RISK & INNOVATION

The Rise Of The Outsourced Chief Investment Officer

OVERVIEW

In the eight years following the global financial crisis, a combination of ultra-low interest rates, market volatility, low growth, and tightening regulatory standards have all impacted the financial markets abilities to deliver consistent returns.

This has put substantial pressure on investment managers. Pension funds, in particular, have struggled to reduce their funding gaps, where the present value of liabilities exceeds the market value of their assets, in an era of historically low interest rates.

An increasingly complex market environment has demanded more sophisticated investment strategies and left many funds, corporations and non-profit organizations reconsidering their approach to how they best manage their assets.

As Andy Cox, CEO EMEA, Retirement & Financial Management, Aon Hewitt, explains: "Investors need to have enough investment knowledge and skill to pay attention to pretty volatile investment markets in a low interest, low inflation environment. In pursuit of a return, we have an increasingly complex set of investment options available. This is a specialized area that needs specialist support."

The idea of turning to external experts to manage their investments is becoming increasingly popular with a broad swathe of assets owners. In the past decade, the concept of using an outsourced Chief Investment Officer (OCIO) has gone from a niche solution – predominantly relied on by corporations managing frozen defined benefit pension plans – to a viable option for numerous asset managers, from university endowments to institutional investors.

With an uncertain political and economic environment around the world, companies and institutions are embracing discretionary investment models in order to access the expertize and scale needed to get the most out of their investments.

IN DEPTH

40%

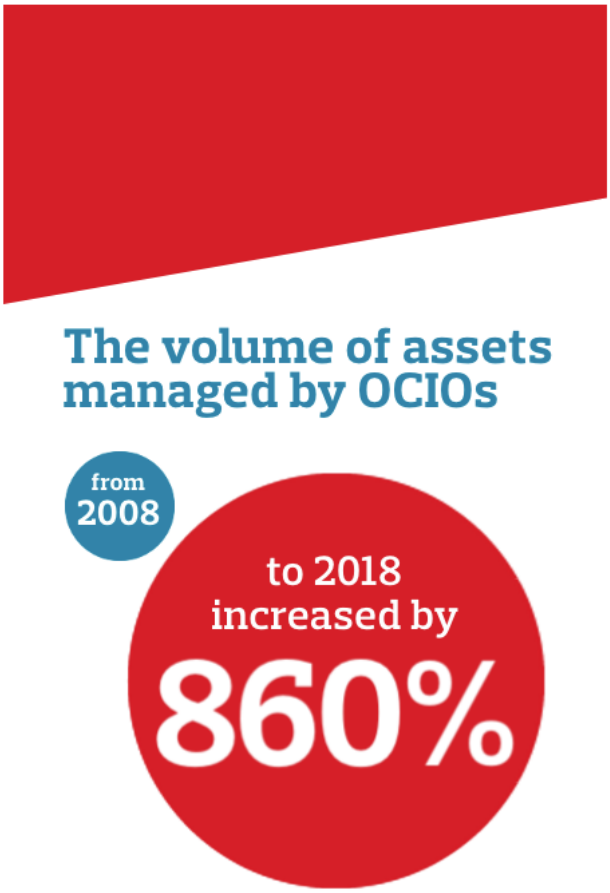
of organizations surveyed are currently outsourcing their investment program, or planning to in the next 2 years

Source: Chief Investment Officer Magazine 2017 OCIO survey

The OCIO or discretionary investment management model enables an asset owner, whether that is a company, fund or institution, to delegate responsibility for all or part of their investment portfolio to a full-time investment adviser.

The OCIO then makes all investments decisions regarding where to allocate the assets under management – including which funds or asset classes (equities, bonds, property, commodities, cash, alternatives) to invest in. Their actions are taken on a discretionary basis, following the agreement of an investment strategy and risk tolerance. OCIO services are mostly provided by banks and brokerages, asset management companies and pension actuaries.

