RVK OCIO Insights

Issue 1: A Knowledgeable Way to Evaluate an OCIO Provider : *Due Diligence Beyond Investments/Portfolio Management*

July 2020

Overview

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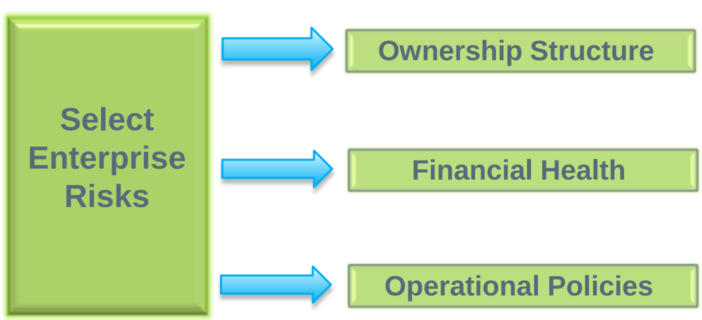
RVK's OCIO Evaluation and Monitoring Practice

RVK's Outsourced Chief Investment Officer (OCIO) Evaluation and Monitoring Team (RVK OCIO E&M Team) has been conducting OCIO education, search, evaluation, and monitoring projects for over seven years. Throughout this time, we have advised asset owners on how to navigate the particular challenges associated with evaluating OCIO providers. In RVK's first edition of OCIO Insights, we highlight elements often overlooked by asset owners when evaluating an OCIO provider—Board/Investment Committee governance structure, key components in understanding a track record, and due diligence on business aspects of an OCIO. This document focuses on one of the three elements: due diligence on business aspects of an OCIO. The complete RVK OCIO Insights Issue 1 can be found on RVK's OCIO website.

Due Diligence Beyond Investments/Portfolio Management

One of the primary reasons Boards/Committees implement an OCIO model is the expectation that it will improve performance. Given that objective, many investors tend to focus their due diligence on evaluating an OCIO's resources and processes directly related to investment portfolio management and performance, such as key investment personnel, portfolio construction processes, asset allocation structuring, manager selection processes, and performance metrics. However, OCIO providers are businesses and thus present clients with enterprise risk as well as investment risk. Conducting due diligence on the business aspects of an OCIO provider and understanding the potential risks associated with various elements of an OCIO's organizational structure is equally as important as investment management and performance. Without a stable and sustainable business model, the success and longevity of an OCIO provider is questionable.

Part of RVK's comprehensive evaluation of an OCIO includes an analysis of the enterprise risks of the firm. Below we highlight a few business components an asset owner should examine when evaluating an OCIO provider.



<u>Ownership Structure</u>

There is no optimal ownership structure associated with the success of an OCIO provider. Ownership structures vary significantly and range from 100% employee owned to a wholly owned line of business within a publicly traded entity and may be a combination of employee and outside ownership. Each type of ownership has its potential benefits and shortcomings, and we have observed varying levels of success among the different types of business models. However, not every model fits the preferences of every client. Therefore, when evaluating an OCIO's ownership, we review the details of the ownership structure and its implications for future success and continuity given the OCIO's unique circumstances, as well as how the firm addresses potential risks associated with the ownership structure.

For example, a 100% employee ownership model generally provides a more direct alignment of interest between employees' careers and compensation and the growth of the business. This model gives the owners autonomy over the direction of their company. In addition, equity ownership can be a powerful tool to attract and retain talented investment professionals. However, when a few owners or even one individual represents a majority of the equity, a single departure can challenge the future of the firm. When we observe ownership concentration, we ask a specific set of questions to understand the OCIO's ability to manage a transition with little to no disruption in the management of our clients' assets. Such questions center on: future ownership distribution, transition of responsibilities, and focus of firm growth under new leadership.

Conversely, an OCIO group that is part of a multi-business line financial firm can benefit from the extensive resources and dedicated teams available through the broader firm, including market and manager research, operations and back office, substantial experience in discretionary management of assets, compliance, and marketing. More specifically, a firm's global reach and ancillary services provided by various business lines, can be advantaged for the OCIO group. However, this type of ownership structure, if poorly executed, can result in muting the authority of key OCIO decision makers to set the direction and growth of their business unit. In addition, the OCIO business unit also shares in any risks associated with the parent company. Furthermore, the values, goals, and objectives of the parent company can differ from those of the OCIO business. Finally, changes in strategic directions or other internal disruptions within the parent company can adversely affect the ability of the OCIO business to execute for clients.

When RVK's OCIO E&M Team evaluates an OCIO that is a subsidiary or a group within a larger financial entity, we assess the parent company's growth plans for the OCIO business (e.g. revenue expectations, compensation schemes, cross selling opportunities, marketing plans, etc.). We also review the stability of the parent organization and examine the OCIO team's degree of dependence and reliance on the parent company's resources. Lastly, it is critical to reevaluate ownership structure on an ongoing basis, especially when there is a significant change in the firm's leadership, product, business strategy, and/or service offerings. These changes can alter the importance and role of an OCIO business within the parent company and create risks for clients.

