Exclusive OCIO Roundtable

OCIO Provides More Than Plan Management


Eric Menzer

B*enefits and Pensions Monitor* invited Eric Menzer, Global Head of OCIO and Fiduciary Solutions at Manulife Investment Management, to share his insights on the continuing growth in the use of OCIO (Outsourced Chief Investment Officer) by Canadian pension funds.

How can you tell if your plan would benefit from using an OCIO approach?

Eric Menzer: One of the big misconceptions is that OCIO is all or nothing –you have to hand over the keys and give full discretion to the consultant or the asset manager. That's simply not the case and this means most plans can benefit from this approach to some degree.

Typically, many plans are being managed by the chief financial officer, the treasurer, or an HR professional, but it is on a part-time basis. They're not doing it full-time and may not have the time and or the staff to do so. Also, specialized skills and investment capabilities often don't exist within a single organization. An OCIO can help you ease in-house staffing requirements for plan sponsors looking for additional help.

Does the size of a plan matter?

Menzer: Historically, early OCIO providers went after the mid-market because the larger plans tended to have investment staff or expertise in house. On the flip side, these early providers stayed away from the smaller end because it just wasn't profitable.

What we're seeing now as OCIO starts to become more of a household name and people get comfortable with it is more smaller plans turning to it. And we are seeing more larger plans adopting it in a strategic partner arrangement where the OCIO provider works alongside the existing CIO.

There's also a trend in the large end of the-market towards using an OCIO for various sleeves. A plan sponsor with a comfort level and expertise around a particular area will continue to manage that. But if they need help in an area such as, for example, private assets, they may hire an OCIO to manage those portfolios.

Do we see OCIO being used as a cost containment measure?

Menzer: Absolutely, particularly as the industry has grown, we've seen the benefits of scalability, in particular for those providers with multi-manager platforms who can pool assets which results in lower fees.

You also have providers that also offer plan custody and record keeping, as well as administration. As you bundle these together, you really get the full benefits of an OCIO by having all that functionality in one place.

How can liability driven investing (LDI) complement or enhance an OCIO strategy?

Menzer: Early providers of de-risking typically offered off-the-shelf products that used benchmark driven, fixed income long duration mandates. These were plugged into a plan. While this would result in some benefits by lowering interest rate exposure, they didn't look at the big picture and take into account liabilities or cash flows or look at the risk holistically at the plan level.

However, there's more to LDI than managing duration.

In this low interest rate environment, LDI, from a managing duration perspective, isn't an attractive proposition.

But if you think of liability driven investing more holistically and include long duration alternative assets, it starts to look more appealing in terms of being able to enhance surplus return, while also managing interest rate risk.

What should be considered when choosing an OCIO?

Menzer: Early OCIOs were typically from the consultant channel. They leveraged their existing books and grew the business that way. However, more players – including investment managers and specialty firms – have come to the table over the last decade and finding an OCIO has become a challenging exercise for plan sponsors.

There are search consultants in the marketplace that specialize in identifying OCIO providers.

However, to start a search, plan sponsors should think very carefully about what they want from an OCIO. Is it something they're lacking so they need a provider who is better in certain areas, particularly when open architecture or expertise in LDI or private assets is needed?

Once you hone in on your need, you identify the real gaps that you're trying to plug. What is the help that you're trying to get?

Weaning out the providers here is difficult. It's unlike doing a search for an existing single asset mandate where you can go into public markets databases, find information on it, query down, and look at performance and fees. In the OCIO space because each solution is customized, no two mandates are alike. There's no database that you can search to try to find that out. It takes a lot of legwork and really meeting with the different providers to truly understand the value proposition they're bringing to the table.

OCIO in the beginning was mostly cookie cutter type approaches. When did we start to see them becoming more and more customized?

Menzer: Custom is in the eye of the beholder.

Typically, in the early days, providers just offered full fund solutions. They basically modeled out a client's asset mix, put their respective percentage allocations into those pools, and called it 'custom.' Now there is a custom aspect to that because it's a custom asset allocation, but the pooled investment vehicle itself is not custom.

Where the industry is trending now is plan sponsors are demanding more customization. They want custom benchmarks that are specific to their plan and they want a say in how the underlying investment managers fit in to their plan.

There's a balancing act between being able to provide scale and being able to manage efficiently.

Our approach is to customize a solution based on the outcomes clients are looking for. The client's pension plan is reviewed and scenario analysis is modelled out and an investment program specific to a client's objectives is designed.

Are there any advantages to using a provider who has their own suite of products?

Menzer: There are advantages, but there are also conflicts which need to be managed appropriately. If those particular managers are using their own products, they need to demonstrate that it's a superior product and that it's providing value in a cost effective way.

Even with an OCIO, the sponsor still has a fiduciary duty that needs to be upheld for plans. It's important to make sure that those managers are putting their fiduciary duty first and can demonstrate this.

That doesn't preclude the use of proprietary products, but it has to have the same scrutiny as any other third-party manager that's being included in the plan.

A lot of this, in my experience, comes down to the process and demonstrating that there is a robust due diligence process around it and that you're managing conflicts.

Does using an OCIO help insulate a plan against market upheavals like we have seen in the past and which, apparently, we're going to see in the future?

Menzer: In the COVID-19 downturn in the markets in March, there weren't very many places to hide. There was a sharp sell off and it happened very quickly

Where we see the benefit – particularly in the recent downturn – is the ability of the OCIO to take advantage of the market dislocation quickly by rebalancing and buying assets at lower prices and with lower valuations. The OCIO doesn't have to wait for the quarterly investment committee to make that decision. Plan sponsors who waited for their quarterly committee meeting at the end of April or May to discuss the first quarter performance and rebalance their portfolios would have missed the entire downturn and rebound.

With the low interest rate environment, are we seeing pension funds using an OCIO to access private markets where they may not have the scale to do so?

Menzer: That's definitely part of it, particularly towards the lower end of the market – smaller pension funds or small endowments and foundations. They may lack the capital or the expertise to go into these. However, they can use an OCIO who can access these asset classes for them.

Where do you see OCIO going from here?

Menzer: We've seen tremendous growth in the OCIO space, particularly coming out of the global financial crisis when a lot of pension funds woke up to the fact that they needed to do a better job of managing their risk and their plan's liabilities.

OCIO really started to get more acceptance in the industry as a legitimate offering and there's been a lot of adoption and a tremendous amount of growth. Predictions are that there's still going to be significant growth in the future.

I expect more plans turning to OCIO as plan sponsors and endowments and foundations realize that they don't have to take their responsibility off the table, they still have a role to play.

And based on the amount of institutional assets that are out there in the small- and mid-sized space, there's still a lot of room for growth.

Any final thoughts??

Menzer: These are challenging times, we're here to help sponsors navigate these challenges. We're also available to discuss your portfolio, conduct scenario analysis, and develop an investment strategy with you.