The OCIO Market Has Rapidly Expanded Over Recent Years

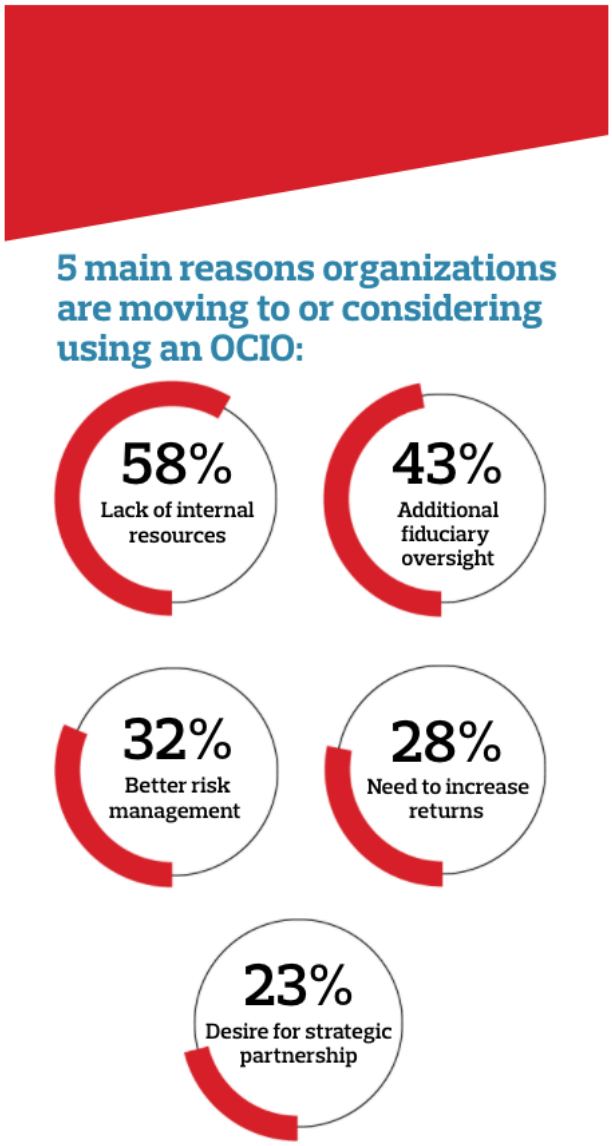


Source: Chief Investment Officer Magazine 2017 OCIO survey

A decade ago, outsourced investment services were predominately used by companies with frozen defined benefit pension plans, as they sought to de-risk their business and minimize the amount of time and energy they spent on it. The use of OCIO solutions has since spread to a variety of asset owners, including active corporate defined benefit and defined contribution pension plans, university and healthcare endowments, sovereign wealth funds and institutional investors.

This has caused the volume of assets under management by OCIOs to rise considerably. In 2017, worldwide OCIO assets reached $1.69 trillion – an 11.2 percent year-on-year increase – a $1 trillion more than just five years ago.

