CLEARPOINT

clearstead

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JOHN EVANS, MANAGING DIRECTOR

CHOOSING AN OUTSOURCED CHIEF INVESTMENT OFFICER (OCIO)

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The Outsourced Chief Investment Officer (OCIO) model has experienced tremendous growth over the last decade. As the model evolves, there are several factors that institutions should consider before choosing an OCIO or when reviewing their current OCIO provider. This ClearPoint article defines the OCIO model, examines its growth over the last decade, reviews considerations for choosing an OCIO, and discusses the evolution of the OCIO model at Clearstead.

WHAT IS THE OCIO MODEL?

Large institutions, those with more than $1 billion in assets, typically have the size and scale to build an internal investment office headed by a Chief Investment Officer.

For small to mid-sized institutions, however, this is not cost-effective or practical. In the OCIO model, an organization retains governance oversight of the portfolio, but delegates many investment decisions and operational

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Private Client team with Emily Keller.

Emily has joined Clearstead as a Client Planning Associate. Emily comes to Clearstead from BDO where she prepared individual, fiduciary, partnership S- and C-corporation taxes. Prior to that, she worked at Novogradac as an audit and tax staff accountant. She is a graduate of Ohio University in Accounting/Finance.

These changes underscore the firm's commitment to building its investment consulting and financial planning practices, promoting the next generation of leadership, and maintaining a rigorous investment process.

responsibilities to an outside advisor. This can include strategic and tactical asset allocation, manager due diligence and selection, portfolio construction, risk management, trading and rebalancing, and reporting.

The table below summarizes the typical breakdown in roles and responsibilities between the institution and advisor in an OCIO relationship.

	INVESTMENT COMMITTEE	OCIO
Investment Policy	Approves	Recommends
Strategic Asset Allocation	Approves	Recommends
Tactical Positioning	Delegates and Monitors	Implements and Informs
Manager Selection	Delegates and Monitors	Implements and Informs
Portfolio Construction	Delegates and Monitors	Implements and Informs
Rebalancing & Trading	Delegates and Monitors	Implements and Informs
Risk Management	Delegates and Monitors	Implements and Informs
Reporting and Oversight	Reviews	Produces and Monitors

GROWTH OF THE OCIO MODEL

Institutional investment portfolios are often overseen by an investment committee that consists of volunteer board members, some of whom have investment experience, and many of whom do not. In the post-WWII era through the 1960s and 1970s, a typical portfolio may have consisted of a few U.S. large cap blue-chip stocks and a few investment-grade bonds (yielding 4-6%, to boot!)

However, today's investment landscape is more complicated. Asset classes such as hedge funds, private equity, emerging markets, and private credit can provide additional return opportunities and diversification and are routinely found in institutional investment portfolios. This complexity has increased the burden on investment committees and staff, resulting in greater adoption of the OCIO model.

Today's increasingly fast-paced market can require quick action to implement an investment program. An investment committee that meets quarterly may not be nimble enough to take advantage of market opportunities.

This was demonstrated during the 2008-2009 financial crisis, when many portfolios suffered significant declines. More recently, the market decline in March 2020 due to the COVID-19 pandemic caught many investors by surprise. Rather than waiting for action at the next quarterly committee meeting or trying to arrange an emergency interim meeting, many OCIOs were able to quickly take advantage of the market environment and make tactical portfolio adjustments. An OCIO model can enable organizations to take advantage of these investment opportunities in a timely manner.

In the aftermath of these crises, it became apparent that increased risk management and closer portfolio monitoring was needed, providing a catalyst to the growth of the OCIO market. In the U.S., OCIO assets have climbed sharply from less than $100 billion in 2007 to more than $1.1 trillion as of 2018, with a spike in demand following the 2008-2009 financial crisis.

