



Fi360

GLOBAL INSIGHTS 2014

OCIO

The New Face of Investment Advisory Services

What's Good for the Client?

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What is OCIO?

In a Nutshell, OCIO is an exercise in *delegation*. It is giving discretionary authority to a third party provider to make and implement decisions regarding the investment process or some part.

- **Conventional Model**

- Investment Committee hires a consultant/RIA to:

- Advise on investment policy

- Develop portfolio construction

- Recommend asset managers

- Monitor and report investment performance

- Implement Committee's decisions

- **OCIO Model**

- OCIO is delegated authority to manage all or some of the elements in the investment process

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What is OCIO and Why should client embrace it?

- OCIO has been around since the 70's and is known by various names:
 - Outsourced CIO
 - CIO in a Box
 - Implemented Consulting or Crossover Consulting
 - Fiduciary Management or Fiduciary Delegation
- Gained momentum in US after 2008 market meltdown in response to “fiduciary fatigue”
- Why embrace it?
 - Is the client's current investment process suitable in today's market environment?
 - Is client able to implement decisions quickly enough to take advantage of short-term investment opportunities?

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What Functions to Outsource?

Outsourcing Opportunities Include:

- Develop Investment Policy Statement (IPS) DB/DC Plans?
- Portfolio Construction – DB/DC plans?
- Asset Liability Management – DB plans?
- Manager selection and Monitoring - DB/DC plans?
- Portfolio Rebalancing – DB plans?
- Tactical Investment Decisions – DB plans?
- Performance Reporting – DB/DC plans?
- Coordination with other providers – DB/DC Plans?

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Who Provides OCIO Services?

- Investment management firms and fund of fund managers
- Financial institutions, such as banks, trust companies, investment banks, brokerage firms
- Pension consultants/RIAs
- Advisory “boutiques” developed by former institutional CIOs

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OCIO Selection Process

This is a fiduciary function requiring an informed and reasoned decision. The client must:

- Articulate investment functions you will outsource and why
- Establish goals and objectives and articulate oversight process
- Establish selection criteria:
 - What analysis standards to apply
 - What performance benchmarks to use
 - What fee and expense benchmarks to use
- Identify universe of potential providers:
 - What data sources to use
- Conduct RFP
- Establish monitoring criteria for selected OCIO

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Fiduciary Considerations

Hiring an OCIO does not relieve the investment committee of its fiduciary responsibility – OCIO/Fiduciary Management is not Fiduciary Nirvana!

- *Conventional Model – Consultant/RIA makes recommendations and the Investment Committee must apply a prudent standard of care when giving approval*
- *OCIO Model – Committee must prudently select the OCIO and then monitor and evaluate the OCIO on a periodic basis*

BUT

Beware Oversight that Encroaches on Exercising Management Discretion – a litigation issue in waiting!!

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Fiduciary Considerations contd.

- OCIO must acknowledge fiduciary status. If the OCIO will make investment decisions it should acknowledge in writing that it is an “investment manager” under ERISA § 3(38).
- Who will contract with asset managers – the Plan or the OCIO? If OCIO, what rights does plan have in relation to the asset manager?
- Be cautious offering proprietary funds – transparency and conflicts
- Who manages proxy voting?
- What Indemnification should client be offered?

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Independent Fiduciary

- **Named Fiduciary – ERISA § 402(a) – principal decision maker – appoints other fiduciaries**
 - Potential turnkey solution**
 - Full scope fiduciary services – ERISA § 3(21)**
 - Investment management - ERISA § 3(38)**
 - Plan Administrator - ERISA § 3(16)**
 - Minimizes role of Trustee, Investment Committee**
 - Implies broad fiduciary risk mitigation**

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Other Selection Considerations

- **Cost Analysis**
 - **Conventional Model – Consulting fees range from 4-10 basis points on a fixed or AUM basis***
 - **OCIO Model – OCIO fees range from 30 – 100 basis points on an AUM basis***
 - OCIO fees are in addition to all other asset management fees and total OCIO expenses can be higher than with an “unbundled” conventional model**
 - However, some OCIO arrangements may offer offsets in reduced manager fees and transaction costs**
 - Look at total costs**

* Source: RV Kuhns & Associates, February 2013

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Is it right for your client?

Conclusions

- ✓ OCIO offers solutions to the complexities of managing plan investments
- ✓ It is a complex process and a long term strategy not easily unwound
- ✓ A service sector in flux but growing
- ✓ Requires an adjustment in governance
- ✓ Experts can help selection process
- ✓ Expert scan help monitoring Process

Final Word – Who Will Watch the Watchers? Client Should Not Go It Alone!

OCIO Fiduciary Issues

