



Overview

RVK’s Outsourced Chief Investment Officer (OCIO) Evaluation and Monitoring Team (RVK OCIO E&M Team) has been conducting OCIO education, search, evaluation, and monitoring projects for over seven years. Throughout this time, we have advised asset owners on how to navigate the particular challenges associated with evaluating OCIO providers. In RVK’s first edition of OCIO Insights, we highlight elements often overlooked by asset owners when evaluating an OCIO provider—Board/Investment Committee governance structure, key components in understanding a track record, and due diligence on business aspects of an OCIO. This document focuses on one of the three elements: key components of understanding a track record. The complete RVK OCIO Insights Issue 1 can be found on RVK’s OCIO website.

Written By:

RVK’s OCIO Evaluation and
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Track Records Matter, but they are not the Primary Decision Point

When searching for a particular investment product, whether a small cap equity mutual fund or a middle market buyout fund, one of the first items up for scrutiny by a potential investor is the proof statement that the fund has been successful—its track record. That track record, measured against a benchmark, often determines if an investor will conduct additional research on the fund itself. While there may be a tendency to focus on results, we believe appropriately evaluating a track record is rooted in understanding the investment basics of who, how, and what led to that historical track record.

A great historical track record is only the “tip of the iceberg” that floats above the massive block of information that explains the reason for those numbers. As a search consultant, it is our job to immerse ourselves in the details of an OCIO’s team and ascription of responsibilities, investment philosophy and process, structural and dynamic tilts of each asset class composite, and performance attribution. Together, all of these factors help to explain the OCIO provider’s track record. While we believe a track record is important, it is the final factor in our evaluation because the building blocks of sound due diligence lead to understanding the track record.



The “Who” of the Track Record

The OCIO business largely remains a boutique business model. We would argue that even large, multi-line financial firms run their OCIO operations like a boutique firm because they concentrate final decisions with a small number of key investment professionals. Whether an OCIO provider has a sole CIO or an Investment Committee structure, it is important to understand the process by which an idea becomes a funded investment. It is critical for our team, and for our clients, to know precisely who is (or was) responsible for the investment decisions that built a firm’s track record. As such, it is important to spend ample time with the researchers, asset class leaders, and lead CIOs who map out decisions from inception to implementation, which we use to assess the impact of various decision makers, as well as the potential effect future personnel turnover may have on future performance.

The “How” of the Track Record

It is easy to judge whether an OCIO has been successful if its total fund track record is above a generally accepted and easily calculated benchmark (e.g. 60% S&P 500/40% Bloomberg Aggregate benchmark). However, we would argue that this comparison may not convey much useful information. Simply constructed benchmarks may not fully capture the amount of volatility or exposure to potential downside risk embedded in the OCIO’s portfolio. Conversely, it is easy to dismiss an OCIO that underperforms that same benchmark without understanding the reasons for the shortfall. When conducting due diligence, it is critical to delve into an OCIO team’s method for constructing both its asset class composites (e.g., allocations to passive vs active and the use (or lack) of alternatives) as well as their stance on making tactical tilts within an asset class or at the total fund level.

Without understanding how and why OCIOs build their portfolios, a Board/Investment Committee might be challenged to understand which market conditions might be reasonably expected to yield outperformance and underperformance relative to a generic benchmark. Analysis of an OCIO’s performance requires a deep understanding of, and experience in, asset class composition, mandate creation, and manager performance. Understanding each OCIO’s investment philosophy, and the details by which it is implemented, allows our OCIO E&M Team to narrow the broad list of OCIO providers in the marketplace for clients to consider. A more focused list of providers allows us to match the risk tolerance, unique investment objectives and general circumstances of our clients with similarly minded OCIO providers. Over the many years and projects our team has conducted, we have witnessed that there is no one-size-fits-all in the OCIO industry.

The “What” of the Track Record

Over the last couple of years, there has been an increasing demand by clients for validated track records according to generally accepted investment industry standards—specifically the Global Investment Professional Standards (GIPS)¹. A small but gradually growing number of OCIOs have either completed or have begun the process of becoming GIPS compliant and verified. Compliance with GIPS standards has been the gold standard within the asset management industry for years, and consultants typically conduct searches only for investment products that comply with GIPS standards. The pool of investors in these GIPS-compliant products is often large with a homogenous investment philosophy dictated by the asset manager. Conversely, the clients of OCIO providers may often have similar end goals, such as meeting similar spending rate goals or fully funding pension plans, each of an OCIO’s clients may have significant differences in their approved target allocation, acceptable investments, and investment horizon. These discrepancies can challenge one’s ability to compare OCIO providers’ total fund composites without a great deal of analysis and scrutiny.

