"O-I-See": Debunking the outsourced CIO myths

This paper addresses common myths surrounding the outsourced chief investment officer model, to help asset owners better understand this alternative management approach to portfolio construction and implementation.

For many asset owners, the fiduciary management model, or outsourced chief investment officer (OCIO) model as it is known in North America, Europe and increasingly in Asia Pacific, is a means of gaining access to more resilient and efficiently managed investment portfolios.

As asset owners struggle to generate returns that meet objectives, manage cash flows and handle day-to-day administration – all with an eye on risk management – the OCIO model offers a new way forward.

Here the OCIO implements an investment strategy within the boundaries set by the investment board or committee, allowing high-level decision makers more time to focus on key strategic issues and core business activities.

The concept is fairly simple, but the implementation can be difficult to visualise. For this reason, a number of myths or misconceptions have arisen around this model which we set out, and expand on, below.

Myth 1: Moving to an OCIO model leads to a loss of control

There may be concerns among asset owners that in delegating some of their decision making to a specialist, they are no longer in control of their fund and potential investment outcomes. In fact, many OCIO users have described precisely the opposite, as their board or committee meetings become more focused on issues which are more likely to impact their fund – such as whether or not the target risk profile is appropriate, or if there is sufficient liquidity in the portfolio to meet outflows, and if costs are being effectively managed.

Asset owners remain in full control, and set the return objectives, risk profile and the constraints within which the OCIO operates. The OCIO simply executes the strategy. If circumstances or needs change, the asset owner has the power to change the objectives and the constraints. Further, the investment board or committee usually remains fully responsible for the oversight of investment activities.

Myth 2: OCIO is a conflicted model

The OCIO service can cover many responsibilities – strategic advice, portfolio construction, manager selection, risk management and implementation.

Critics argue that OCIO service providers are conflicted because they could profit from their position as a portfolio allocator, as well as, in some cases, the underlying investment manager if in-house investment funds are used.

Normally the asset owner will pay a portfolio management service fee to the OCIO, and we believe this fee should be transparent and separate from any fees paid to investment managers. In our view, the OCIO should not get paid by, or receive incentives from investment managers, including those of in-house funds.

Moreover, asset owners tend to look for an OCIO service provider that adopts an open architecture approach. With this approach, the service provider implements through specialist external managers rather than in-house investment teams, (some of which may be very good, while others may not be).

The formal assessment of an OCIO's performance should be based on the outcomes, for example, meeting risk and return objectives of the mandate after all fees, reducing operational burden and delivering on client service needs.

Myth 3: The OCIO model is a new and untested concept

While the terms "OCIO" and "fiduciary management" are relatively new to asset owners in the region, the ideas that underlie them are not.

Multi-asset portfolios are not new. However, across the industry, we believe the approach is often implemented through a range of expensive products and often with inefficient allocations.

This model typically involves a higher degree of customisation relative to a single manager multi-asset product. Client portfolios are tailored to their specific objectives, liabilities (if any), cash flow needs and the evolving views or investment beliefs of the asset owner and wider stakeholders.

We further note this model has been in place for more than 10 years, especially in North America and Europe. OCIOs have helped improve the funding status for defined benefit pension plans and provided a smoother return stream for other asset owners like defined contribution plans and endowments – particularly important in volatile market conditions.

The 2018 KPMG Fiduciary Management Survey estimates that approximately 15% of all UK defined benefit schemes now use some form of delegated management. According to a recent survey by Cerulli Associates of OCIO assets under management in the US, the market size is now $1.1 trillion and is expected to reach $1.7 trillion by 2023.

Myth 4: An OCIO framework is only for asset owners of a certain size

We can directly observe asset owners ranging in size from $10 million to $10 billion utilising the OCIO model. Some have found value in using this model for a particular asset class, and not necessarily their entire portfolio. This could be the case for more difficult to access alternative asset classes and private markets allocations.

Our view is that the model is less about size, but more about investment beliefs, robust portfolio design and efficient implementation.

Of course, very large asset owners do have the option of developing an in-house team, and some have exercised this option. But for most other resource-constrained asset owners, we believe the OCIO model can improve their governance and investment outcomes.

To arrive at the type of multi-asset, multi-manager specialist portfolio you should expect from an OCIO, would require a substantial dedicated in-house portfolio management team, market and manager research coverage, operations infrastructure, technology and scale. This is not naturally found in most corporate, university, charity and foundations' finance functions, and to develop such expertise would amount to a substantial cost.

Myth 5: An OCIO service is expensive

It is certainly the case that asset owners are being asked to spend more money on some services, which were previously a relatively small part of the annual budget. However, it's not about the expense, it's about the value.

Firstly, the OCIO takes on a significant number of responsibilities in terms of designing, building and implementing the investment strategy, as well as on-going management, oversight, compliance and reporting.

Secondly, employing an OCIO does not necessarily mean costs rise. An OCIO can bring substantial buying power that can reduce investment manager fees and even result in a reduction in total fees (even allowing for the OCIO fee).

Finally, it is important to consider the time and energy saved by freeing up resources and executive time spent on managing the day-to-day investment arrangements of the portfolio.

Summary

In summary, don't let the myths prevent you from taking advantage of the investment experience, innovation and buying power provided by an OCIO like Willis Towers Watson. Talk to your professional advisor or consultant today and explore how the OCIO model can help build and execute investment portfolios on your behalf.

Further information

Please contact your usual Willis Towers Watson consultant or email investment.solutions.asia@willistowerswatson.com

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This paper was written by members of the APG for general information purposes only.

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