

Navigating the OCIO Spectrum

MAKENA INSIGHTS

Dear Investors,

The last decade has seen tremendous growth in Outsourced CIO (“OCIO”) assets, from just \$100 billion globally in 2007 to over \$2 trillion today.¹ However, the term “OCIO” is broad, at best. A large and diverse array of firms provide OCIO services with different goals, strategies and fees. Combined with each firm’s specific nuances, comparing this array of firms is nearly impossible. The derivative industry of search consultants – advisors who charge handsome fees to conduct an OCIO search – has emerged to assist institutions with negotiating the complex OCIO landscape. Yet, even with the assistance of search consultants, an institution’s decision-makers must be able to clearly articulate their goals and needs to navigate the OCIO landscape and ultimately select a provider. We have identified four key areas of differentiation among the OCIO industry. Within each area, there is a wide spectrum of offerings. This document acts as a guide to navigating each area of differentiation. Understanding the breadth of offerings and how to assess them will help focus an institution’s OCIO search.

1. Investment strategy: How do you determine which OCIO provider has the right investment strategy for you?

Targeting an OCIO provider who partners with institutions like yours is a good place to start. Whether your primary goal is risk mitigation for defined benefits, long-term appreciation plus payout, or something in between, there are OCIO providers specializing in an investment strategy to suit your needs. Some firms specialize in low cost passive options which offer greater liquidity. Some firms specialize in manager selection and alternative strategies, seeking to capture a return premium for illiquidity risk. Some firms exercise tactical asset allocation, while others adhere to a rigid strategic asset allocation. Having a clear vision of your institution’s risk and return goals and decision-making abilities will significantly narrow the type of OCIO provider whose services best fit your needs.

2. Discretion: What is the interaction model between you and your OCIO provider?

Do your institution’s decision-makers want to retain discretion over investments, or will that be delegated to the OCIO provider? Some OCIO firms may require full discretion (and with added responsibility likely comes a higher management fee), while firms offering a more consultative OCIO service do not. Many Investment Committees have regular turnover, which presents a challenge to continuity. In these instances, delegating discretion to an OCIO provider’s dedicated team can provide the continuity required to ensure your institution meets its goals over the long-term. Your institution’s ability to make investment decisions is also an important consideration. Amidst a volatile market, can your institution make timely decisions to protect against permanent capital loss? Investment discretion should be detailed in the Investment Policy Statement, as well as items such as benchmarking, reporting guidelines, and interaction expectations.

¹ <https://www.blackrock.com/institutions/en-us/literature/whitepaper/ocio-at-an-inflection-point.pdf>

3. Customization: Is a custom portfolio solution right for you? What are the pros and cons?

The foremost pro of customization is that it allows institutions to fine tune risk, return and liquidity parameters to fit their specific needs. For example, if institutions have stringent ESG requirements, full customization may be a great option. However, OCIO firms offering custom portfolios may approach customization differently; some provide completely bespoke investments, while others customize using commingled pools as building blocks, enabling custom allocations but not bespoke investments. A commingled approach can be favorable when capacity-constrained alternative investments are included, removing potential allocation conflicts. A commingled approach might also better align interests among clients; a customized approach could lead to misalignment among clients, especially if a particular client pays higher fees compared to other clients.

4. Fees: What costs are included (or excluded) in stated fees, and are services offered at a competitive value?

OCIO fees come in several different flavors: flat management fees, tiered management fees, performance fees, negotiable fees, supplemental fees for add-on services (e.g., access to alternatives or legacy portfolio oversight), etc. Fees may be advertised anywhere from 10bps to 100bps or more.² It is important to know what costs are included or excluded from the stated fees; à la carte services and expenses such as audit, tax, custodian, and administrative may be left out. If the OCIO provider allocates to third-party managers, what fees do they earn? Are third-party managers affiliated in any way to the OCIO provider? Transparency is critical when assessing and comparing fees among OCIO providers. Equally important, fees should represent the level of service provided. Actively managed or alternative strategies will cost more than passive strategies because of the resources required for optimal execution.

Conclusion

The OCIO industry is a vast spectrum. Even when two OCIO providers look comparable on paper, there are likely nuances and intangibles (concerning anything from track record to fees to client service) which must be approached with caution and transparency to accurately compare the two providers. An important “golden rule” when selecting an OCIO provider is that there should be alignment with the provider, and ideally with other clients, when considering the four key areas of strategy, discretion, customization and fees. An OCIO relationship is a partnership, and therefore both the client and the OCIO provider should prosper in a successful partnership.

Sincerely,

Nic Amaroli on behalf of the Partners of Makena Capital

² <https://www.diversifiedtrust.com/site/web/assets/2017/07/DTC-WhitePaper-OCIO-201707-R12.pdf>,
<https://www.commonfund.org/research-center/articles/of-apples-oranges-and-onions-assessing-ocio-performance-and-fees>

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