¹ Global Investment Professional Standards (GIPS) were created by CFA Institute (formerly the Association for Investment Management and Research). They are a voluntary set of standards that were developed on the principles of full disclosure and fair representation of performance results. GIPS are a globally accepted industry standard for the calculation and presentation of historical investment performance for asset managers. (<https://www.gipsstandards.org/standards/2020/Pages/index.aspx>) While GIPS has been widely accepted among asset managers, it has only recently begun to be considered and implemented for the OCIO’s track record.

We believe that when a Board/Committee analyzes a GIPS-compliant track record, there should be a focus on answering several questions regarding the size and homogeneity of the data, including:

- What percentage of clients are included in the composite?
- What clients are excluded and why?
- What is the dispersion of returns?
- How similarly-invested are the return-seeking assets and non-equity assets?
- How reflective are GIPS composite portfolios of a prospect's proposed portfolio solutions?

We have observed OCIOs creating composites with specific criteria. This increases the number of an OCIO's GIPS-compliant composites, but lowers the number of underlying portfolios in each composite. Thus, there is the potential for OCIOs to cherry pick the composite track record they present to prospective clients, which may not be a complete representation of their broader clients' actual experience/track record. As such, we apply both a qualitative and quantitative approach to our expert analysis of OCIO providers' track records. We take this approach because we firmly believe that the importance of a track record comes from a series of analyses of the components that created that record, not just the valuation of the track record alone.

About RVK's OCIO Evaluation and Monitoring Practice

RVK, Inc. ("RVK") has been providing OCIO search, evaluation, and monitoring services to institutional clients since 2012 and has conducted over 50 projects. Our OCIO Evaluation and Monitoring practice was a natural extension of RVK's sole line of business of providing non-discretionary investment consulting services to institutional clients since 1985. The success of our group has led our firm to add a companion practice—RVK Investment Program Review—focused on reviewing a Board's or Investment Committee's governance, structure, operations, and the efficacy of their own internal investment organization.

Contact us to learn more about how we can educate and guide you through the important and long-term decision of evaluating the OCIO option, hiring an OCIO, as well as to discuss how we can help fulfill your fiduciary duty to monitor and evaluate an incumbent provider.

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RVK was founded in 1985 to focus exclusively on investment consulting and today employs over 100 professionals. The firm is headquartered in Portland, Oregon, with regional offices in Boise, Chicago, and New York City. RVK is one of the ten largest consulting firms in the US, as reported by *Pensions & Investments' 2019 Special Report – Consultants*. Additionally, RVK received a notable award in April 2020 when it was named a *Greenwich Quality Leader* among large US investment consultants, based upon Greenwich Associates' 2019 study. Greenwich is an industry-recognized third-party firm which asks plan sponsors to rank their consultants on a series of key metrics. Notably, RVK is the only firm among large US consultants to receive an award for a third consecutive year.¹ RVK's diversified client base of over 190 clients covers 30 states, and covers endowments, foundations, corporate and public defined benefit and contribution plans, Taft-Hartley plans, and high-net-worth individuals and families. The firm is independent, employee-owned, and derives 100% of its revenues from investment consulting services.

¹Between July and October 2019, Greenwich Associates conducted interviews with 1,100 individuals at 896 of the largest tax-exempt funds in the US—including corporate and union funds, public funds, endowments and foundations—with either pension or investment pool assets greater than \$150 million. Study participants were asked to provide quantitative and qualitative evaluations of their asset managers and investment consultants, including qualitative assessments of those firms soliciting their business and detailed information on important market trends. RVK is one of three firms recognized in the large investment consultant category. The ratings may not be representative of any one client's experience with RVK; rather they are representative of those clients submitted and that chose to participate in the survey. The results are not indicative of RVK's future performance.

To read the Greenwich article, please refer to the following URL: <https://www.greenwich.com/sites/default/files/files/reports/Five-Factors-Distinguish-Best-in-Class-Consultants-Average-Practitioners.20-4012.pdf>

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