

Pensions & Investments®

THE INTERNATIONAL NEWSPAPER OF MONEY MANAGEMENT

crain

Investing

\$586 billion put into outsourcing, P&I survey says

At least 2,700 institutions leave investing to others

By Christine Williamson

Assets managed in investment outsourcing arrangements for institutional investors globally totaled \$586 billion as of March 31, according to *Pensions & Investments'* first survey of firms that assume responsibility for managing all or significant portions of institutional client portfolios.

Globally, more than 2,700 pension funds, endowments, foundations, sovereign wealth funds and health-care organizations have outsourced all or part of their investment management decision-making to the 31 investment outsourcing firms that participated. (Outsourcers were asked to exclude target-date and lifecycle funds and insurance company assets from their reported assets.)

Industry observers and investment outsourcers themselves report a huge surge of interest and investment by institutional investors, particularly since the 2008 financial crisis, as organizations seek solutions to shrinking internal resources for investment management, volatile capital markets and increasing portfolio complexity.

Historical growth comparisons aren't possible, but money manager consultant Casey, Quirk & Associates LLC predicts a 13% compound annualized growth rate for outsourcing in just the U.S. institutional market over the five years ending Dec. 31, 2015.

"These outsourcing companies will become major investment gatekeepers for a large proportion of the defined benefit and defined contribution plan market globally over the next 10 years," said Kevin P. Quirk, partner and principal at Darien,

Conn.-based Casey, Quirk & Associates.

The largest outsourcer on *P&I's* ranking is Russell Investments, which ran \$75.7 billion as of March 31, followed by Cambridge Associates LLC with \$72.1 billion, and SEI Investments Co., with \$54.7 billion.

P&I's survey unveiled wide variations in the degree of investment discretion each manager has, as well as the proportion of a client portfolio each actually manages.

Among the highlights:

- The weighted average for full investment discretion was 42%; for partial discretion, 50%; and for minimal to no discretion, 8%;
- The weighted-average amount of assets for which outsourcers manage 100% of a client portfolio was 63%, while partial portfolio management totaled 37%;
- Most outsourcers offer a customized strategy; the weighted average was 96%; and
- The weighted-average split between outsourcing vehicles was commingled funds, 52%, and separate accounts, 48%.

Wide spectrum

Survey results show just how wide a spectrum investment outsourcing encompasses.

At its simplest, investment outsourcing involves the delegation of 100% of an investor's portfolio to a third party that grants a level of investment discretion for a



CHALLENGING: Joseph Gelly thinks investment discretion is 'a big challenge' for firms.

portfolio-based fee, according to Casey, Quirk.

The definition of outsourcing and the delineation of what's meant by "investment discretion" is "one of the biggest challenges for the industry," said Joseph Gelly, managing director-investment outsourcing solutions, at Russell Investments, Seattle. Mr. Gelly is based in the firm's New York office.

"It really matters whether you're talking about investment discretion over asset allocation or manager selection or both. The definitions are really blurred and a lot of outsourcing buyers are confused. A lot of what we do here is to help investors understand what kind of discretion they are comfortable giving to their outsourcer," Mr. Gelly said.

Russell's outsourcing approach, more than 20 years old, integrates investment consulting, which gives the company the bench strength and capability to offer 94% of its 376 clients a fully customized approach, Mr. Gelly said. Russell's average plan size is \$140 million.

Kimberly Wood, partner and U.S. leader for implemented consulting solutions in Mercer Investment Consulting's Chicago office, acknowledges "the definition of outsourcing is certainly a big challenge, but we decided that we can't be rigid about it and we decided not to try to bucket what we do."

"For us, anything that's more than an advisory role is implemented consulting, outsourcing," Ms. Wood said. She said Mercer's

Largest managers of outsourced assets

Ranked by total institutional outsourced assets, in millions, as of March 31. Excludes target-date and lifecycle funds.

