimal outcomes, such as underfunded pension plans, watered-down philanthropic programs, underfunded expansion projects, or other undesirable tradeoffs.

OCIO-architects should work with decision makers and stakeholders to understand and, when appropriate, inform them about the vision and objectives of the institution. They should be capable of bringing a broad array of investment and reporting capabilities and possess deep experience in asset allocation, portfolio construction, and risk management. Additionally, they may also need to bring to the table comprehensive segment knowledge along with an understanding of the regulations that govern each specific entity. Lastly, they should provide dedicated client service and be able to work with additional vendors, such as banking partners, auditors, accountants, actuaries, and legal services. (See Figure 1, which provides a window into the broad spectrum of qualities and responsibilities that we believe translate into value for many institutional clients).

Continued

Figure 1

Our view on the characteristics of an OCIO that are required, as well as those that can add value

	Must have	Value-add
Helps fulfill the fiduciary responsibility	●	
Understands organization mission/objectives	●	
Conducts cash flow/liability analysis	●	
Helps build an investment framework	●	
Provides investment policy statement (IPS) construction	●	
Recommends asset class and portfolio benchmarks	●	
Assumes investment discretion	●	
Performs outside manager due diligence	●	
Executes trades	●	
Works closely with custodian bank	●	
Offers active and passive investment implementation		●
Utilizes a full complement of asset classes	●	
Engages in tactical asset allocation		●
Reviews IPS on at least an annual basis	●	
Includes private markets* capabilities		●
Offers sustainable investing alternatives		●
Can use direct/custom indexing to tailor portfolio, when appropriate		●
Continually improving product offerings to keep pace with clients' evolving needs		●
Provides investment performance updates, at least quarterly	●	
Offers performance attribution reporting		●
Delivers quarterly board reporting	●	
Capable of custom reporting (including cash flow analysis)		●
Seeks to maintain complete fee transparency	●	
Separates OCIO fee from investment manager and custody fees	●	
Provides transparency when using proprietary investment strategies	●	
Partners with banking providers		●
Conducts board and staff education, as needed		●
Serves as an "in-house" dedicated specialist		●
Dedicated client relationship manager	●	
OCIO is a distinct business line, dedicated to institutional clients	●	

* Private markets are only available to investors that meet Securities and Exchange Commission standards and are qualified and accredited.

Source: Wilmington Trust Investment Advisors, Inc.

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What is the rationale for so many institutions outsourcing their investment responsibilities to a third party? Improved risk management, better governance, cost savings, and investment sophistication.

The surge in OCIO popularity—are you falling behind?

Institutions across the size and segment spectrum have been gravitating more toward using an OCIO model in recent years. According to *Pensions & Investments*, total worldwide outsourced assets are up 41.5% over the previous five years, ending March 31, 2023.* In the United States, that trend is more pronounced with total outsourced assets up 52.4%. The publication also reports that the number of clients is up even more significantly, with endowments seeing a 164% increase, foundations up 133%, defined benefit plans up 82%, and defined contribution plans up a whopping 1,042%. This suggests the trend is moving down market.

The surge in OCIOs over the past few years begs the question: Why? What is the rationale for so many institutions outsourcing their investment responsibilities to a third party? The answers can be grouped into a few categories: improved risk management, better governance, cost savings, and investment sophistication, to name a few.

Figure 2

Reasons for outsourcing and their significance

Very important

5

1

Not important at all

	Score
Better risk management	**4.4**
Lack of internal resources	4.1
Faster implementation/decisions	3.9
Additional fiduciary oversight	3.8
Need to increase returns	3.7
Desire for strategic partnership	3.4
Cost savings	2.9

Source: 2023 Outsourced Chief Investment Officer Survey, *CIO Magazine*, June 13, 2023.

* "Volatility, complex markets buoy OCIO," *Pensions & Investments*, July 17, 2023.