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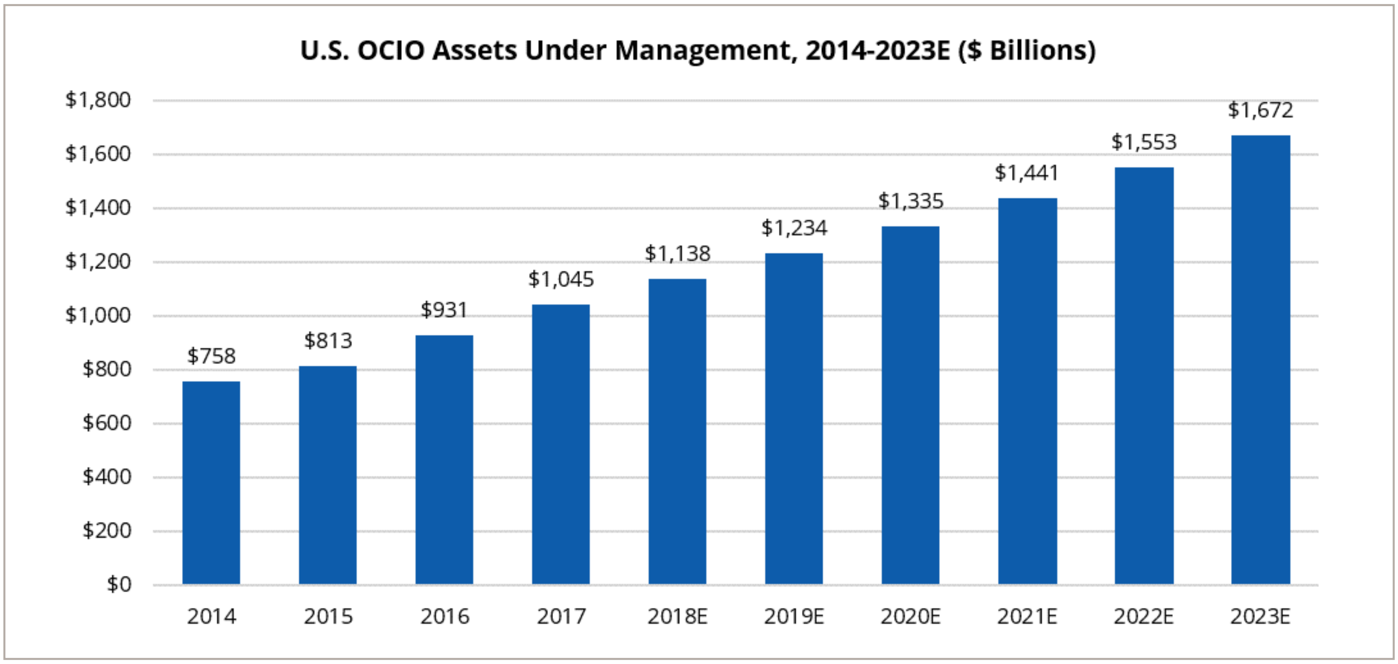
OCIO assets in the U.S. are expected to grow to nearly $1.7 trillion by 2023, representing an annualized growth rate of just over 8%.[1]



Source: Cerulli Associates

Institutions that have switched to OCIO providers cite the following reasons for change:[2]

1. Better risk management
2. Cost savings
3. Lack of internal resources
4. Additional fiduciary oversight
5. Need to increase returns
6. Faster implementation/decisions
7. Desire for strategic partnership

CONSIDERATIONS

With OCIO assets growing rapidly, many firms have jumped into providing OCIO solutions, including traditional consultants, OCIO boutiques, banks, and asset managers. This has made it more confusing for organizations to navigate and select an appropriate OCIO advisor. There are several considerations that institutions should evaluate before selecting an OCIO provider.

One of the biggest considerations is what type of OCIO model is best for an organization. The chart on the following page summarizes the various approaches.

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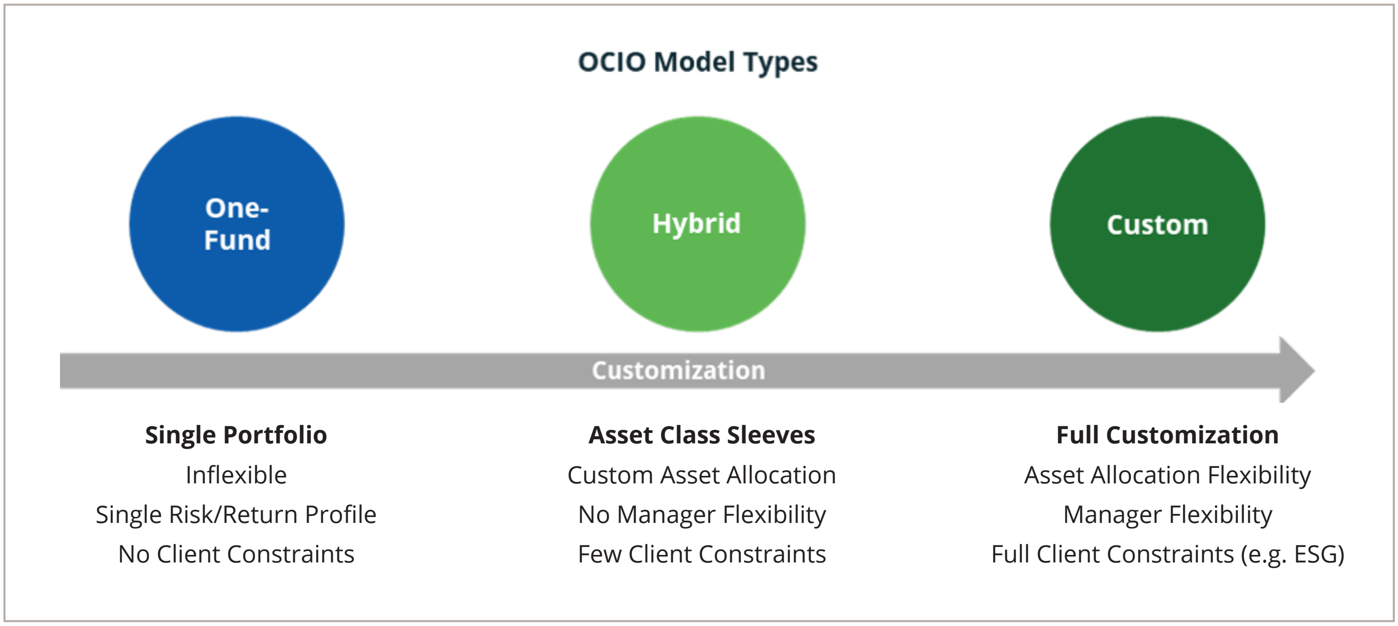

