FUNDfire
A Financial Times Service

'Getting Married and Talking Divorce': Investors Prioritize OCIO Exit Strategies

By Aziza Kasumov

June 17, 2019

Institutional investors are increasingly paying attention to how they might unwind their outsourced CIO (OCIO) relationship – even as they're just getting started with a new provider.

The heightened focus comes after a generation of early OCIO adopters realized that it can take years to get out of some holdings, and they can still incur high fees for "legacy funds" that their old OCIO administered, search consultants tell *FundFire*.

"It's very easy to sign up a new OCIO, but the exit strategy is a very critical deficiency," **Tom Donahoe**, managing director of OCIO search and governance at **Manager Analysis Services**, said at Investment Management Institute's OCIO Solutions Summit last week.

Donahoe said that often institutional investors don't discuss exit language "when they jump into an OCIO agreement." But once a provider is terminated, it's "pencils down." That creates "slippage where you lose real value over the period of two weeks or three weeks simply because people are taking their eye off the ball," Donahoe explained.

Further, at least one OCIO continued to charge a client full fees for an entire year while cutting off performance reporting, according to **Brad Alford**, founder and principal of OCIO and consultant search firm Alpha Capital Management.

"That's just bad behavior," he says.

As the landscape for OCIO providers expands and more investors rely on search firms for assistance, exit strategies have become top of mind.

"Our clients are very focused on it," Alford says. It's like "starting marriage thinking about divorce."

The attention on this space coincides with OCIOs entering their seconding inning — the industry has amassed more than $1 trillion in assets under management, according to data from Cerulli Associates. And replacement searches have started to go up as investors, who are now more familiar with the OCIO model, heightened their demands, as reported.

When institutional investors transition to a different OCIO provider, however, they might not be able to liquidate all their assets and move them over to a new custodian right away. Especially investments in the alternative space that can sometimes take up to a decade to liquidate.

“Any search consultant should tell their client to treat this as a long-term relationship, but if you need to exit, understand what will be liquid and what won’t be liquid,” says **Tony Johnson**, a senior consultant and director of Midwest consulting at RVK’s OCIO search unit.

More traditional investments may cause headaches, too.

“Clients are just shocked when they find out it can take years to get out of liquid holdings,” says Alford.

In such cases, clients leave so-called “legacy funds” with their old providers until those funds sunset and they can get their investments back. In the meantime, however, they still need to pay fees – and those can be hefty.

“You’re paying an asset management fee on top of the management fee, [and] that could be a fund-of-fund fee,” says Johnson.

That’s why Johnson pushes for discussions in the search process on what happens on the backend if things change.

“It’s a bigger part of our discussion with clients, especially when they’re doing a search to possibly exit the relationship,” Johnson says. “Are you willing to undergo that type of cost and that kind of disruption?”

He adds that all search consultants should advise clients to think about exactly what can go wrong as such scenarios have been overlooked in the past.