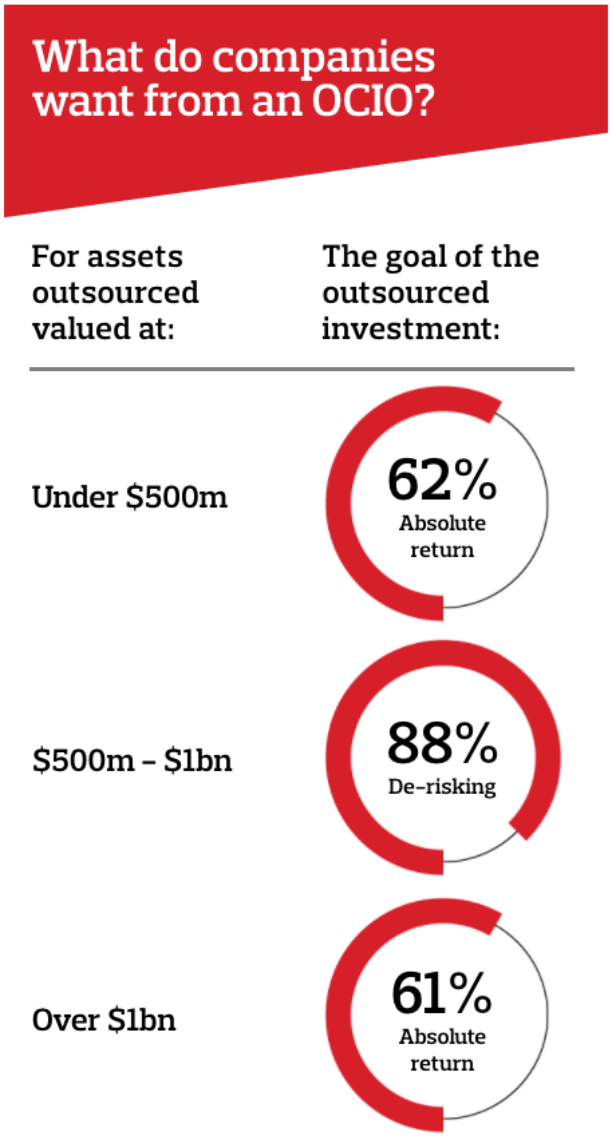
Why Is This Happening?



Source: Chief Investment Officer Magazine 2017 OCIO survey

In a period of high uncertainty and low interest rates, firms are questioning whether managing their investment program is something they should be doing on their own. Many companies lack sufficient resources to manage the portfolio internally. They do not have the necessary speed of internal decision-making or the economies of scale to get the investment returns they want. By delegating that responsibility to a full-time investment adviser, they can focus on their area of specialization.

What Should You Consider When Choosing An OCIO?



Source: Chief Investment Officer Magazine 2017 OCIO survey

There are a number of priorities to consider when deciding whether to outsource your investments. Does the OCIO have the scale and broad infrastructure to leverage a multitude of competencies and investment specialists? Can they access all investment classes and allocate the assets across a range of risks? What kind of fees do they charge, and how transparent is their pricing process? Does the OCIO have a financial incentive to include or exclude any particular investment manager or sell you their own products? Do they have a history of generating returns and meeting client expectations?

Full consideration of these factors is essential if a company is to delegate its assets to an investment adviser with whom they wish to have a successful relationship.

Is Outsourcing The Future?

"The markets are more complex and volatile, and there's increasing geopolitical uncertainty, so asset owners are continuing to seek outside expertise," says Cary Grace, CEO, Global Retirement & Investment Solutions Group, Aon Hewitt.

OCIOs offer the ability to delegate investment responsibility to specialized managers who are focused exclusively on the task at hand, leaving the asset manager in a position of oversight and free to focus on the objectives of their organization. The dynamic of the relationship itself also has value – with the distance between asset owner and asset manager providing a useful commodity that can be hard to come by in times of volatility: perspective.

TALKING POINTS

"Many plan sponsors are not in the investment business, and the OCIO model lets them outsource that responsibility to a full-time investment advisor, which may provide better outcomes and allows them to focus on their area of specialization." – Stephen Cummings, Chief Executive Officer, Aon Hewitt Investment Consulting

FURTHER READING

- Pros And Cons Of Outsourcing Investments – FT Adviser, July 6, 2017
- Ready For Launch: The Firms Giving Fund Groups A Run For Their Money – Money Marketing, March 13, 2017
- Complex Portfolios Spur Increased Use Of Outsourced CIOs – Pensions & Investments, June 26, 2017

- Branching Out – Why OCIO Services Are Taking Root in New Markets – Chief Investment Officer Magazine, April 19, 2017
- Five Considerations For Evaluating An Outsourced Chief Investment Officer – Wealth Management.com, June 30, 2017