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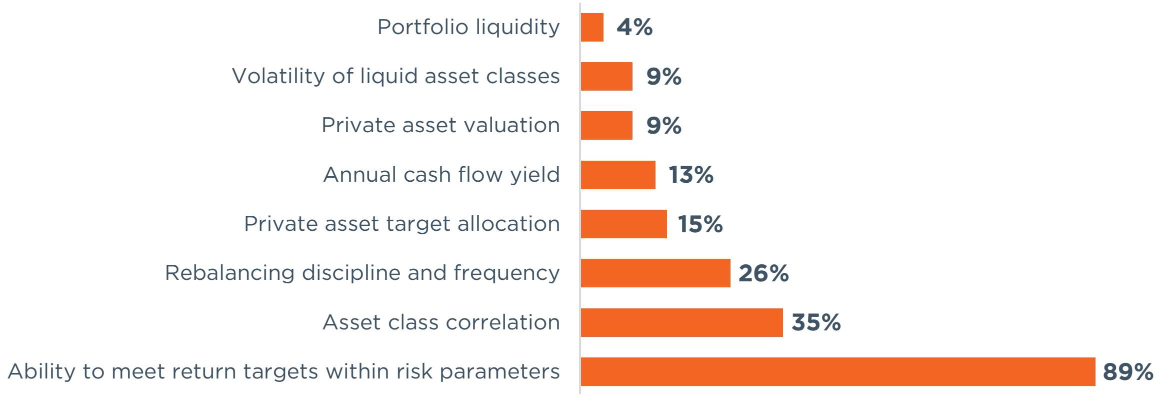
Figure 3

Top portfolio concerns of institutional investors



Data as of 4Q 2021, published in 2022.

Source: Chestnut Advisory Group, "The Widespread Impact of OCIO Growth," OCIO.org.

If a comprehensive assessment of your current OCIO reveals you are not receiving the full complement of value and services you are entitled to, let's discuss next steps. You deserve the very best guidance, resources, and solutions to help bring your organization's goals to fruition.

Asking the right questions

Understanding the framework within which your existing or prospective provider operates is crucial in helping to ensure expectations are aligned among the board, committees, staff, and providers hired to manage the investment portfolio. An alignment of convictions can lead to greater efficiencies, allowing an institution to focus on its mission while providers are dedicated to bringing that mission to life. Misalignment can lead to suboptimal outcomes at best, or a breach of fiduciary responsibility at worst. It is important to ask the following questions of—and receive satisfactory answers from—your provider or prospective provider:

1. Do you explicitly assume fiduciary responsibility for a portfolio?
2. Can you work with us to conduct a cash flow analysis—and how does that inform our investment policy and your investment decisions?
3. Are you proficient in the specific laws and regulations that govern our institution?
4. Are you able to show us the fees we will pay, both as a total and individually (e.g., OCIO fee, compensation for proprietary investment or other vehicles, custody, etc.)?
5. Does our relationship management and investment management team specialize in OCIO relationships?
6. Do you have additional subject matter expertise at the firm that you can make available to us should we request it?
7. What is your risk management process?
8. Can you assist us with an IPS review and help us revise our IPS if necessary?
9. Can you meet with us, at least quarterly, and be available for ad-hoc meetings, as necessary?
10. Will our portfolio be tailored to our organization vs. one that is more cookie-cutter and applies to many organizations?

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Summary

The growth of institutional asset management and the desire to outsource critical investment management functions has led to a landscape that includes a wide variety of providers and services. We have observed that, in many cases, this has further led to a misalignment of expectations, overpaying for services, and increased fiduciary risk, often unbeknownst to the asset owner. All of this can result in suboptimal outcomes, causing harm to the mission of an institution, underfunded pension obligations, or financial shortfall for capital expenditures.

Knowledge is the first step in empowering you to fulfill your organization's investment and other goals. To that end, clarifying whether your board or provider is truly fulfilling the many responsibilities of an OCIO can start the process of optimizing your investment strategy and uncovering resources that were previously unknown or underutilized. From there, go through the checklist of responsibilities to see where your organization—or OCIO—is lacking. To learn more, click here, and then reach out to us at OCIO@WilmingtonTrust.com to discuss next steps.

Figure 4

Most important factors driving OCIO hiring decisions

Data as of 4Q 2021, published in 2022.

Source: Chestnut Advisory Group, "The Widespread Impact of OCIO Growth," OCIO.org.

[1] Environmental, social, and governance

[2] **Alternative assets, such as strategies that invest in hedge funds, can present greater risk and are not suitable for all investors.**

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