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Replacement Searches Surge as Inst'l Investors Expect More From OCIOs

By Aziza Kasumov

March 19, 2019

Institutional investors are becoming pickier about OCIOs and demanding more from service providers in the booming market, a new study from Cerulli Associates finds.

The OCIO space has grown substantially – Cerulli estimates a total AUM figure of approximately $1.1 trillion - and investors' expectations have increased as they've become more familiar with the model. Consequently, replacement searches have started to rise.

The report sampled 45 institutions, which collectively control $25.5 billion in assets and are using 28 different OCIO providers.

Out of the sampled institutions, almost all the nonprofits or corporate defined benefit plans – 53%– had previously conducted a replacement search. Half of those had chosen to replace their OCIO upon concluding the search. The search numbers were slightly higher among nonprofits, and lower among corporate DB plans.

"Institutions have a larger and more diverse pool of OCIOs from which to choose," says **Michele Giuditta**, director of Cerulli's institutional practice. "We're seeing a lot of the early adopters conducting routine due diligence to see if their OCIO is keeping up with the market and ensure quality and fit of their existing OCIO."

Institutions have also expanded their list of expectations, according the report, a reflection of clients "wanting more from their OCIO provider, or having their needs change over time," says Giuditta. "Where we did see actual replacement, the top reasons were desire for greater flexibility and better performance," she adds.

More than one half of respondents who had replaced their OCIO cited performance as an issue – but a sizeable minority, one third of those who replaced, also noted wanting more flexibility, such as allowing them to divest from certain holdings or making customized choices around the use of active and passive managers, Giuditta adds.

Some nonprofits cited a growing interest in ESG as a driver behind replacement searches. Of the sampled nonprofits, for instance, 62% said they expect needing more support with investment services in the next few years, most citing ESG and mission-aligned investing specifically. “That could be a range of things,” Giuditta says, “anything from ESG integration to help with shareholder engagement or proxy voting.”

In recent years, OCIO providers have come under increased scrutiny from clients who seek more flexibility in the ESG space, as reported. The Rockefeller Foundation, the Commonwealth Fund and Barnard College Endowment all cut ties with their OCIO provider Investure between 2014 and 2017 over mission-related investing concerns. “For endowments and foundations, [ESG] is a certainly one of the criteria,” says **Tom Iannucci**, president of Cortex Applied Research**.** From his firm’s experience, the uptick in replacement searches hasn’t been drastic, but clients who review their OCIOs sometimes find that there are different firms out there with whom they might be “feeling a better connection, a better investment fit and a better philosophic fit.”

Most of the replacement searches Cortex is conducting arise from performance issues or because a client hasn’t revisited the relationship in a while, Iannucci says.

For other OCIO search consultants, the rise in replacement searches has been more striking.

“For the first two or three years of our business it was all searches, and no replacements or evaluations,” says **Christian Eicher**, a consultant at RVK, which has done OCIO searches for about six years.

“But the last year or two, half of our work is focused on clients that already have an OCIO and are looking to evaluate that against other opportunities in the marketplace,” he adds.

Eicher attributes the trend to the growing number of OCIO providers in the marketplace, many of whom are “differentiating by targeting specific clients and their investment needs.”

At search consultant company Alpha Capital Management, the increased demand for searches has pushed the firm “close to capacity,” says founder **Brad Alford**.

Turnover here, however, seems to be higher than indicated in the Cerulli report. “Of our last 20 searches, only one [client] stayed with the existing OCIO provider,” says Alford.

“There’s just so many different choices out there, and most haven’t been to search in seven to 10 years,” a timeframe during which the industry has been undergoing “the greatest change in decades,” Alford adds.

A new investment committee chair is usually a “big trigger point” for a new search, Alford says. Other than that, many clients feel like they’ve not been getting enough attention from their OCIOs, want to explore other pricing options, are interested in more mission-related investing, or, most commonly, take an issue with the OCIO’s performance.

“They’ll say that’s not what it is,” Alford says, “but if performance is good, they’re not going to search.”

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