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SPECIAL REPORT: OCIO

Complex portfolios spur increased use of outsourced CIOs


Cary Grace

By James Comtois

The current low-return environment combined with a recognized need to build more diversified portfolios is driving increased institutional investor appetite for outsourced chief investment officer services, experts said.

Plus, more foundations, endowments with larger pools of assets and defined contribution plans are seeking OCIO services.

"The markets are more complex and volatile, there's increasing geopolitical uncertainty, so (asset owners) are continuing to seek outside expertise," said Cary Grace, CEO of Aon Hewitt's global retirement and investment solutions group, Chicago.

Pensions & Investments' data show total worldwide OCIO assets among firms in its database reached $1.69 trillion as of March 31, up 11.2% from a year earlier. Total U.S.-client outsourced assets, meanwhile, reached $1.15 trillion during the period, a 13% increase.

"More asset owners are looking at their ability to manage their retirement assets and are saying they don't have the resources to compete," said Debra Woida, a director and head of delegated investment services, North America, Willis Towers Watson PLC, Chicago.

The intention to take advantage of more market opportunities, the need to achieve improved outcomes and the desire for more transparency within the industry also is driving asset owners to partner with OCIO providers, Ms. Woida said.

It has become more normal for asset owners to outsource than it was 10 years ago, she added.

"If you haven't thought about (OCIO) or done it, either your CFO or someone on your board will ask you to consider it," Ms. Woida said.

According to P&I's data, Willis Towers Watson's OCIO business had $81.3 billion in total worldwide institutional outsourced AUM as of March 31, up nearly 10% from the year before.

In terms of outsourced institutional AUM, Mercer LLC tops the list of the largest managers of outsourced assets, with $157.5 billion in worldwide institutional outsourced AUM as of March 31, up 26% from the same period a year ago.

"It's been a culmination of strategy, implementation and execution," said Rich Joseph, a Boston-based partner and head of Mercer Investment Management's U.S. delegated solutions business.

Mr. Joseph said he's seen OCIO pick up traction in the defined contribution market as well as within foundations and endowments.

"Historically, the E&F clients who have looked at OCIO have been on the smaller side of the industry spectrum," Mr. Joseph explained. "We are now seeing much larger pools of E&F assets, as committees look to leverage the buying power and governance structure that our OCIO model can bring to bear. This allows committees to focus more attention on their strategy and/or missions."

To succeed in the OCIO business, it is essential to "have solutions in all spaces, not just DB, but also DC, foundations and endowments and non-profits," he said.

Russell Investments Group LLC was the second-largest outsourcer in P&I's database, with $123.69 billion in global outsourced institutional AUM as of March 31, up 13% from the year-earlier period.

"Every organization knows that the implementation of their assets is very difficult, and their boards are asking them to do more with less," said Bryan Weeks, head of Russell Investments' Americas institutional business in Seattle, on why asset owners are increasingly looking to partner with outside companies to help invest their portfolios.

Mr. Weeks, like Mercer's Mr. Joseph, also has noticed that interest in OCIO services goes well beyond the defined benefit universe.

"On the DC side of things, there's an increased awareness of their (DC plan sponsors') fiduciary responsibility," Mr. Weeks said. "As DC becomes a bigger and bigger part of the retirement space, (sponsors) want to bring the best solution they can to their participants."

Meanwhile, foundations and endowments are facing two major challenges with which an OCIO provider can help, Mr. Weeks said.

One challenge centers on raising capital. Foundations and endowments typically raise money by delivering smart performance — or superior risk-adjusted investment performance, according to the Russell executive. If performance is challenged, donors are less eager to give.

The other challenge is having a spending rate expectation that's supported by investment returns of between 7% or 8% — also difficult in an environment where market returns are predicted to be significantly lower.

"These situations are where partnerships are going to be important," said Mr. Weeks.

Mr. Weeks has seen more larger plans also turn to OCIO. "It's not just small institutions," he said. "Two of our (newest OCIO relationships) are above $1 billion each. And that just didn't happen five years ago."

Aon Hewitt, the third-largest OCIO provider, had $102.9 billion in total global institutional outsourced AUM as of March 31, up 18% from the same time the year before. Ms. Grace attributed the company's growth to a combination of increased investor need for OCIO services and Aon Hewitt's strong reputation, business model and scale.

Most asset owners are taking a long, hard look at what their core business objectives are, and in most cases, realize they're not investment managers, she explained.

"So, they're looking at the backdrop of the market and looking at what they want to achieve, and decide their outcomes will become more optimized if they partner with an outsourcer," Ms. Grace added.

Rounding out the top five were SEI Investments (SEIC) Co., with $95.9 billion in global institutional outsourced AUM as of March 31, up 13% from the year-earlier period; and BlackRock (BLK) Inc. (BLK), with a 1% gain to $88.3 billion.

"We've always been strong in corporate defined benefit plans, but we're also seeing growth among foundations and endowments, and in DC," said Paul Klauder an executive vice president of SEI and head of its institutional group in Oaks, Pa. "Many our DB clients have also selected us for their DC plans."

As these institutions' portfolios become more sophisticated and more diversified, more asset owners — particularly foundations and endowments — are questioning if managing their portfolios internally is the right move, he explained.

"There's also been an explosion in DC plans as many DB plans are closing. Many sponsors feel like they've given their participants too many choices, so they need to simplify," said Mr. Klauder.

The SEI executive added he's seen these trends escalate "within the past three years."

Meanwhile, Ryan Marshall, a managing director and global head of client solutions within BlackRock Solutions, New York, said the low return environment has been forcing asset owners to recognize they need to build more diversified asset portfolios.

This, in turn, is driving asset owners toward OCIO providers, because many realize they don't have the in-house staff necessary to build such diversified portfolios.

"This may be the single largest challenge for institutions, particularly those global investors that historically have invested in bond-heavy portfolios," said Mr. Marshall referring to asset owners' lack the staff and/or experience necessary to properly handle a more diversified and complex asset class base.

Another factor driving increased interest in OCIO is the need for improved governance and risk management, he said.

At the same time more institutional clients want to build more diversified portfolios to achieve better returns, they also recognize they need to bring on or have in parallel a more robust risk management framework.

"So, that element of providing OCIO around the measurement and management of risk is another theme that goes hand-in-hand with this trend of building more diversified portfolios," Mr. Marshall said.