Financial Health

An important component to the success and longevity of any business is financial stability. It may be an obvious statement, but tenure in the market is not a dependable measure of forward viability. Evaluating the financial health of an OCIO can be quite challenging given that audited financial information may not be disclosed nor publicly available. For OCIO teams housed within a larger financial firm, it is often unrealistic to obtain financial information solely attributed to the OCIO line of business. However, investors can gauge financial stability of an OCIO by evaluating certain revenue and expense related information OCIOs are able to provide and by having discussions with key decision makers regarding the metrics used to measure profitability.

A client should also evaluate an OCIO firm's strategy for managing unexpected events that can significantly impact its revenue, such as the inability to meet near-term growth expectations and significant client turnover/client AUM withdrawals. Although insightful, obtaining details regarding a firm's expenses (such as employee salaries and benefits, rent, equipment cost, etc.) can be challenging. To evaluate this aspect of an OCIO, it is important to discuss the firm's process for evaluating firm expenses, responsible parties for approving these expenses and setting the budget, and the frequency of reviewing expenses.

Operational Policies

Evaluating the operational policies and procedures of any investment firm is as important as evaluating its investment process. This exercise becomes even more critical when hiring an OCIO, given the fiduciary responsibilities and decision-making authority an OCIO retains over a client's portfolio. Policies and procedures that are clearly stated, tested, and strictly monitored can build confidence in an OCIO's accountability for managing a client's pool of assets. A review of an OCIO's operating policies, often incorporated in the firm's compliance manual, should include conflicts of interest, insider trading, valuation, cybersecurity, and data privacy. RVK's OCIO E&M Team also reviews the firm's disaster recovery plan, which outlines process and procedures for data recovery, protections around IT infrastructure, and business continuity frameworks in the event of a disaster. In addition to ensuring an OCIO has best practice policies, it is important to understand the individuals or teams responsible for reviewing and updating these policies, how these policies are monitored for compliance, and how frequently the policies are reviewed, updated, and tested.

About RVK's OCIO Evaluation and Monitoring Practice

RVK, Inc. ("RVK") has been providing OCIO search, evaluation, and monitoring services to institutional clients since 2012 and has conducted over 50 projects. Our OCIO Evaluation and Monitoring practice was a natural extension of RVK's sole line of business of providing non-discretionary investment consulting services to institutional clients since 1985. The success of our group has led our firm to add a companion practice—RVK Investment Program Review—focused on reviewing a Board's or Investment Committee's governance, structure, operations, and the efficacy of their own internal investment organization.

Contact us to learn more about how we can educate and guide you through the important and long-term decision of evaluating the OCIO option, hiring an OCIO, as well as to discuss how we can help fulfill your fiduciary duty to monitor and evaluate an incumbent provider.

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RVK

RVK was founded in 1985 to focus exclusively on investment consulting and today employs over 100 professionals. The firm is headquartered in Portland, Oregon, with regional offices in Boise, Chicago, and New York City. RVK is one of the ten largest consulting firms in the US, as reported by *Pensions & Investments' 2019 Special Report – Consultants*. Additionally, RVK received a notable award in April 2020 when it was named a Greenwich *Quality Leader* among large US investment consultants, based upon Greenwich Associates' 2019 study. Greenwich is an industry-recognized third-party firm which asks plan sponsors to rank their consultants on a series of key metrics. Notably, RVK is the only firm among large US consultants to receive an award for a third consecutive year.[1] RVK's diversified client base of over 190 clients covers 30 states, and covers endowments, foundations, corporate and public defined benefit and contribution plans, Taft-Hartley plans, and high-net-worth individuals and families. The firm is independent, employee-owned, and derives 100% of its revenues from investment consulting services.

[1]Between July and October 2019, Greenwich Associates conducted interviews with 1,100 individuals at 896 of the largest tax-exempt funds in the US–including corporate and union funds, public funds, endowments and foundations–with either pension or investment pool assets greater than $150 million. Study participants were asked to provide quantitative and qualitative evaluations of their asset managers and investment consultants, including qualitative assessments of those firms soliciting their business and detailed information on important market trends. RVK is one of three firms recognized in the large investment consultant category. The ratings may not be representative of any one client's experience with RVK; rather they are representative of those clients submitted and that chose to participate in the survey. The results are not indicative of RVK's future performance.

To read the Greenwich article, please refer to the following URL: https://www.greenwich.com/sites/default/files/files/reports/Five-Factors-Distinguish-Best-in-Class-Consultants-Average-Practitioners.20-4012.pdf

For more information about RVK, please refer to the following URL: https://www.rvkinc.com/about/about.php