The Skorina Letter

News, Interviews, Research for Institutional and Family Office Investors

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OCIO assets up over 21% in Skorina's latest OCIO list!

Last month in our annual OCIO report, we listed OCIO assets up 18% from the prior year. We promised to come back with some additional thoughts about the outsourcing decision for endowments, and here we are.

Now, with recent AUM updates as of June 30th from a few big OCIO providers, we're reporting $1.7 Trillion in full-discretion assets under management by outsourced chief investment officer firms.

That's a year-over-year jump of $364 billion – or a little over twenty one percent – since September 2016!

See our OCIO list from last week with these latest updates here: http://www.charlesskorina.com/?p=5145

Our headline now says that total outsourced AUM is up over 21 percent (about $364 billion) year-over-year by our reckoning -- but we didn't hazard any guess about where all that money was coming from.

Our friend Dr. Alan Biller in Menlo Park, whose firm manages almost $40 billion on a full-discretion basis, has some thoughts on the matter.

We profiled Mr. Biller last year. See: *Alan Biller: An accidental money manager*

http://www.charlesskorina.com/?p=3916

Skorina:

Alan, you deal with prospective OCIO clients on a daily basis. What do you think is driving the growth in this niche?

Biller:

The effort by corporate pensions to de-risk and off-load their retirement liabilities probably accounts for the lion's share of the AUM growth, Charles.

U.S. private pensions totaled about $25 trillion in assets as of year-end 2016 according to the latest OECD report (Organization for Economic Co-operation and Development).

See http://www.oecd.org/pensions/private-pensions/Pension-Markets-in-Focus-2017.pdf

And endowments, foundations, health systems, charities, etc., account for maybe a tenth of that: $2 to $2.5 trillion. So, that big jump you see in your list is bifurcated. The growth rate for pension assets is probably well over 21 percent. The growth rate in E&F is, I suspect, more modest than that.

Pension investors can't go to their employees for more money to meet unanticipated expenses, and they have no flexibility over distribution. There are no rewards or promotions for meeting pension obligations; just the prospect of embarrassment if they can't. It's understandable why they're looking for ways to outsource the headaches!

Skorina:

OK, we get that the E&F sector is relatively small in the total institutional world and probably hasn't contributed more than $10 or $20 billion to that year-over-year OCIO growth. But they're still very desirable clients to OCIO vendors. And we know you talk to a lot of them. What are they saying about their needs?

Biller:

First, they're worried about returns. The last year has been great, but don't forget that trailing 10-year returns have still been pretty poor for most institutions, with many falling short of their long-run targets. Public market volatility has been high and, having been badly burned in 2009, they're still worried about risk.

Meanwhile, university cost pressures are increasing, foundations struggle to maintain their level of grant-making, and health-delivery systems are being crushed under regulatory and pricing loads.

All this is making it very tough for volunteer board members and trustees. And you could add the rising emphasis on ESG and PRI investing (Environmental/Social/Governance and Principals of Responsive Investing).

There is a widening gap between the hours available from boards and committees on one hand, and the increasing complexity of their responsibilities. I call it the "fiduciary gap." You referred to it as "meeting fatigue" in your last newsletter. It's the same thing. There's just so much you can reasonably ask of volunteer trustees who often have demanding day jobs.

Skorina:

There's no doubt that ESG investing is more than a fad. Just last month, Barnard College in New York switched their OCIO mandate from Investure to Strategic Investment Group because they needed more flexibility and expertise in that area to execute their divestment program. That's a $356 million pickup for SIG.

https://www.bloomberg.com/news/articles/2017-09-13/barnard-replaces-investure-as-manager-of-286-million-endowment

Biller:

When I ask a visitor why they are thinking about OCIO, I'm seldom asked about my asset-allocation views, or which managers I use. Their concerns are more fundamental than that. They want to know: How can I keep my money safe?

Pension plans worry about paying their retirees while staying solvent. Endowments and foundations worry that they may have to cut programs if the markets turn sour.

The people I talk to have a lot of promises to keep in a very uncertain world. They're looking for someone they can trust. All of the technical issues come much later in the conversation.

Endowment costs: A correction for Harvard

In our last newsletter, the endowment management costs we estimated for Harvard weren't quite right.

The main problem was that we started with an incorrect guess about the breakdown between internally-managed vs. externally-managed AUM. We assumed it was close to 50/50 in this period. We now think that it was closer to 20 percent internal vs. 80 percent external. Since they paid more for external management, total costs must have been significantly higher than we originally calculated.

