

Our Fiduciary Focus educational series is your resource for information about not-for-profit institutional investing, board governance, OCIO services and more. Learn best practices and industry trends that improve your operations and advance your organization's mission!



OCIO 101: Transparency in Performance and Fee Reporting

We continue our exploration of the **Outsourced Chief Investment Officer (OCIO)** model with a look at the key to a strong investor-OCIO provider relationship: transparency.

Trust is the foundation for success when an organization partners with an OCIO to outsource a portion of its fiduciary duties. Transparent communication from the provider is the first step in establishing trust—especially as it relates to performance and fee reporting.

Also read: [Why Organizations Are Outsourcing Their Investment Operations](#)

Transparency in Performance Reporting

Understanding an OCIO provider's performance track record may present challenges for investors. More specifically, there are many hurdles for investors looking to compare performance track records across providers.

For example, many OCIOs provide prospective investors with "composite" performance—a look at combined performance of various strategies—as a way to represent their track record. In this context, OCIOs construct a composite using their client portfolios managed with a similar strategy or objective as that of a prospective investor.

Until recently, there were few established guidelines around creating composites. When aggregating sample sets of representative clients, OCIO providers could simply select those with the strongest performance track records, while omitting poor performing portfolios. Providers might also present a "sample portfolio" of their strongest performing investments that they never actually implemented for a client.

When evaluating an OCIO, investors should seek performance information that accurately represents real performance from all clients using an OCIO's relevant strategy. Furthermore, investors should scrutinize their provider's choice of benchmark. Comparisons should only be made to appropriate benchmarks, not those that may be "cherry-picked" and easily beaten (also read: [Using Benchmarks to Measure Investment Performance: Wespath's Approach](#)).

Risk-adjusted Performance

Another consideration when evaluating a track record is risk-adjusted performance. For instance, if Portfolio A and Portfolio B both returned 10% annually over a three-year period, but Portfolio A has a standard deviation of 16%, while Portfolio B had one of 8%, then Portfolio B posted stronger risk-adjusted returns. In other words, it generated the same performance, while keeping risk lower. This is a simplified example that is missing important comparisons like the extent to which the portfolios hold illiquid non-public securities, but the principle of risk-adjusted performance holds true.

Risk-adjusted performance helps answer more questions about an OCIO's track record. Is the OCIO skilled at selecting individual asset managers? Is it great at determining specific asset allocations? Or is the provider taking on excessive risk to achieve returns?

While this information has not always been readily available in the OCIO market, the industry is working towards providing better performance transparency to investors.

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Industry Initiatives to Improve Performance Reporting Transparency

- **GIPS:** The [Global Investment Performance Standards](#) (GIPS) are a set of ethical principles intended to guide asset managers and asset owners on fairly calculating and presenting their investment results to investors.
- **OCIO Indices:** Alpha Capital Management, a consultant focused on OCIO searches for investors, has teamed up with Nasdaq to create composite indices measuring providers' performance across different asset allocations and risk profiles. The [Alpha Nasdaq OCIO Indices](#) include data from over 25 major providers.
- **Data Standards Working Group:** OCIO consultant North Pier has formed the "Discretionary Investment Management Industry Working Group on Data Standards." The group plans to publish guidance on industry standards for comparing provider performance in 2021.



In an effort to help investors make informed decisions regarding their OCIO provider, Wespath and its subsidiaries participate in the Alpha Nasdaq Indices and contribute to North Pier's working group. We are also pursuing full GIPS compliance and verification in 2021.

Transparency in Fee Reporting

There are also transparency challenges related to OCIO provider fees. For certain institutions, such as banks or large financial organizations with brokerage arms, the OCIO offering is just one of many businesses. With these providers, fee reporting can become murky as hidden costs and model portfolios may come into play.

HIDDEN COSTS: A large OCIO may not be fully transparent on fees when it uses its own investment funds or strategies as the underlying products for constructing an OCIO client's portfolio. For instance, a provider managing assets for a foundation could invest in their own emerging markets equity offering. It is important that the OCIO fully disclose any separate fee attributable to its own product offering in addition to its management fee.

MODEL PORTFOLIOS: In this situation, an independent third-party asset manager provides the OCIO with a list of its securities holdings. The OCIO then uses its own trading desk to replicate the "model" portfolio. The client may therefore believe their achieved results are similar to those achieved by investing directly with the third-party manager. For one, this does not account for the additional fees captured by the OCIO's trading desk. Also, results will likely differ due to timing differences between the third-party manager executing similar trades and the quality of execution achieved by the OCIO's proprietary trading desk. OCIOs using model portfolios should report all fees, as well as evidence of the quality of their trading desks' execution.

There is nothing fundamentally wrong with large OCIO providers operating multiple business lines. The important thing here is—you guessed it—*transparency*. OCIOs should fully disclose all fees incurred by their clients. When investors hear "Our fees are bundled, and we do not provide a breakdown," they should raise an eyebrow and ask questions. As fiduciaries, boards and investment committees have a duty to seek transparency.

Aligned With Your Values

At Wespath and WII, "Stewardship" and "Integrity" are two of our core values. We believe that trust is the foundation for a long lasting, successful partnership. Furthermore, we have designed our OCIO services to be transparent and easy to understand. We invite you to explore our website [here](#), or contact:



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About Wespath

Wespath Benefits and Investments (Wespath) is a not-for-profit agency that has been serving The United Methodist Church (UMC) for over a century. In accordance with its fiduciary duties, Wespath administers benefit plans and, together with its subsidiaries, including Wespath Institutional Investments, invests over \$28 billion in assets on behalf of over 100,000 participants and over 130 United Methodist-affiliated institutions (as of June 30, 2021). Wespath funds invest in a sustainable manner that supports long-term value creation while having a positive impact on the environment and society and upholding the values of the UMC. Wespath maintains the largest reporting faith-based pension fund in the world. wespath.org



About WII

Wespath Institutional Investments (WII) is a not-for-profit subsidiary of Wespath, a general agency of The United Methodist Church (UMC). WII provides investment solutions for institutional investors related to the UMC, including foundations, children's homes, older adult facilities, higher education institutions and healthcare organizations. WII offers diversified global exposure to its world-class investment managers through a family of daily priced funds. WII's investment process proactively incorporates the consideration of environmental, social and governance (ESG) factors into investments across asset classes and in the selection of external asset managers. wespath.com

