OUTSOURCED CHIEF INVESTMENT OFFICER SURVEY

As firms outsource because they lack internal resources, bigger shops benefit.

This year, the bigger players in the OCIO industry got even bigger, while the smaller ones showed much less growth, according to our Outsourcing Chief Investment Officer buyer's guide and 2017 survey. Aon Hewitt's assets under management with full discretion grew by $17 billion. Goldman Sachs' grew by $13 billion. **Russell Investments' grew by $8 billion**, and Northern Trust's grew by $3 billion.

Colleges and university endowments had a tough year, and it's no secret that they've needed to find answers. When it comes to institutions' endowments, the latest NACUBO-Commonfund Study, released in late January with data from 805 US colleges and universities, is a good barometer. It found that participating institutions' endowments returned an average of -1.9% (net of fees) for the 2016 fiscal year July 1, 2015, to June 30, 2016, following a low 2.4% return reported for 2015. This is far below the median 7.4% they need to earn to maintain their endowments' purchasing power after spending, inflation, and investment management costs, according to the study. Yet 74 percent of the study's respondents reported that they increased the dollars spent from their endowments. The median increase was a hefty 8.1%.

These details are in lock step with our survey, which found a firm's reason for outsourcing is fairly consistent. "Lack of internal resources" topped the list for outsourcing this year, as well as 2016, with nearly six in 10 respondents citing this as a "critical" reason for outsourcing. It was deemed "important" by another 33%. Cost savings, by contrast, was considered a "critical" reason for outsourcing by only 18% of respondents, and "not very important" by 25%.

The top reason for selecting an outsourcing firm was the "experience of top management," listed by 93%. When asked about outsourcing goals, absolute returns outweighed de-risking by 4%.

Full discretion mandates—where the OCIO provider can hire and fire managers without prior client approval—are still the preferred arrangement to a "recommend" situation where the OCIO provider cannot hire or fire managers without the client's approval. Overall, nearly two thirds of asset owners that outsource have given full discretion to their vendor. Smaller asset owners are somewhat more likely than larger ones to give full discretionary responsibility to an outsourcing provider.

Staffing

There's also a bit of irony occurring in business of outsourcing CIOs, and some staffers at institutions will breathe a sigh of relief. According to our 2017 OCIO survey, somewhat counterintuitively, the asset owners that outsource have more internal investment staff (14) than the asset owners who don't outsource (9). Predictably, the number of staff goes up along with the size of the asset owner's investable portfolio, but a surprising finding is that smaller asset owners are more likely to outsource than larger ones. As in past surveys, European asset owners usually tend to employ more investment staff (10) than US asset owners (7).

Their Profile

That being said, of the 148 different organizations that responded to our survey, 40% percent outsource or plan to outsource within the next 24 months.

Of the organizations that plan to outsource, most, or 63%, are defined contribution (DC) plans whose average size of investment staff is two, in contrast to another high number on our list, public pensions, whose average size of investment team is around 15 people, of which 41% intend to, or already are, outsourcing.

These numbers have some sharp increases compared to our survey in 2016, when the numbers of those who were or planning to outsource were 52% for DC plans and 32% for public pensions. Of portfolio sizes of less than $100 million, 70% outsource or plan to, which is up from 48% last year.

Most, or more than six in 10 asset owners who choose to outsource do so for 100% of their portfolios. That percentage rose to 68% in the under $500 million category and hiked up to 100% in the $500 million to $1 billion category.

Trends from the Field

"Outsourcing by larger defined benefit pension plans (over $1 billion) is becoming more commonplace, for the same reason that smaller plans are outsourcing: fewer dedicated staff, lean resources, delays in execution," says Joseph McInerney, managing executive, Multi-Manager Solutions at Northern Trust Asset Management. He is also starting to see more DC plans evaluate the outsourcing model for similar reasons, in addition to having increased litigation concerns and the desire to create more customized solutions for participants. Endowments and foundations are looking to outsource for more access to dedicated investment expertise and to increase their sophistication of alternative investments. "We're also seeing greater involvement by third-party overseers in the search process and periodic independent oversight after the relationship begins," he says.