Our official estimate for Harvard is now that their internal costs were about 24 bps and external costs about 120 bps (both figured on total AUM, not just the respective pieces). That works out to a total of 144 bps. In dollars, that's an average of $512.3 million annually in this period.

Interestingly, that means Harvard's management costs were just about average among this group of nine, which suggests that our bottom-up estimate is at least reasonable.

We've also rejiggered our Harvard numbers so that internal bps plus external bps sums across to total bps, making them compatible with other schools. Several puzzled readers noticed this. We were attempting to add weighted averages to accommodate the "hybrid" model. Our intentions were good, but it was a bad idea.

Here's the first chart from our last newsletter, with corrections:

Endowment investment office costs (updated 10/24/17)

Group 1: The Normal Nine

3-year average: FY2013-2015

-	School	AUM $bn	Staff FTE	Internal Cost $	Int Cost %	External Cost $	Ext Cost %	Total Cost $	Total Cost %
-	-	-	-	-	-	-	-	-	-
1	Amherst College	$2.1	6	$2,115,000	0.10	$33,774,333	1.66	$35,889,333	1.76
-	-	-	-	-	-	-	-	-	-
2	Boston University	$1.6	6	$4,102,333	0.26	$15,064,403	0.97	$19,166,737	1.23
-	-	-	-	-	-	-	-	-	-
3	Columbia	$9.0	21	$41,514,333	0.46	$104,401,188	1.17	$145,915,521	1.62
-	-	-	-	-	-	-	-	-	-
4	Grinnell College	$1.7	6	$2,820,000	0.16	$15,444,667	0.90	$18,264,667	1.06
-	-	-	-	-	-	-	-	-	-
5	Harvard	$35.6	200	$85,386,400	0.24	$426,932,000	1.20	$512,318,400	1.44
-	-	-	-	-	-	-	-	-	-
6	New York University	$3.3	9	$4,048,000	0.12	$42,808,667	1.30	$46,856,667	1.43
-	-	-	-	-	-	-	-	-	-
7	Princeton	$20.6	42	$22,000,000	0.11	$270,000,000	1.31	$292,000,000	1.42
-	-	-	-	-	-	-	-	-	-
8	Washington University, St Louis	$6.5	20	$5,583,411	0.09	$80,970,295	1.25	$86,553,706	1.34
-	-	-	-	-	-	-	-	-	-

9	**Wellesley College**	**$1.0**	8	**$4,445,109**	**0.24**	**$23,767,602**	**1.36**	**$28,212,711**	**1.60**
-	-	-	-	-	-	-	-	-	-
-	**Mean**	**$9.1**	**35**	**$19,112,732**	**0.20**	**$112,573,684**	**1.24**	**$131,686,416**	**1.43**
-	**StdDev**	**$11.7**	**63**	**$28,078,424**	**0.12**	**$142,554,762**	**0.22**	**$167,863,683**	**0.21**
-	**Median**	**3.3**	**9**	**$4,445,109**	**0.16**	**$42,808,667**	**1.25**	**$46,856,667**	**1.43**
-	**Count**	**9**	**9**	**9**	**9**	**9**	**9**	**9**	**9**
-	**Max**	**35.6**	**200**	**$85,386,400**	**0.46**	**$426,932,000**	**1.66**	**$512,318,400**	**1.76**
-	**Min**	**1.0**	**6**	**$2,115,000**	**0.09**	**$15,064,403**	**0.90**	**$18,264,667**	**1.06**

The summary numbers at the bottom of the chart include our adjustments for Harvard.

Overall, costs for these nine endowments ranged from 106 to 176 bps and averaged 143 bps.

This squares very well with Commonfund’s 2015 estimate (based on a much larger sample), that total costs should be between 100 and 175 bps.

The archived version of our last newsletter is now available on our website, here: http://www.charlesskorina.com/?p=5211

It can be downloaded as a PDF.

It includes a more complete explanation of the Harvard numbers, and the convoluted calculation we needed to generate a cost estimate for their unique “hybrid” model.

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The Skorina Letter:

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Our insights and commentary come from our clients - board members, CEOs, chief investment officers - and the global investment community within which we work as executive search professionals.

Institutional investors operate at the crossroads of capital, talent, and ideas, shepherding over seventy trillion dollars in global assets. It's a constantly evolving spectacle and The Skorina Letter gives readers a ringside seat.

Prior issues can be found in "archives" on our website, www.charlesskorina.com