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# The OCIO Model: How Do We Measure Success?

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The outsourced chief investment officer (OCIO) industry has grown significantly over the last 10 years. Low barriers to entry have contributed to a proliferation of providers in this space, from boutique firms to larger investment management and investment consulting organizations. Given this growth, institutional investors will need to be prudent in evaluating the changing dynamics of this space.

***(Estimated reading time: 3 min 1 sec)***

According to Cerulli Associates and Plansponsor, defined benefit plans and nonprofits with $250 million or less in assets represent the largest client base for OCIO services. Institutional investors with limited internal resources are particularly attracted to this model, as some do not have the capability to handle the complexities of less liquid and less transparent investments that may be necessary to achieve desired return objectives.

One of the key questions for evaluating the performance of the OCIO community is: How do we measure success? We recently wrote a comprehensive paper on the subject, and wanted to share in this blog post several fundamental factors that successful institutional programs should embrace:

- **Keep the Best Interest of the Fund and Its Beneficiaries in Mind:** This is a fundamental principle in supporting the investment needs of clients. This is particularly important for OCIO mandates given their custom nature and the need to manage multiple variables to enhance the potential for competitive performance.
- **Open Architecture Platforms:** In our experience, open architecture platforms with best-in-class products at competitive fees offer a better opportunity for implementing best-in-class mandates, as no investment manager is proficient in every asset class it offers. Furthermore, model portfolios may not meet the needs of every client. This approach also helps eliminate potential conflicts of interest inherent in a proprietary fund framework.
- **Power of Simplicity:** We believe in keeping investment structures relatively simple, without needing to sacrifice sophistication or diversification opportunities. In some cases, as assets grow, investment structures become more complex to take advantage of specialized strategies. Even in these circumstances, we believe in reducing complexities and introducing efficiencies in implementing a sound manager structure.
- **Monitoring Agency Risk:** Here are some of the common agency risks we believe need to be monitored closely:

a. **Fees:** Underlying product fees may be higher for some OCIOs compared to alternatives. Fee negotiations should create value for the exclusive benefit of the client. Fee transparency is also very important. The fund sponsor needs to be aware of the fee structure to ensure that common interests are aligned appropriately.
b. **Tactical Approaches:** OCIO service providers usually command a premium for tactical positioning to take advantage of short-term market anomalies for alpha generation. However, in our experience, managers have had limited success creating value consistently using this approach. This raises the question of the manager’s value proposition regarding a tactical approach. If the client is paying for tactical asset allocation, the OCIO should take advantage of these market dislocations for alpha generation. Otherwise, why should the client pay these fees? We believe fee structures need to be aligned with the best interests of the client in mind.
c. **Manager Selection:** The quality of the OCIO’s manager selection process has implications for the client, mainly in terms of performance, manager turnover, frictional costs, and the potential for conflicts of interest. OCIO providers need to have a well-documented manager search process that supports quality, operational efficiencies, value creation, and operational continuity to help identify long-lasting product solutions for clients. The process needs to avoid a manager-selection process driven by any economic interests between the OCIO and other third parties and needs to focus on identifying the best possible product solution for the mandate in question.

- **Managing Client Expectations:** We believe it is important to set realistic expectations with clients to make sure they understand the full range of services offered by the OCIO and its limitations. There is a fine line between employing aggressive sales practices in pursuit of new business and setting the right expectations with clients and prospects. This dynamic may tempt some service providers to over-promise and under-deliver, impacting the quality of their services and contributing to a situation that may not be sustainable or tolerated by clients.