



# Outsourced chief investment officers: Challenging five common myths

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# The five common myths and why we should challenge them

For plans that do not have in-house investment capabilities, the delegated investment model, or outsourced chief investment officer (OCIO), is a means of filling the gap between the resources required to run efficient investment strategies and the typically constrained governance budget of a pension plan. The delegated manager implements an investment strategy within boundaries set by the investment or pension committee, allowing high-level decision makers more time to focus on key strategic issues and long-term plan goals.

The concept is fairly simple, but the implementation can be less easy to visualize. For this reason, a number of myths have arisen around this model.

## Myth 1: An OCIO leads to loss of control

A concern among some sponsors and investment committees is if you delegate some of your decision making to a specialist, you are no longer in control of your plan and potential investment outcomes. However, delegating investment does not mean giving up control. Investment committees still control the objectives and the constraints within which the plan operates, such as which asset classes are selected – potentially the hedge ratio, cost budgets and liquidity. If circumstances or needs change, investment committees and plan sponsors still have the power to change the objectives and the constraints within which the delegate is working.

In addition, the investment committee or plan sponsor is fully responsible for the oversight of investment activities. Importantly, the time freed up allows the committee to focus on strategic decisions that really matter.

## Myth 2: An OCIO is a conflicted model

Critics argue that OCIOs are conflicted because they profit from their position as both advisor and investment implementer. But we believe there is surely a distinction to be made between incentives and skewed incentives. A good service will always command a fee. In the OCIO model, plans may pay a service fee, and it should be transparent and separate from any investment management fees. OCIOs will only retain these mandates if they perform their duties and are held accountable. Quite often the investment committee will make an annual assessment for their records.

If the perception of an unmanaged conflict persists, this is not necessarily a reason to jettison a service that is potentially highly beneficial to the plan – such a move turns a win-win situation into a lose-lose one. We believe conflicts of interest exist in every walk of life and can often be managed effectively with some thought.



### Myth 3: An OCIO is a new and untested concept

While the terms “OCIO” and “delegated management” are relatively new, the ideas that underlie them are not. A multi-asset approach to managing pension fund portfolios is nothing new. However, across the industry, we believe the multi-asset approach is often implemented through a range of costly or inefficient allocations. We feel this is unwieldy, as it requires a high level of governance on the part of the plan. In the outsourced model, governance is considerably strengthened and portfolio decisions can be made in real time to take advantage of changing market opportunities. Delegated management has been a feature of the pension landscape for more than a decade. Based on our experience, outcomes have been generally positive and have the potential to improve funded status, particularly in volatile market conditions.

### Myth 4: An OCIO is only for plans of a certain size

We feel the model is less about size and more about how feasible it is to build a dedicated in-house resource to manage the considerable demands of institutional portfolio management. Although such a resource can appear to be a natural fit at first glance, many organizations have discovered that finance professionals are strained to assess

risks within a real-time investment environment. In addition, finance functions today are often shared services, so we believe allocating individuals to the pension plan can leave the function short of resources. Of course, the very large plans do have the option of developing an in-house team, and some have exercised this option. But for most other plans, we believe the OCIO may potentially improve their investment governance and outcomes.

### Myth 5: OCIO is expensive

It is understandable that this criticism is leveled at the OCIO model. After all, plans are asked to spend more money on a service that was previously a relatively small part of the annual budget. But in aggregate, across the plan, employing an OCIO does not necessarily mean costs rise.

Why? The client may anticipate an overall potential savings for the plan from lower investment fees due to the OCIO’s buying power as well as intangible time savings for staff and committee members.

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