Greg Calnon, managing director—Global Portfolio Solutions, Goldman Sachs finds pension funds are focused on hedging liability and increasing expertise. Endowments and foundations are heavily focused on environmental, social and governance (ESG) investments.

Another strong reason for outsourcing was "additional fiduciary oversight," with 43% of our survey respondents listing it as a critical reason for outsourcing. Russell Investments, which won high scores for customer satisfaction in our survey, has been a fiduciary for more than 40 years. Part of its approach is to meet frequently with clients and offer multi-asset investing once an organization has reached the point where they're comfortable delegating more discretion to a co-fiduciary. "In today's investment environment, there is not enough low-cost beta for the outcomes most institutional investors need to achieve," said Bruce Clarke, managing director, institutional investment services, at Russell Investments. "Investors are realizing they can beat their asset class benchmarks, but still not make the progress they need toward achieving their broader investment goals. That is why multi-asset investing is so important."

Choosing When to Outsource

The choice to outsource usually occurs without a quantitative measure. "I think it ends up being more of a fatigue situation," said Calnon, such as when returns have been disappointing over the past five years.

"For pension plans that are focused on de-risking, actuarial capabilities and experience with designing and implementing investment glide paths and incorporating pension risk transfers is important," said Northern Trust's McInerney. For defined contribution plans, experience with customizing white label funds and target date funds is important. An endowment with a knowledgeable internal staff and an investment process that runs well might want to outsource the management of an asset class in which they don't have a lot of experience.

Before outsourcing, due diligence should at least include reference checks and evaluating how the firm works with you, said Kane Brenan, Global Head of Global Portfolio Solutions at Goldman Sachs Asset Management. To evaluate the firm's past performance, ask for their GIPS compliant composites, (which require a firm's discretionary, fee-paying portfolios to be included in at least one composite.)

Your assessment checklist should also include the firm's ability to customize; the breadth of its capabilities; its acumen; risk management capabilities; service capabilities; and it should have a deep understanding of liability and liability capabilities, Brenan said.

"Make sure your prospective OCIO has experience in managing plans of similar size and nature as yours," adds McInerney. Consider an on-site evaluation to meet with general partners and risk takers. Cultural alignment is also important, as well as investment expertise, manager research, portfolio construction and operations. Also review whether the firm has a designated compliance practice in place. "Keep in mind, there is no one-size-fits-all approach: Clients don't always use fiduciary management services in the same way," McInerney said. —*CIO*

METHODOLOGY: Responses from 148 asset owners were accepted for the survey from January 9 to 24, 2017. Responses are aggregated on the following charts and the results are shown in comparison to last year's survey. *CIO* would like to extend a special thank you to all those who submitted responses for the survey, as well as those vendors, asset owners, and consultants who helped the *CIO* editorial and survey teams construct the survey. For more information, contact surveys@strategic-i.com.

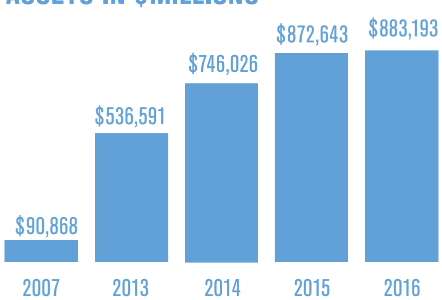
2017 OUTSOURCED-CIO VENDOR RATINGS

Consistent with surveys published in *Chief Investment Officer* throughout the year on other topics, this year's OCIO survey includes a section for vendor ratings.

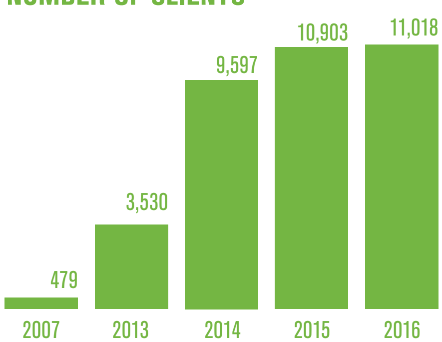
In order to provide more color and client experience information on OCIO vendors, we asked the asset owners who participated in the survey to select and evaluate the OCIO vendor(s) they use. Asset owners indicated their satisfaction with vendors on four separate areas of service: investment results, value for fees paid, ancillary services (e.g. shared research), and overall client service. A total of 37 vendors received ratings from at least one client, and five vendors—BlackRock, Goldman, J.P. Morgan, Morgan Stanley and Russell Investments—received evaluations from five or more asset owner clients. Those five are detailed herein.

