XPS Group

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Investment Briefing

Outsourced Chief Investment Officer (OCIO) – what does it mean and how is the market evolving?

Recently, there have been a number of headline-grabbing announcements of multi-billion-pound Outsourced Chief Investment Officer ('OCIO') appointments for some of the largest UK pension schemes, including Tesco, British Airways, National Grid, and Royal Mail. However, there remains quite a bit of confusion about what OCIO means and how it is different to fiduciary management ('FM'), if at all.

In this paper, we outline XPS' understanding of OCIO and provide some thoughts on how the market is evolving, which is supported by having surveyed a number of entities that have experience in managing OCIO appointments.

What is OCIO?

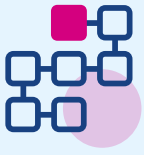
Unlike FM there is no 'formal' definition of OCIO, and it is often made more complicated by firms who offer these services having different definitions themselves.

To put this into context, several of the largest defined benefit pension schemes have 'in-house' teams that manage the pension arrangements, typically including administration, actuarial and investment functions. These teams are often employed by the sponsor, and work alongside the trustees. Recently, for a number of different reasons, we have seen several of the 'in-house' investment teams move to a third-party entity that already provides fiduciary management. The fiduciary manager then becomes responsible for setting the investment strategy and managing the day-to-day aspects of the investment arrangements.

It is often the transfer of an internal team to a third-party entity that is the distinguishing factor of an OCIO appointment. This differs from traditional FM where there is typically little or no existing internal capability within the pension scheme. Crucially, the strong link between the 'in-house' investment team and the sponsor means there is likely to be more engagement and input on the investment strategy from the sponsor. However, the approach taken towards pricing and commercial terms is challenging for key decision makers given the transfer of people and teams, as well as being potentially viewed as more of a corporate transaction than a FM-type appointment.

Although there are other interpretations of OCIO arrangements, none are particularly informative or differentiated from standard fiduciary management. This can often lead to confusion and interchangeable use of FM and OCIO.

There is also a push to use an OCIO investment approach for non-pension assets, as firms that offer fiduciary management look to diversify away from traditional defined benefit pension clients.



Assess your governance requirements

The first step for trustees should be to fully understand the range of investment approaches and governance models, to decide which best suits their needs, beliefs and skill set.

If you are considering alternative governance models such as OCIO, it is important that this is considered in the context of the needs of the scheme, not just because of the recent market trends and media attention.

How is the market changing?

There has been a trend of large pension schemes pivoting away from having an 'in-house' team managing the investment of their assets and moving to a more delegated approach, like OCIO.

There has been unanimous agreement from FM providers that the market, and transition to OCIO mandates, will continue to grow. Opinions from FM providers around the speed of growth and the range of schemes moving to an OCIO-type appointment is slightly more mixed, with the number expected to be anywhere from 2 to 10 new mandates in total.

What are the key drivers of this trend, and why now?

The main drivers of this trend appear to be:

- **Proof of concept** – As more, large OCIO mandates are appointed, the model moves from being niche to a more mainstream approach.
- **OCIO firm push/pull** – OCIO firms are actively seeking new mandates, and with greater media attention, this helps to drive new business.
- **Longevity of current 'in-house' teams** – It is becoming increasingly challenging for 'in-house' teams to retain/recruit the personnel and teams they need to manage mandates.
- **Greater operational robustness** – Both the increased investment/manager research expertise and more sophisticated risk management processes which an OCIO provider can boast should help to alleviate the operational burden of the 'in-house' team.

What to consider if thinking about changing investment governance models

Appointing an OCIO has the potential to be a much wider exercise than appointing a fiduciary manager. In most cases it will involve the transfer of all or some of the current 'in-house' team to the preferred provider, along with any proprietary systems/tools/data. This increases the complexity of any selection process and adds in the transactional element of any change. Additional considerations and constraints, such as the size of the 'in-house' team or value placed on the entity, are likely to reduce the universe of OCIO providers which would be willing to onboard such a mandate, given that some may have minimum size requirements or capacity constraints.

The additional nuance and complexity that comes with an OCIO-type appointment versus a FM appointment means that the following factors are worth considering to a greater extent:

- Nature of the appointment – does this involve the transfer of the current team (in its entirety?) and intellectual property;
- What governance model do you want to use and what level of delegation;
- Which organisations have the capacity to take on the mandate and team;
- How are the commercial aspects of any appointment structured;
- Cultural fit of the organisation;
- Capabilities of the organisation; and
- Other strategic or operational synergies that can be made by the move of the mandate.

Trends looking ahead

It is clear that the number of UK and global pensions schemes and other asset owners that will consider the move to an OCIO-type arrangement is likely to increase. However, the approach taken to select a chosen provider is much more nuanced than a typical FM appointment, the devil is in the detail and there certainly isn't a one size that fits all approach.

Key takeaways

We have recently seen a number of high-profile OCIO appointments in the market, but the definitions from providers of what constitutes such an appointment are often conflicted and confusing.

We believe that the characterisation of an OCIO arrangement typically centres on the transfer of a pension scheme's 'in-house' investment team to a fiduciary manager.

We expect to see further growth in these styles of mandates due to increased media attention, proof of concept, and the inability of 'in-house' teams to continue operating effectively without additional expertise and backing to hire the required personnel.

Any OCIO selection is incredibly nuanced given the additional operational and commercial complexities that come with transferring an entire team to a third-party entity.

An OCIO appointment somewhat resembles a corporate transaction, therefore bringing with it a greater focus on capacity of the onboarding entity, the commercial structure of the arrangement, cultural fit, and any synergies.

What can XPS do to help?

1. We can help you consider the effectiveness of your current governance structure within the pension scheme, and whether the main challenges to achieving the scheme's objectives are addressed within this.
2. Provide our insight into the market to help you assess whether your scheme could benefit from the additional investment expertise and resourcing capacity which a large FM provider could deliver, through an OCIO arrangement.
3. We can lead or contribute to a selection exercise for an OCIO provider, to determine which provider offers the most suitable terms and is best aligned with your scheme.

Find out more

To discuss any of the issues covered in this edition, please get in touch with André Kerr or Fraser Weir. Alternatively, please speak to your usual XPS contact.

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