



TAKING STOCK: NEPC OCIO ROUNDTABLE, THE 2024 EDITION

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Our [OCIO services](#) ensure our clients' investment programs are in the hands of dedicated experts who will make and implement the most appropriate investment decisions on their behalf. In this discussion, we offer you an insight into the benefits and goals of an outsourced CIO.

THE PARTICIPANTS:

Christopher J. Klapinsky, CFA *Partner, Senior Director of Portfolio Strategy, OCIO*

David Jennings, CFA *Senior Investment Analyst, OCIO*

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Aparajita Bubna *Managing Editor, facilitated this roundtable*

Please describe NEPC's OCIO services for investors new to this space?

Chris: OCIO stands for outsourced chief investment officer. What we do as an OCIO provider is take over various fiduciary duties on the client's behalf, including asset allocation, manager selection (hiring and firing investment managers), and back-office functions such as money movements and legal agreements.

Our OCIO clients are served by 25 legal, compliance and operational professionals and a nine-person OCIO investment team

OCIO adoption is widespread and growing, from \$2.4 trillion by the end of 2021 to an estimated \$3 trillion by the end of 2026—an overall growth rate of 5.6%—according to Cerulli Associates. At NEPC, our OCIO clients are served by 25 legal, compliance and operational professionals and a nine-person OCIO investment team.

What type of organization would benefit from an OCIO?

Dave: At the highest level, it's organizations that do not have the capacity or budget to hire investment and operations staff. Many committees would rather stay focused on the mission and strategy of their institution and don't want to be bogged down with the minutia of managing their investment program, including hiring and firing investment managers and handling trading and operations. There's a lot that goes into investment decisions, and you need to have the capacity and expertise to manage the investment program and hire and retain staff to make those decisions.

Organizations that do not have the capacity or expertise internally are the groups that would benefit

from having an OCIO. Also, an OCIO makes the investment implementation process smoother.

At NEPC, our OCIO team can step in and offload some of the decision-making and operational tasks. We also have the advantage of agility. There is a dynamic aspect we can provide to organizations that aren't able to move as quickly when it comes to implementing investment decisions. We've demonstrated the ability to see opportunities and threats in the market and act promptly. That is a big benefit for organizations that cannot move as quickly or are not consistently focused on the investment program. There are also the back-office resources we provide for our OCIO clients. For instance, we'll pay capital calls and conduct legal reviews for new investment managers.

Chris: Exactly! The only thing I'll add is we work across different client types. We have a client base diversified not only by type, but also size. We work with clients that range from \$20 million in assets under management to those with multi-billion-dollar portfolios. We work with endowments and foundations, ultra-high-net-worth individuals and families, healthcare systems, public pension plans, corporate defined benefit and defined contribution programs, Taft-Hartley clients and insurance companies.

Steve: Adding to what Dave and Chris said, what we often find is that clients come to us because they want a certain level of expertise that they're not able to replicate in-house. Often, there are trustee groups that have historically had an appropriate level of expertise, but now that person or persons are no longer there, and they can't replace the necessary expertise going forward.

For example, they might want to hire NEPC to get access to a specific allocation like alternative assets. If they no longer have that capability on their investment team or trustee group to gain access to certain investment products with constrained capacity, they're looking for assistance that will help bolster their ability to build out their alternative asset portfolio. Investment committees and staff members are often asked to move quickly to secure access to top alternative asset funds and may be challenged to meet the timeframes expected. NEPC has built relationships over decades with the investment community, and we have the operational staff to move quickly, and this is what our clients look to leverage.

What are the advantages and disadvantages of using an OCIO?

Dave: I'll talk about the advantages. A primary advantage is that we handle all aspects of investment manager selection.

That's something we mentioned previously, but that's likely the biggest advantage to hiring an OCIO. We use our research team of 70 professionals to find innovative ideas. Since we ensure we have no conflict of interest with our clients, our only goal is to do what's best for them by finding the finest investment managers for their portfolios. We decide the right time to hire investment managers and the right time to move on.

As Steve noted, another advantage that is worth emphasizing is the speed of execution. We have operations and investment teams that can quickly execute.

Chris: I think 2020 is a great example of how clients benefit from our OCIO services. At the onset of the COVID pandemic, we quickly positioned our client portfolios to hold significant cash levels which we raised from selling equities. Once we saw the extremely large federal stimulus programs ramping up—about three-to-four weeks after the market collapsed—we were able to quickly re-enter the market and remained overweight

Our large and experienced 70-person investment research team are experts in their respective asset class

equities for the rest of the year. Few clients acting on their own were able to move as quickly.

