Changes in the OCIO landscape: What lies ahead for institutional investors?

A conversation with SEI's Mike Cagnina, Senior Vice President and Managing Director, Institutional Investors

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With more than 25 years' experience, Mike is recognized as an expert in investment outsourcing and discretionary strategies for institutional investors. He regularly speaks at industry conferences and webinars on the topic of investment outsourcing and discretionary investment management. He has been interviewed on best practices by numerous media outlets, including *Nonprofit News*, *PLANSPONSOR*, *Bloomberg News*, *Pensions & Investments*, and *FundFire*.

What changes have you seen in the OCIO space over the past several years?

I don't think anyone would dispute that there has been a lot of change in the OCIO (outsourced chief investment officer) space. Some of the change represents good news for investors, and some has made the OCIO decision much more complex. I would categorize that change into three broad categories:

1. Provider growth and consolidation

The OCIO model has attracted a diverse range of providers, including consultants, asset managers, pure OCIOs, and RIAs. When I started in the business several decades ago, there were three organizations providing these types of services. There are now more than 100 OCIOs for investors to choose from, each offering a broad range of experience, capabilities, and solutions.

The more recent trend, which has accelerated over the past few years, is toward consolidation. Large OCIO firms are acquiring smaller ones to increase assets under management (AUM)—we believe sometimes without regard for strategic fit or impact on the affected client base. We're also seeing some smaller, boutique firms that are monetizing and selling their business. These firms may have been formed as a spinout, perhaps from a university or another organization, and we are seeing some of those decide to monetize the business and move on. This has caused some disruption for the clients affected.

2. Increased specialization

I would say we see greater specialization based on the type of investor. Universities versus pension plan investors, as an example, have very distinct needs. Even within a particular space, OCIOs are tailoring their services to match the organization's needs. Universities don't all look and feel the same. We talk to some that are very well established and financially sound—their fundraising efforts are strong, and they are not overly reliant on the endowment beyond the spending that's required. So, they tend to invest more aggressively, perhaps take on more illiquidity. Yet, there are other universities that are not as financially strong. Maybe they need to rely on the endowment to fund operations, or enrollment is down, causing financial pressures. Investors will see some OCIO providers specializing their resources and focus to meet these distinct investor needs. This is a good thing and something investors should seek to understand when choosing an OCIO as your strategic partner.

3. Diverse approaches across providers

Finally, we are seeing diverse investment strategies or approaches across OCIOs. For example, there are low-cost providers out there. They tend to invest in asset classes that are very liquid. They might use index strategies, ETFs, and/or factor models with limited exposure to illiquid investments or other alternatives. Conversely, there are some other OCIOs that are focused heavily on alternative investments and illiquid investments. And that's really what they stand for. I think that these trends are going to continue, and we think that could be dangerous. It's important to have an OCIO that understands your organization and builds an allocation that's appropriate for you. You don't want a firm promoting an investment approach based on its own internal bias. OCIOs should have broad capabilities across all the asset classes and all the opportunities. Once they understand your cash flows, return targets, volatility levels, liquidity needs, drawdown, etc., the approach should be custom and best in class.

What factors are causing this evolution in the space?

Several factors are driving change within the OCIO space. I think the biggest factor is continued end-investor demand for OCIO.

OCIO assets nearly doubled between 2016 and 2023, and current OCIO assets of almost $2.5 trillion are expected to grow to almost $4 trillion by 2028.[1] This dramatic growth has continued to draw new providers to the space. Investors continue to embrace the OCIO model because of the core benefits. These include real-time decision-making and access to unique investment ideas, which can be implemented in a way that's more efficient. Additionally, focused resources—whether around risk management or certain asset classes—and cost savings are always a consideration.

Complexity and economic uncertainty

Whether it's market volatility, rising interest rates, inflation, expansion in the illiquid markets, digital assets, or opportunistic investment opportunities, these complex issues are affecting institutional investors, and they're going to need some more help. As a matter of fact, we're seeing more in-house investors pulling back and adopting an OCIO model. We see institutional investors who are using an OCIO tend to stay with the model and look for a new OCIO if they're not satisfied, rather than going backward and building it themselves or hiring a traditional consultant.

