

OCIO RFPS: ARE YOU ASKING THESE KEY QUESTIONS?

Fiduciary Insights

RFPS FOR OUTSOURCED CIOS OFTEN FAIL TO ASK SOME CRITICAL QUESTIONS ABOUT THE QUALIFICATIONS OF THE OUTSOURCER AND THE NATURE OF THE RELATIONSHIP BETWEEN THE OUTSOURCER AND ITS CLIENTS. We propose some questions to add to the typical RFP.

Introduction

As outsourcing of the CIO role has gained momentum in recent years, with a throng of new entrants in the outsourcing arena, organizations needing an outsourced CIO (OCIO) are using traditional RFPs to identify suitable candidates. Consultants who aid in the selection of an OCIO have fostered the trend toward using RFPs, in an effort to institutionalize the search process. Although RFPs can help to evaluate potential outsourcing partners, we find that RFPs often leave important questions unasked or fail to effectively solicit critical information. We believe that there are important lines of inquiry that should be added to the traditional RFP as asset owners evaluate potential OCIOs. We list some of them below.

I. Service Model

What to Look For: Are they a higher-paid consultant or a real value-added OCIO?

There are various ways to structure the relationship between client and OCIO, and the service model of the OCIO may be an outgrowth of the firm's background. For example, some newer OCIOs are consulting firms that have expanded into the field of outsourcing to increase their fees. A legacy of consulting may shape the role that an OCIO firm takes in various aspects of the client-OCIO relationship. Inquiring about the basic service model of the candidate will set the stage for an understanding of the responses to subsequent questions.

- a) In your typical client relationship, what is your role in developing investment policy?
- b) What is the nature and extent of your discretion over asset mix? Segment strategy? Manager selection?
- c) Would you characterize the management structure for your clients as more or less uniform across clients or as client specific?

- d) Do your assignments generally span the entire client portfolio, or a segment of the portfolio? If the latter, which segments are most commonly included in your mandate?

II. Resources, Experience, and Commitment to the Business

What to Look For: Do they have hands-on, long-term experience or a "fill-a-bucket/ paint-by-number" approach?

It is important to determine, in this evolving service area, what experience with discretionary asset management and fiduciary relationships an organization has and how durable its commitment to the business model is. Questions such as these can help provide important information.

- a) What resources will be brought to bear on our account? How many staff members would be directly involved in management of our asset pool, and what professional designations and years of experience do they have?
- b) How long have you been engaged in discretionary management of multi-asset class investment pools? What portion of your revenues does this activity constitute? How does it fit into your future business strategy?
- c) If you are a division or subsidiary of a larger organization, what percentage of the parent firm's total revenue does your entity generate?
- d) Describe your ability to assist our tax and audit service providers with regulatory reporting requirements, e.g., FBAR, 990s, 5500s, etc.
- e) Please indicate the length of the relationship for your 10 largest discretionary OCIO clients (if they were

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originally non-discretionary, please start as of the date the assignment became discretionary).

III. Potential For Conflict

It is critical to gauge whether there are any potential conflicts that might impact your choice of provider.

What to Look For: Hidden traps and costs.

The organizations that offer outsourcing services vary widely in size, structure (public vs. private), and products (e.g., OCIO only, asset management, consulting, brokerage, custody, global banking, actuarial services). It is critical to gauge whether there are any potential conflicts that might impact your choice of provider.

- a) Are you a broker-dealer? Are managers employed on our behalf expected to trade with your brokerage? Do you accept soft dollar payments?
- b) Do you sell services to investment managers – e.g., databases, software, consultancy on product development/positioning – or sponsor conferences attended by investment managers for a fee? Do you charge investment managers for inclusion in your manager universe?
- c) Do you have any affiliates, divisions, or investments in joint ventures that would be involved in the management of our assets under this assignment?
- d) Do you anticipate using proprietary products – for instance, for security selection, reporting, or analytics? Are fees for any such products explicitly included in your fee proposal?
- e) Do you have any other relationships with our organization or its key decision makers– such as investment banking, brokerage, custodial, or actuarial relationships?

IV. Performance

What to Look For: Do they have real net-of-fee outperformance or cherry-picked, theoretical, or aspirational results?

Of course, performance analysis is central to the RFP process for most investment products. For full outsourcing, clarity as to the manner of representing performance is key.

- a) Is the performance represented net of your fee, and net of underlying manager fees? If you allocate to funds of funds (e.g., in hedge funds or private equity), is the performance net of both the fund-of-funds fees and underlying manager fees?
- b) Is the composite performance representative of all accounts with similar characteristics over which you have had full discretion?
- c) How is the composite performance constructed (e.g., does it include results from terminated clients/strategies)?
- d) If composite performance is not provided, please explain what is being provided, and why.

V. Regulatory Status and Compliance Culture

What to Look For: A strong compliance culture.

