

# Strategic Considerations for Choosing Between an Advisory or OCIO Consulting Model

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**O**utsourced chief investment officers (“OCIOs”) have been receiving a lot of attention in recent years, as many organizations consider switching from an advisory model to an OCIO model. There are many factors to consider in making such a decision and this article examines just a few of them.

Under an *advisory* consulting model, funds retain an investment consultant to advise them on both investment policy matters, such as long-term asset mix, and operational matters, such as manager selection. Under this model, the investment consultant has no discretion and provides only advice and recommendations, and the fund (typically the investment committee or the board) approves all decisions. Under an *OCIO* model, the fund still approves all major policy decisions, such as the long-term asset mix, but delegates to the OCIO the authority to carry out operational tasks, such as hiring and firing managers, re-balancing the portfolio, tactical asset allocation, and back-office operations.

Deciding which model is right for a fund is seldom straightforward, as there are a number of factors to consider. Many fiduciaries focus on assessing which model offers the highest expected investment returns after costs. This is certainly a critical question and will be addressed in forthcoming articles. In this article, however, we

focus on questions that are more strategic in nature, including:

- Which consulting model best reflects our **mission**?
- Which consulting model best aligns with our investment **philosophy**?
- What are our core **competencies** and what implications do they have for the model we choose?
- Is our **culture** more conducive to one model or the other?

## *What is our Mission?*

**W**hen selecting an investment consulting model, fiduciaries should first consider their organization’s mission, which describes its core *business*. It sets out the products and services the organization provides, its customers or stakeholders, and the value it seeks to create.

Sometimes asset management is central to an organization’s mission, as in the case of a public retirement system. In other cases, however, it is peripheral to the mission. For example, a manufacturing company may also manage a pension fund for its employees, but the pension fund is not central to the company’s mission.

If managing an investment fund is a core part of an organization's mission, there may be a stronger case for the organization to invest in the staff and board resources necessary to effectively manage the fund. On the other hand, if the investment fund is not central to the mission, the organization may prefer to focus its resources on its core business and delegate most aspects of the asset management function to an OCIO.

Every organization with an investment fund should define its mission and the core business activities that directly support it, and then assess whether the investment function is truly a strategic activity that warrants internal investment and resources. Such an assessment will shed light on whether an advisory consulting model or an OCIO model will best meet the organization's needs.

#### ***What is our Investment Philosophy?***

Every investment program implicitly reflects some type of philosophy regarding issues such as asset allocation, risk, and active management. At one extreme, the philosophy may call for a simple investment program that is largely passive in nature, limited to public market investments, and perhaps subject to strict portfolio rebalancing (i.e. no tactical shifts in asset allocation). In this scenario, the investment program is unlikely to realize the potential benefits associated with an OCIO model, which often has higher fees associated with it, and instead may be perfectly well served by the advisor model.

At the other extreme, the philosophy may call for a complex program with private market investments, hedge funds, and tactical or opportunistic asset allocation. An OCIO model may be more appropriate for such a program, as it allows an OCIO greater opportunities to use its

expertise and experience in a discretionary capacity and add value.

Organizations that have not explicitly discussed their investment philosophy should do so before selecting an investment consulting model. If they find they do not have a clear philosophy, they may wish to explore and define their philosophy before proceeding with a search for an investment advisor or OCIO.

#### ***What are our Core Competencies?***

After considering their mission and investment philosophy, organizations should then determine whether they possess the necessary core competencies to manage the investment program they have in mind. Core competencies are the skills, knowledge, and capabilities an organization requires to achieve superior performance. Every organization requires a unique set of core competencies – whether it is a car manufacturer, a charitable organization, or a financial services firm.

Organizations with investment funds need to assess whether they have individuals on the board, investment committee, and management team with enough investment expertise to effectively manage and govern the fund. If gaps exist, and most organizations will have at least some, they must decide which consulting model will best help to address those gaps. For example, some organizations may believe they have the internal skills and knowledge necessary to select and terminate investment managers, but simply lack the time and/or resources to perform the manager due diligence and research that precede manager selection and termination decisions. For such organizations, an advisory consulting model may be the best solution.

Other organizations may conclude that, even with an investment advisor providing manager

research and due diligence, they lack the internal expertise necessary to make effective and timely manager selection and termination decisions. Such organizations may therefore be better served by an OCIO model.

A careful and honest assessment of an organization’s core competencies is crucial to identifying an appropriate consulting model. Without it, organizations may unknowingly face gaps in their ability to successfully manage their fund over the long term.

**What is our Culture?**

The culture of an organization may also have a bearing on the model that is most appropriate. In particular, the views of the board and management on outsourcing and delegation of authority, and potentially those of stakeholders (e.g. donors), may be critical to the long-term sustainability of any solution.

At its heart, the OCIO model involves delegating to a qualified third-party the authority to manage the day-to-day operations of the investment program. Outsourcing may create discomfort among trustees and staff and potentially stakeholders. Perhaps it is at odds with the organization’s human resource policies and philosophy, or there may be a view that manager selection is simply too important to delegate to an

outside party. Whatever the reasons, if the board, management, or stakeholders are unlikely to support an OCIO consulting model over the long term, this should factor strongly into any assessment. While it is true that an organization can change its consulting model at any time, such changes can be disruptive and costly and should be avoided, if possible.

**Table 1** below summarizes the four decision factors addressed in this article.

**Conclusion**

This article has addressed a number of strategic considerations that may influence whether a fund is best served by an investment advisor or an OCIO. These include the organization’s mission, investment philosophy, core competencies, and culture. Given that every organization will have a unique position on each of these issues, the optimal model will differ across organizations. Accordingly, before initiating a search for an investment advisor or OCIO, organizations are well advised to explore these issues and ensure a consensus exists on each of them. This paper does not address the costs and expected returns associated with different consulting models. These, of course, are also important considerations and will be addressed in a future article.

**TABLE 1. STRATEGIC CONSIDERATION FOR SELECTING AN INVESTMENT ADVISORY MODEL – A SUMMARY**

STRATEGIC DECISION FACTORS	RESPONSE	CONSIDER AN ...	
		ADVISORY MODEL	OCIO MODEL
1. Is asset management central to our mission?	Yes	✓	
	No		✓
2. Does our investment philosophy suggest a relatively simple investment program?	Yes	✓	
	No		✓
3. Can we build/maintain the necessary core competencies?	Yes	✓	
	No		✓
4. Does our organizational culture support outsourcing?	Yes		✓
	No	✓	