DISCRETIONARY OCIO GROWTH

ASSETS IN $MILLIONS



NUMBER OF CLIENTS



Russell Investments

CLIENT SATISFACTION

	Very satisfied	Somewhat satisfied	Not very satisfied	Not at all satisfied
Overall service	90%	10%	0%	0%
Investment results	73%	27%	0%	0%
Value for fees	73%	27%	0%	0%
Ancillary services	73%	27%	0%	0%

TOP 3 REASONS WHY RUSSELL INVESTMENTS WAS SELECTED

1. Reputation/track record	73%
2. Management experience	73%
3. Breadth of services/Fiduciary	64%

INVESTMENT OUTSOURCING AUM

	Assets	Clients
Recommends~	$7.7B	10
Full discretion	$104.9B	362

OCIO AUM BY CLIENT TYPE

Corporate pensions	$65.7B
Public/government pensions	$11.7B
Endowments/foundations	$2B
Educational institutions/health care	$6.4B
Other	$19B

OCIO AUM BY FUND TYPE

Defined benefit pensions	$62.5B
401(k), 403(b) or other DC plans	$17.1B
Endowments/foundations	$2.5B
Health care pools*	$1.6B
Other	$21.1B

OCIO AUM BY INVESTMENT VEHICLE

Separate accounts	$34.5B
Pooled vehicles (proprietary to clients)**	$53.1B
Pooled vehicles (outsourcer selected)***	$17.3B
Other	$0

REVENUE BY FEE STRUCTURE

Flat fee	33%
Sliding asset-based	65%
Performance-based	2%
Other	0%

OCIO EXECUTIVE(S):

Eric Macy

J.P. Morgan Asset Management

CLIENT SATISFACTION

	Very satisfied	Somewhat satisfied	Not very satisfied	Not at all satisfied
Overall service	29%	71%	0%	0%
Investment results	14%	86%	0%	0%
Value for fees	43%	43%	14%	0%
Ancillary services	14%	71%	14%	0%

TOP 3 REASONS WHY J.P. MORGAN WAS SELECTED

1. Management experience	86%
2. Reputation/ track record	71%
3. Breadth of services	57%

INVESTMENT OUTSOURCING AUM

	Assets	Clients
Recommends~	$8.1B	33
Full discretion	$45.2B	410

OCIO AUM BY CLIENT TYPE

Corporate pensions	$6.95B
Public/government pensions	$4.2B
Endowments/foundations	$16.4B
Educational institutions/health care	$6.4B
Other	$11.2B

OCIO AUM BY FUND TYPE

Defined benefit pensions	$15.68B
401(k), 403(b) or other DC plans	$236M
Endowments/foundations	$20.7B
Health care pools*	$0
Other	$8.55B

OCIO AUM BY INVESTMENT VEHICLE

Separate accounts	$45.2B
Pooled vehicles (proprietary to clients)**	$0
Pooled vehicles (outsourcer selected)***	$0
Other	$0

REVENUE BY FEE STRUCTURE

Flat fee	0%
Sliding asset-based	100%
Performance-based	0%
Other	0%

OCIO EXECUTIVE(S):

Jeffrey Geller, Monica Issar, Anthony Werley

~ Recommends manager selection or replacement subject to prior client approval; ^BlackRock: Full discretion mandates include assignments where client retains veto rights as part of their governance model. Figures do not include 13 clients and $18B in mandates where no discretion exists.* Board designated, funded depreciation.** Proprietary to clients, managed by outside managers; *** Securities are selected by OCIO

BlackRock, Inc.