In the One-Fund model, a firm has a single portfolio or set of portfolios in which a client can invest. The advantages of this model are the economies of scale created by pooling assets, but disadvantages can include lack of flexibility and lack of liquidity with some providers.

The Hybrid model typically uses a concept called asset class sleeves. These asset class sleeves are pooled vehicles that contain several managers. Institutions can customize the allocation to each sleeve, but not customize the allocations and managers within each sleeve. The advantage of this approach is that it combines the benefits of economies of scale with some level of customization. Disadvantages can include a lack of customization and control by the institution.

The Custom model offers full customization around asset allocation and manager selection. A portfolio can be built that is customized to a client's parameters, including risk, return, liquidity, and unique preferences. This can include clients that wish to incorporate environmental, social, and governance (ESG) factors in the portfolio, maintain daily liquidity, or avoid certain asset classes. A potential disadvantage is that the economies of scale may not be as large as with a pooled vehicle.

In addition to the type of OCIO model, there are other factors that organizations should consider, including:

- Use of internal advisor products that can present multiple layers of fees and conflicts of interest
- Fee structure
- Active vs. passive strategies
- Liquidity
- Alternative investment capabilities
- Performance track record

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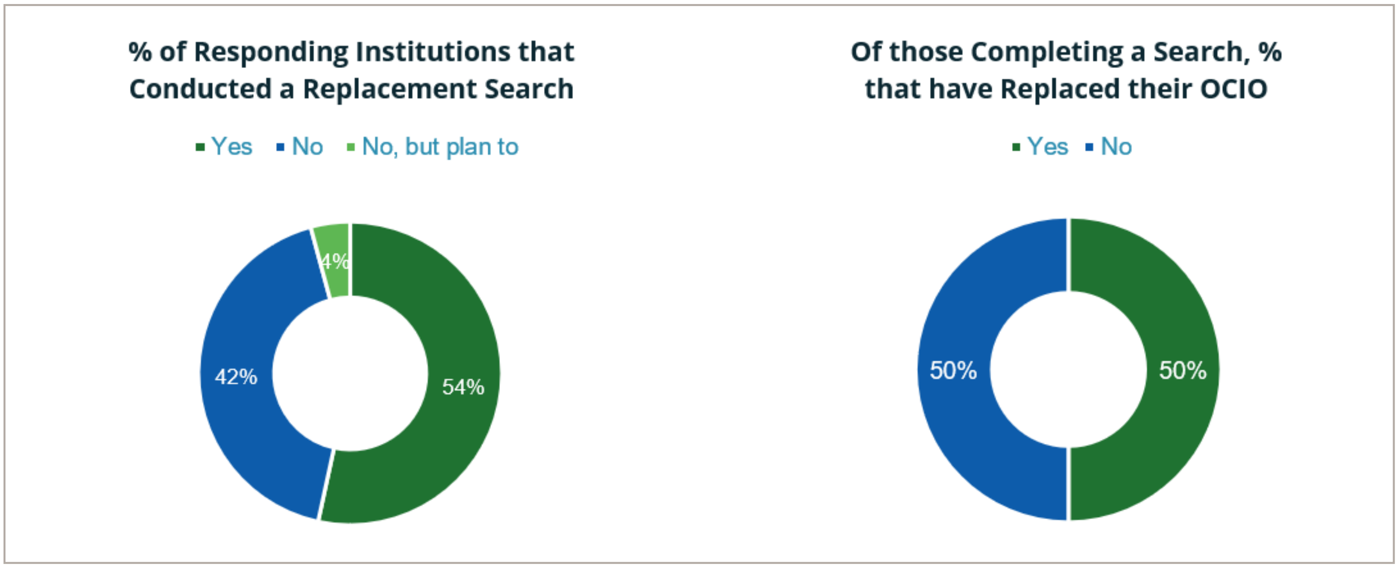
NEXT PHASE