Search firms are more prevalent

One other factor that is important to mention is the growth in the number of OCIO search firms. These are firms that specialize in helping institutional investors identify quality OCIO firms, and they're really helping institutional investors realize the benefits of the model. Investors who choose to use an OCIO search firm must be careful to select a firm that is independent, not conflicted, provides full transparency, and does not eliminate communication with the OCIO candidates that are being considered.

How do you see OCIO evolving in the coming years?

I think there's going to be continued consolidation. Some of the boutiques are still potentially looking to monetize. Additionally, we have seen some lift-outs of full teams.

In the pension space for example, some larger OCIO organizations have taken over the entire investment teams for large investors. I don't think that consolidation is going to stop. I think it will continue, and we'll probably see that consistently over the next decade.

Focus on three critical pillars

I believe the OCIO definition is becoming more comprehensive. Most people would define OCIO as an asset management partnership. I think going forward, people are going to think about the relationship from an asset management, technology, and operational perspective. When you think about those three critical pillars, top-tier OCIOs should have capability across all three areas: world-class asset management, technology that helps them oversee and identify investment opportunities as well as communicate and prepare information for clients, and then operational expertise that allows them to customize the solution for each client's needs.

I believe market complexity is always going to be part of the evolution, and it always has been for institutional investors. I also see the customization continuing when we talk about the evolution of OCIO. If you think about customization, that could also come in areas such as sustainable investing/ESG.

What do you think these changes mean for institutional investors going forward?

First and foremost, I think this evolution is good news for investors. With a lot of firms entering the OCIO space, there will be a lot of specialists and greater access to a high level of expertise. When it becomes this competitive, you get greater minds and technology involved in the process.

Ongoing provider consolidation means institutional investors will need to pay close attention to organizational structure. Does the OCIO have longevity and a commitment to the space? Are they financially stable? Is this an OCIO that's truly going to be around with me for the next seven, 10, or 15 years? Creating a good, long-term partnership is what it's all about in the OCIO space.

Full capability is a must

Additionally, investors should make sure their OCIO has the full set of capabilities to meet their long-term needs. For a nonprofit organization, you might not be equipped to have a significant amount of assets tied up in long-dated illiquid assets. But five or 10 years from now, that might change. Perhaps a big donor event happens, resulting in more cash flow coming into an organization; this may allow for a greater allocation to illiquid investments. For a pension plan, the plan might become fully funded and the priority might change to be de-risking. You want to make sure that your OCIO has full capabilities so you're not continuing to change OCIOs because you're changing.

How does value compare to cost?

It's important for investors to understand the total fee picture. What value are you getting from the OCIO, and how do you measure that value relative to the cost? In my experience, investors can fail to accurately evaluate the programs by asking: What's your OCIO fee? That fee is only part of the equation and investors need to understand the total costs. What are the costs of the third-party managers and how do those costs play into the total fee? Investors definitely want transparency and need to ask if there are performance-based fees or other fees that the managers are charging. Also, what is the value of the services you derive from that fee? Not all OCIOs provide the same suite of services for that fee. We have a checklist of services to help our customers evaluate that. Is one OCIO saving you internal costs over another?

Take time to find the right partner

I also think, given this increased choice, institutions will need to spend more time evaluating once they get to a short list of organizations they might consider. Over the last decade, it's been a race to get the OCIO search done, "Let's find our partner." I'm starting to see additional time being spent. Rather than just one meeting with three OCIO providers, firms will spend time getting to know each other and make sure this partnership is something that will last into the future.

And then lastly, I think there needs to be a greater focus on what matters most, which is your mission, your cause, and your employees, depending on the type of institutional investor that you are. Investors should demand that!

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[1]Sam Heller, "OCIO AUM to Increase at Least 54% Over Four Years: Report," FundFire, April 4, 2024.

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