Dave: I'm also going to mention fees. Another advantage in hiring us in an OCIO capacity is that our scale allows us to negotiate lower investment management fees on behalf of our clients.

Investment managers find us more efficient to work with because they're dealing with our OCIO team that has built relationships and strong processes with leading investment managers, and the managers typically don't have to go to onsite presentations for clients. So, it makes sense that they lower fees for this ease of implementation. All fee savings we negotiate go directly to our clients, so all financial benefits accrue to our clients.

Chris: In terms of disadvantages, I'm biased here. I can't really think of many, but I certainly know OCIO isn't the appropriate model for everybody. If you're an organization with an experienced staff and seasoned decision makers, and they enjoy doing the due diligence, making asset allocation decisions and interviewing investment managers, then an OCIO will probably not make sense for you. Essentially, OCIO may not be suitable in situations where the organization wants to maintain the decision-making responsibility.

What makes the NEPC OCIO experience different from the competition?

Chris: There are multiple things that differentiate us as an OCIO provider. First and foremost, we're not a one-size-fits-all organization. We do a nice job of recognizing and addressing different types of clients. As a result, we customize our approach and our investment solutions to suit each client.

The second thing, which is unique to NEPC, is our practice group framework. Each OCIO client not only works with a strategist from our OCIO team, but also a consultant, both of which specialize in that client type and have expertise in that area. We believe this approach to building teams is the best way to fulfill our duty to our clients.

Dave: It is worth mentioning that we can provide services for just a single asset class, like private equity, private debt or hedge funds. This allows clients to utilize our expertise in a certain asset class without giving up control and decision-making on other parts of the portfolio where clients might still want to be involved in asset allocation or selection of the underlying investment manager and execution. For example, some clients use our OCIO services for only private markets to take advantage of the operational efficiencies that come with our investment research team's relationships and due diligence, and our OCIO team's portfolio construction and operational capabilities. These clients still retain decision-making in the rest of the portfolio and can use NEPC's advisory services for assistance as needed.

Chris: Finally, I must again mention our large and experienced 70-person investment research team. These professionals are experts in their respective asset class, including public markets and alternative investments, and investment managers in these fields. We also have teams that focus entirely on asset allocation and portfolio construction.

So, as an OCIO provider, these resources are integral to our process of building customized and optimal investment programs for our clients.

Do any client types stand out as being unique from an OCIO standpoint?

Chris: All clients vary, sometimes significantly, in their goals and objectives, be it returns, liquidity and/

or risk posturing. That really speaks to why we provide such a deep level of customization. But there are a few client types that have different top-down frameworks.

For instance, our clients in the defined contribution space clearly need a different approach. Defined contribution plan participants control their own allocation decisions, and daily valuation plays a huge role in determining the plan design -- more so than any other client type that we work with. In fact, so much so it warrants its own roundtable discussion!

Another client type with a unique set of needs are our private wealth clients. For them, we need to assess portfolios holistically from a tax perspective and will use a tax-aware approach like a loss-harvesting strategy. Also, we often work with multiple generations of a family, which can add an additional layer of complexity. They can have multiple—five, 10 or even 20—separate underlying accounts, and we generally collaborate closely with their other advisors such as estate planners, lawyers and auditors.

Finally, I will also mention liability-driven investing. Our services are very differentiated for our LDI clients as we can monitor their liabilities and funded status. We do that daily and, as a result, we can dynamically adjust their hedge ratios in short order. We work closely with our LDI solutions team at NEPC that provides guidance on best practices when managing LDI portfolios.

Sam: I can offer perspective on our healthcare clients. What is unique about healthcare systems is they often have multiple pools, whether it's operating pools, a foundation or endowment, pensions, or insurance. So, a single committee or staff member managing the complexity of these different pools is often daunting and overwhelming – particularly managing the daily cash flows and adjusting for various market environments. The investment pools are also typically related and can react differently in different market environments, adding additional complexity and risk to a healthcare system.

Dave: NEPC OCIO has deep experience managing various types of healthcare portfolios, including operating, defined benefit and defined contribution plans, non-profit, and insurance portfolios. We have systems in place that allow us to confidently navigate through times of market and operational stress. For instance, we can raise liquidity at short notice, we are able to monitor gain/loss implications in relation to debt covenants and operating requirements, and work with offshore administrators and actuarial firms to ensure healthcare portfolios are managed in accordance with their goals.

Private markets are becoming an increasingly important part of investment portfolios. Please explain the role NEPC OCIO plays in creating private markets portfolios for its clients.