As the OCIO industry enters its next phase, many organizations are reevaluating these factors. In a 2019 survey conducted by Cerulli Associates, more than half (58%) of organizations have initiated or plan to conduct a replacement search since hiring their OCIO provider. Of those organizations that have completed a search, exactly *half* have replaced their OCIO.



Source: Cerulli Associates

The growing complexity of the OCIO market means it is more important than ever for organizations not just to hire *an* OCIO, but to hire the *right* OCIO.

EVOLUTION AT CLEARSTEAD

Clearstead has been providing discretionary services for over 30 years, although we have seen our OCIO business grow significantly in the last decade. Over the last 5 years, our discretionary business has grown by over 14% on a year-over-year basis, based on the number of clients. Many clients that were previously non-discretionary have converted to an OCIO relationship and granted us discretion to implement the portfolio within the guidelines of their investment policy statement. As our business has grown, we have reinvested in additional resources, strengthened our research team, and bolstered our ability to implement alternative investments through our ClearAccess investment platform.

In addition to providing traditional OCIO services to institutional clients, we have also seen growth in two other variations of OCIO: Registered Investment Advisor OCIO (RIA OCIO) and Defined Contribution OCIO (DC OCIO).

Registered Investment Advisor OCIO (RIA OCIO)

Small registered investment advisors (RIAs) typically have limited staff, time, and resources. Rather than building an in-house research team, many are now choosing to outsource this function by hiring an OCIO. Some hire an OCIO solely to provide investment research, model portfolios, and manager selection capabilities. Others will hire an OCIO to manage portfolios for the underlying clients. Through this arrangement, the RIA can leverage the size, scale, and institutional rigor of an OCIO, while freeing up time and resources to focus on relationship management and business development. At Clearstead, we have seen increased interest in this capability, and we currently work with a number of RIA OCIO clients who leverage our in-house research team, experience, scale, and rigor.

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Defined Contribution OCIO (DC OCIO)

Defined contribution plan sponsors typically hire an advisor in a 3(21) fiduciary capacity – ERISA terminology for non-discretionary status – to advise on plan design, investment menu options, investment option selection and monitoring, target date funds, and fees. However, in a 3(21) relationship, it is still up to the plan sponsor to ultimately approve all investment decisions.

As with pensions, endowments, and foundations, the increasingly complex investment landscape combined with the need for better risk management and oversight has led many plan sponsors to delegate responsibility of these investment decisions. This is known as a 3(38) or discretionary fiduciary relationship. Plan sponsors and participants can benefit from an increased focus on strategy and participants, quicker and more efficient investment action, and a reduced investment oversight burden. At Clearstead, many of our new and existing DC retirement plan clients are moving to this type of structure.

CONCLUSION

At Clearstead, helping clients achieve their objectives is at the core of what we do. For organizations that may be reevaluating their current provider, Clearstead can help navigate the OCIO landscape and find a solution that is right for your organization.

As the investment landscape becomes increasingly complex and fast-paced, more and more organizations are choosing Clearstead as an OCIO advisor. We would be happy to discuss our OCIO solutions with you further.

Sources:

(1) Cerulli Associates, 2019 OCIO Survey, February 2019.

(2) Chief Investment Officer, 2020 Outsourced Chief Investment Officer Survey.

MARKET BENCHMARK RETURNS

October 31, 2020		1M	3M	12M	YTD
US Large Cap	S&P 500	-2.7%	0.4%	9.7%	2.8%
US Small Cap	Russell 2000	2.1%	4.2%	-0.1%	-6.8%
Developed Intl	MSCI EAFE	-4.0%	-1.7%	-6.9%	-10.8%
Emerging Intl	MSCI Em Mkt	2.1%	2.6%	8.3%	0.9%
Real Estate	NAREIT	-3.2%	-5.3%	-17.0%	-16.5%
Core Fixed	BarCap Agg	-0.4%	-1.3%	6.2%	6.3%
Short Fixed	BarCap 1-3Yr	0.0%	0.1%	3.4%	3.1%
Long Fixed	BarCap LT G/C	-1.6%	-5.4%	11.2%	12.4%
Corp Debt	BarCap Corp	-0.2%	-1.8%	6.7%	6.2%

Source: Bloomberg

Past performance is not indicative of future results.