FAQ: Who does what?

Outsourcing versus the in-house management model

Outsourcing, or OCIO, is clearly evolving, but what does outsourcing mean in our industry today? And how does Russell Investments approach it?

Outsourcing boils down to the delegation of the day-to-day management for all or a portion of a portfolio. There is more than one way to divide responsibility for the many tasks that go into running an institutional investment program. There are certain things that only the client can do, and certain things that always fall squarely into Russell Investments' areas of responsibility. But there are some other tasks where the decision is going to depend on whether the client is looking to delegate as much of the investment process as possible, or whether they want a more consultative relationship, retaining many of the day-to-day duties in house.

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What are some typical examples of activities that are delegated in an outsourcing relationship?

Manager selection and fee negotiations are the most obvious examples, but it goes beyond that to include things like tactical tilts around the strategic asset allocation targets; dynamic use of both active and passive management; and daily risk management, including the use of exposure management strategies. These are all commonly delegated investment activities.

We also see the delegation of administrative and operational duties—for non-profit organizations, this can include donor accounting, planned giving administration, securities gift processing, regulatory reporting and audit support. For plan sponsors, this may include the monitoring of funded status and adherence to a glide path, or the management of cash flows into and out of the portfolio.

Is there anything that can't be outsourced?

Yes. While Russell Investments acts as a co-fiduciary in every outsourcing relationship, all investors—whether a plan sponsor or non-profit organization—retain their fiduciary obligations. This means they continue to conduct governance oversight. Their focus, however, shifts. For example, rather than approving things such as manager changes or tactical tilts (which are really daily portfolio management decisions), in an outsourcing relationship, an outsourcing client's focus changes to ensuring that the OCIO's decision-making and implementation processes remain sound.

Another example is asset allocation. While Russell Investments is often given some discretion around strategic asset allocation, our clients ultimately approve policy targets—because strategic asset allocation is a direct reflection of risk tolerance, and risk tolerance is unique to each investor.

So, the fiduciary retains a hands-on role in many ways?

Absolutely. In fact, "outsourcing" is not the best term for these relationships. It's more an extension of staff, whereby our clients focus on the "long lever" decisions and we focus on the day-to-day implementation of these decisions.

How do these relationships typically start? Is it a flip of the switch, or more of an evolution?

We've seen both, but it's more common for relationships to evolve toward outsourcing. For example, we might start by assuming responsibility for a client's manager selection decisions and portfolio rebalancing, and that may then migrate over time to full asset allocation discretion within the client's approved investment policy targets.

Why is the outsourcing approach gaining momentum?

It really boils down to the world getting more complex and resources being squeezed. In this environment, it's difficult for a busy CFO or investment committee to stay on top of timely market shifts, which has translated to investors looking to delegate some tasks so that they can focus on getting the big picture right.

When might an investor choose *not* to delegate as much as possible?

A lot of this has to do with scale. Very large organizations have the option of building an investment staff to take care of many of the day-to-day tasks that smaller and medium-size organizations have little choice but to delegate. It also has to do with how much time is left after they have given full attention to really understanding and articulating their objectives, constraints, fee budgets, risk tolerances and so forth.

And, finally, what is next in this area?

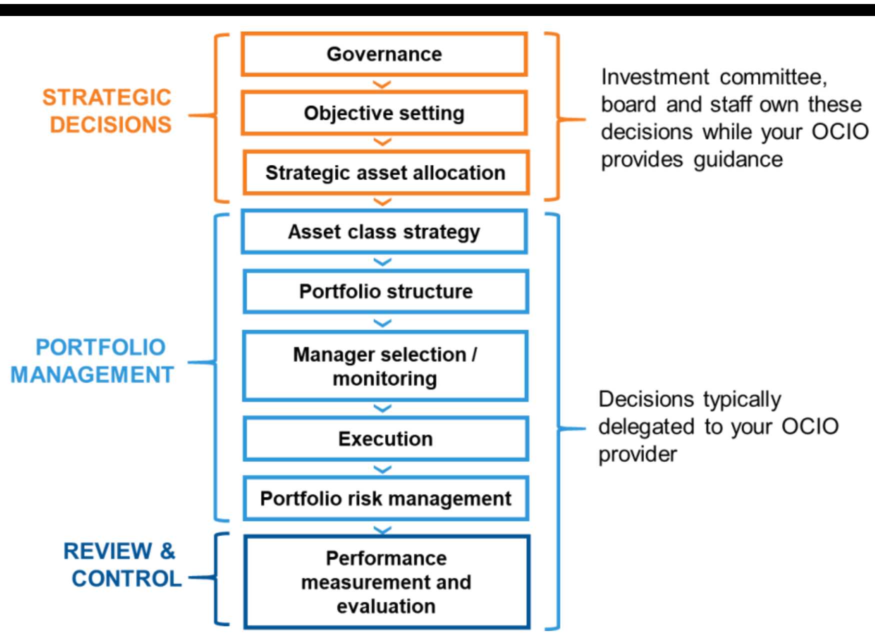
Well, you never know for sure. Resources continue to be stretched. The investment world continues to get more complex. So, the conditions that have led to an increase in outsourcing seem set to persist. We expect this to mean that the practice will continue to gain ground, even among some of the larger organizations that might not have considered it in the past.

Appendix

Management options

There are many ways to divide responsibility for the tasks involved in running an institutional investment program. Some essential functions cannot be delegated by the investment committee, while others are widely accepted as the responsibility of a traditional consultant. Between these two extremes lie a number of outsourcing and delegation options.

Fiduciary oversight process



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First used (US): November 2013. Revised: January 2021. First used (Canada): June 2022 AI-28619-01-24