Dave: We are essentially an extension of our investment manager research team, which includes 20 professionals specializing in private markets. They source ideas, conduct due diligence and rate multiple private market strategies each year.

We have frequent meetings with the private markets research team where we discuss their future pipeline for funds and ask them to rank their highest-conviction strategies. We then take those ideas and gauge their suitability and fit for each client's portfolio. We have also developed investment frameworks in concert with the research team, so each client has their own allocation to private markets, tailored to their individual goals and objectives for private equity, private debt and private real assets. Some clients like to be more aggressive, some and some like to be more conservative, so we have built frameworks that help us allocate for each client's needs.

Another important piece is private market pacing plans. It is the first step to creating an allocation to

private markets. We build pacing plans and update them every year for all our OCIO clients that allocate to private markets. So, it's one centralized team creating pacing plans for all OCIO clients, and then it's that same team that matches those pacing plans to the available investment strategies that are raising capital that given year. This allows us to have good visibility to effectively secure capacity and allocate effectively across our entire client base.

While you don't typically associate speed with private markets, it can be critical when it comes to gaining access to top funds. This is especially useful for venture capital and smaller buyout funds as a lot of those fundraises have a tight turnaround. If it's a high-demand strategy that investors flock to, the fund will be raised in as short a time as three months (or less). We have a legal and back-office team that works with our investment group, so if there is a fund that we really like that we want to allocate our clients' capital to, we're able to move quickly and get them into those funds. We see this broadly across private equity, private credit and private real assets too.

What role does reputation play in having access to managers in the private markets?

Chris: It's certainly no secret that the best private market managers are extremely hard to access. We have spent years earning a strong reputation for being a great firm to work with, and that results in our clients getting access to a number of premier managers that are usually difficult to access.

I believe managers enjoy working with NEPC for several reasons. One, we are not fickle. We're long-term investors and our research team is made up of people who have been general partners and/or capital allocators with a great deal of experience.

Also, for any given fund, we're transparent about the dollars we intend to invest on our clients' behalf and we're able to fulfill that targeted amount. Again, we can move quickly if that's something that's necessary as well.

Finally, I think our OCIO team makes the process seamless for investment managers. Dave mentioned this before, but managers work only with a couple of contacts at NEPC when we are onboarding a new fund all the way through the life of that fund. This ensures consistency and ease of communication. For these reasons, managers tend to give our clients—who would otherwise be typically jumping through hoops to get documents in order—access to funds.

How is NEPC thinking about the role of private credit in the portfolio of institutional investors?

Dave: Some clients view private credit as an income generator, while others look for diversified returns. Consistent with our customized approach, we assess the entire portfolio to understand the right fit for a given client. We can move into slightly riskier and more equity-like private credit for more total-return oriented portfolios, or traditional direct-lending for clients looking for more income and a more conservative approach.

We are keeping an eye on potential defaults and, within private credit, are focused on investing with managers raising smaller funds. They are writing smaller checks and are nimbler with their capital. We also tend to concentrate on private credit managers that use less leverage. We are also looking for managers with folks on their teams that have experience doing distressed credit and more complex deals. We have managers in our portfolios and in our pipeline that are experts at taking advantage of a messy situation, while making money when things are good.

The kind of managers we are weary of are the much bigger funds that are writing more and larger checks

and doing riskier and higher leverage deals. We don't want to invest in managers that are over-levered and price insensitive.

What is a checklist to keep in mind while looking to retain an OCIO?

Chris: I can think of a few good places to start. First, a client should determine where they need help. I mentioned three fiduciary responsibilities: asset allocation, hiring and firing investment managers, and the back-office operational support. The majority of our clients use us across all three of those areas, while the rest use us for one or two of those areas because they can do some of it on their own.

Second, you will need to decide if you want to outsource one area of the portfolio or the entire portfolio. We have a handful of clients that continue to manage the traditional assets in their portfolios, but they outsource all the alternative investments to our OCIO team.

Once you answer these questions, you need to decide if you want a fully customized OCIO approach—like the one NEPC offers—or a less customized, one-size-fits-all approach.

I would like to conclude by saying we are happy to answer any questions you might have. OCIO is a rapidly growing part of the investment landscape, and we are willing and ready to brainstorm with prospective clients to determine if we are the right partner for their organization.

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IMPORTANT DISCLOSURES

Past performance is no guarantee of future results.

All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.

This memo should not be considered customized investment advice. Please contact NEPC for advice specific to your investment program.

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