Manager	Inst'l outsourced assets	Inst'l clients
Russell Investments	\$75,728	376
Cambridge Associates	\$72,122	199
SEI Investments	\$54,698	454
Mercer	\$51,010	283
Towers Watson Investment	\$50,000	43
State Street Global Advisors	\$41,066	353
Northern Trust Global Advisors	\$40,700	95
BlackRock	\$39,007	13
Strategic Investment Group	\$27,793	50
Makena Capital	\$15,000	50
Hewitt EnnisKnupp	\$13,374	51
Hirtle Callaghan	\$12,800	111

Manager	Inst'l outsourced assets	Inst'l clients
Cardano Risk Mgmt.	\$11,000	N/A
Rogerscasey	\$10,600	11
Commonfund	\$8,002	91
Morgan Creek Capital Mgmt.	\$8,000	14
Graystone Consulting/MSSB	\$7,994	28
Pyramis Global Advisors	\$6,693	45
Investure*	\$6,500	N/A
Aetos Alternatives Mgmt.	\$5,855	141
Marco Consulting Group	\$5,500	36
TIAA-CREF	\$5,000	N/A
Independent Fiduciary Services	\$3,842	25
HighVista Strategies	\$3,021	71

Manager	Inst'l outsourced assets	Inst'l clients
Partners Capital Investment	\$2,800	39
Hall Capital Partners	\$2,000	19
Fund Evaluation Group	\$1,670	78
Angeles Investment Advisors	\$1,300	22
Wilshire Associates	\$1,247	3
Wurts & Associates	\$1,200	2
NEPC	\$734	4
Total	\$586,643	

*Declined to return questionnaire; assets are as of April 30 and are from the firm's website. Source: Pensions & Investments survey.

283 institutional outsourcing relationships range from customizing a mix of the firm's funds of funds for smaller clients with between about \$100 million and \$300 million to portfolio construction for larger clients that uses an entirely customized mix of separate accounts from individual managers.

Charles Salmans, a Mercer spokesman, declined "for competitive reasons" to provide Mercer's outsourcing client average size.

Like Russell and Mercer, SEI Investments' roots were in consulting, but in the mid-1990s, the firm got out of the business of giving advice and into the business of managing money, said Jonathan Waite, director and chief actuary of the Oaks, Pa.-based firm.

"We couldn't respond to clients appropriately as a consulting firm," he said. "We really needed investment discretion. We built managers of managers, built up an advice unit and over the last five years or so, have increasingly been given more responsibility for managing larger portions of many client portfolios and in a number of cases, have taken over whole portfolios," Mr. Waite said.

The average plan size among SEI's 454 clients is \$122 million.

Strong inflows

Messrs. Gelly and Waite, and Ms. Wood, all report strong institutional investors inflows into their outsourcing programs in

WHERE THEY RANK

Investment consultants like Russell Investments, Cambridge Associates LLC and Mercer Investment Consulting dominate the ranks of investment outsourcers, with 15 firms sharing information about their business. Their total outsourcing assets of \$307 billion account for 52.5% of the total universe.

Dedicated investment outsourcers — led by Strategic Investment Group, Makena Capital Management LLC and Hirtle Callaghan & Co. LLC — were the next most numerous category, with seven firms managing \$70 billion or 11.9% of total outsourced assets.

The five traditional managers of managers and hedge funds of funds that offer outsourcing approaches to institutional clients managed a total of \$82 billion or 13.9% of total assets. SEI Investments Co. was the largest of these outsourcers, followed by Commonfund and Morgan Creek Capital Management LLC.

Traditional money management firms with in-house outsourcing units represented the smallest category with four respondents. But with an aggregate \$127 billion under management, they accounted for 21.7% of the P&I universe. The largest traditional money manager ranked by outsourced assets was State Street Global Advisors, followed by Northern Trust Global Advisors and BlackRock Inc.

— CHRISTINE WILLIAMSON

the past two years. They said 2011 is shaping up to be a banner year.

Russell Investments, for example, reported an increase in outsourcing hires of about 40% for the first six months of the year, compared with the same period in 2010.

Ms. Wood said different kinds of potential clients have been contacting Mercer officials. "We've started to hear from larger investors, from more sophisticated investors that are seeking alternatives and more esoteric strategies. We've also seen a strong push from defined contribution

plans over the same time frame."

Said Deborah D. Boedicker, partner, at outsourcer Strategic Investment Group, Arlington, Va.: "In every year since 2008, on the tailwind of the market crisis, we've seen very strong growth and interest from institutional investors who are reviewing how to best manage their portfolios going forward."

Strategic Investment Group's average plan size is \$564 million. ■