An outsourcing partner is truly a co-fiduciary, sharing responsibility with your governing body. Given the length, breadth, and intensity of the relationship, exploring the candidate firm's culture is particularly important. These days, fiduciaries are expected to be purer than Caesar's wife to meet all of today's regulatory requirements, and that takes a well-developed compliance effort.

- a) Describe your code of ethics and procedures for ensuring compliance. Who is responsible for communicating expectations as to conduct, monitoring compliance, and determining the course of action in the event of a breach of the code?
- b) Have you experienced any material breaches of your code of ethics? If so, please describe.
- c) Have you been subject to any litigation related to your investment advisory and/or consulting services? If so, please describe.
- d) When was your last regulatory examination? Please describe the findings of that examination.
- e) Have you been subjected to disciplinary actions or settlements by regulators? Please explain.

VI. Investment Discipline

What to Look For: Lots of process, facts, and insights.

An OCIO assignment requires investment tools that bring value and discipline to a complex portfolio.

Providers approach this task in various ways. Given the scope of the assignment, it is important to understand what tools are developed internally, how they serve the portfolio, and where third-party skills and insights are tapped.

- a) Describe the quantitative and qualitative tools that inform your asset mix decisions and the strategy you adopt within asset classes.
- b) How do you benchmark client portfolios? When did you last make significant changes in the nature of your benchmark portfolios, and what motivated those changes?
- c) Describe the manner in which you account for and allocate risk at the total portfolio level. How are decisions as to allocation of portfolio risk taken and who makes those decisions? What is your methodology for evaluating the coincident and offsetting sources of risk in a multi-asset class portfolio?
- d) Describe the most important research initiatives you have underway and how you expect them to contribute to future value-added.

VII. Communication, Education, and Evolution

What to Look For: How well do they communicate and collaborate with their clients?

In an effective outsourcing relationship, the parties see themselves as stakeholders in a common enterprise. When successful, these relationships are lasting, built on clear communication, compatible cultures, and complementary skills. Success therefore requires that both partners grow together and adapt to change well.

- a) Describe the resources available for clients and their service providers to readily access in a secure manner agreements, performance reports, policy papers, tax documents, and audited financial statements of underlying commingled vehicles.
- b) Describe specific tools you have developed to support your clients in fulfilling their fiduciary responsibilities and enhancing their capabilities.
- c) Describe a circumstance in which a client's objectives or constraints changed significantly over time and the manner in which you worked with the client to adjust the investment policy and address the change in circumstance.
- d) How should we, as a client, measure our joint success?

VIII. Capital Structure, Partners, and Incentives

What to Look For: Capital structure and incentives that serve to foster the firm's evolution.

Business success and growth follow a life cycle over which younger employees replace founding entrepreneurs. New partners are brought in to improve capitalization, distribution, and business practices. The choice of incentives and partners can weaken or strengthen the evolution of a firm. There is no business success without growth, but growth, capital, human, and strategic resources need to be managed wisely.

- a) Describe your capital partners and why they were chosen. What do they bring to the firm?
- b) Describe your incentive structure to attract and retain staff.
- c) Describe your human resource management policies, employee turnover, and diversity of workforce.

Machiavelli wrote, "Every prince needs allies, and the bigger the responsibility, the more allies he needs." The modern asset owner bears a complex responsibility, with multiple constituencies and an ever-growing range of investment options. The trend toward outsourcing reflects this growing complexity. An outsourcing partner can be a valuable ally, bringing fresh energy and skills and sharing responsibility. Thoughtful and relevant inquiry will enhance the likelihood of identifying the right long-term partner.

Strategic Investment Group

Strategic, a pioneer in dedicated Outsourced CIO (OCIO) solutions since 1987, offers a comprehensive service platform for managing customized portfolios for institutional and private investors. Our proprietary process combines active portfolio management, rigorous risk management, and open architecture manager selection.

Strategic functions as our clients' investment partner and co-fiduciary, effectively becoming an extension of their resources. Clients are then free to focus on their core businesses, while we focus on providing the highly specialized portfolio management expertise that clients need to meet their investment goals. Depending on a client's needs and preferences, Strategic can orchestrate the management of an entire portfolio comprising multiple asset classes, focus on specific asset classes, such as alternatives (e.g., hedge funds, real estate, and/or private equity) or international investments, or manage strategies with high potential for adding value (e.g., portable alpha through investor-friendly turnkey structures). Customized liability-driven investing (LDI) solutions, whether through an integrated total portfolio approach or a targeted long-duration strategy, are also available, as are solutions that address mission-related investment objectives.

We strive to build enduring partnerships with our clients by strengthening their investment programs through a dynamic, value-enhancing investment process, sound governance framework, and world class client service. Our mission is to empower investors through experience, innovation, and excellence.

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