CLIENT SATISFACTION

	Very satisfied	Somewhat satisfied	Not very satisfied	Not at all satisfied
Overall service	60%	40%	0%	0%
Investment results	20%	60%	20%	0%
Value for fees	40%	60%	0%	0%
Ancillary services	60%	40%	0%	0%

TOP 3 REASONS WHY BLACKROCK WAS SELECTED

1. Reputation/track record	80%
2. Breadth of services	60%
3. Client service	60%

INVESTMENT OUTSOURCING AUM

	Assets	Clients
Recommends~	$12.25B	26
Full discretion^	$80.1B	81

OCIO AUM BY CLIENT TYPE

Corporate pensions	$31.5B
Public/government pensions	$39.9B
Endowments/foundations	$1.1B
Educational institutions/health care	$152M
Other	$7.4B

OCIO AUM BY FUND TYPE

Defined benefit pensions	$68.7B
401(k), 403(b) or other DC plans	$0
Endowments/foundations	$1.8B
Health care pools*	$0
Other	$9.6B

OCIO AUM BY INVESTMENT VEHICLE

Separate accounts	$76.1B
Pooled vehicles (proprietary to clients)**	$0
Pooled vehicles (outsourcer selected)***	$3.95B
Other	$0

REVENUE BY FEE STRUCTURE

Flat fee	n/a
Sliding asset-based	n/a
Performance-based	n/a
Other	n/a

OCIO EXECUTIVE(S): Ryan Marshall, Simona Paravani-Mellinghoff, Edward Ng

Morgan Stanley

CLIENT SATISFACTION

	Very satisfied	Somewhat satisfied	Not very satisfied	Not at all satisfied
Overall service	60%	40%	0%	0%
Investment results	0%	100%	0%	0%
Value for fees	40%	40%	20%	0%
Ancillary services	50%	50%	0%	0%

TOP 3 REASONS WHY MORGAN STANLEY WAS SELECTED

1. Reputation/track record	80%
2. Management experience	60%
3. Breadth of services	60%

INVESTMENT OUTSOURCING AUM

	Assets	Clients
Recommends~	$490M	5
Full discretion	$18.2B	251

OCIO AUM BY CLIENT TYPE

Corporate pensions	$422M
Public/government pensions	$0
Endowments/foundations	$4.8B
Educational institutions/health care	$1.8B
Other	$11.2B

OCIO AUM BY FUND TYPE

Defined benefit pensions	$9.8B
401(k), 403(b) or other DC plans	$106M
Endowments/foundations	$4.9B
Health care pools*	$600M
Other	$2.8B

OCIO AUM BY INVESTMENT VEHICLE

Separate accounts	$10.9B
Pooled vehicles (proprietary to clients)**	$7.3B
Pooled vehicles (outsourcer selected)***	$0
Other	$0

REVENUE BY FEE STRUCTURE

Flat fee	10%
Sliding asset-based	90%
Performance-based	0%
Other	0%

OCIO EXECUTIVE(S):
Suzanne Lindquist, Lisa Shalett

Goldman Sachs

CLIENT SATISFACTION

	Very satisfied	Somewhat satisfied	Not very satisfied	Not at all satisfied
Overall service	69%	23%	0%	8%
Investment results	62%	31%	0%	7%
Value for fees	54%	38%	0%	8%
Ancillary services	75%	25%	0%	0%

TOP 3 REASONS WHY GOLDMAN SACHS WAS SELECTED

1. Reputation/ track record	75%
2. Management experience	67%
3. Client service	50%

INVESTMENT OUTSOURCING AUM

	Assets	Clients
Recommends~	$40.9B	23
Full discretion	$60B	227

OCIO AUM BY CLIENT TYPE

Corporate pensions	$26.3B
Public/government pensions	$4.1B
Endowments/foundations	$6.7B
Educational institutions/health care	$2B
Other	$21.4B

OCIO AUM BY FUND TYPE

Defined benefit pensions	$30.4B
401(k), 403(b) or other DC plans	$175M
Endowments/foundations	$8.2B
Health care pools*	$451M
Other	$21B

OCIO AUM BY INVESTMENT VEHICLE

Separate accounts	n/a
Pooled vehicles (proprietary to clients)**	n/a
Pooled vehicles (outsourcer selected)***	n/a
Other	n/a

REVENUE BY FEE STRUCTURE

Flat fee	0%
Sliding asset-based	100%
Performance-based	0%
Other	0%

OCIO EXECUTIVE(S):
Kane Brenan