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CIO OUTSOURCING: LEANER TIMES INCREASE DEMAND, AND RAISE NEW QUESTIONS

Experts from Cambridge Associates LLC Available to Discuss Issues Institutional Investors Face as they Delegate Responsibilities to Outsourced Providers

BOSTON (December 1, 2009) -- The number of U.S. institutional investors outsourcing their entire portfolios has doubled in recent years and is expected to continue to grow rapidly, in part because of staffing and budget cuts inside institutions and a continued desire to diversify portfolios by investing across a wide variety of asset classes, according to industry research.

“With pressure to pare budgets, improve returns, and simplify internal operations, a turnkey approach to managing investments and streamlining administration and reporting grows more appealing. With that said, there are many areas that institutional investors should consider when moving in this direction, among them, the long-term nature of these relationships, the ability to create a customized portfolio, the cost of oversight, and the staff and committee resources available to address portfolio strategy and implementation issues,” said Sandra A. Urie, CEO and President of **Cambridge Associates, LLC**, provider of independent investment advice and research to institutional investors and private clients.

Ms. Urie and her colleagues at Cambridge Associates are available to address the increasingly important, and complex, topic of CIO outsourcing. During a conversation, they can elaborate on....

- **The growth of CIO outsourcing.** A study by consulting firm Casey Quirk predicts that the investment outsourcing market will grow to \$510 billion by 2012, representing 13% of institutional assets and 25% of institutional investors. Some institutions choose to outsource as an alternative to developing internal capabilities, and others do so as a temporary expedient while they search for a new CIO or work to deepen their existing staff’s expertise.
- **What CIO outsourcing really means.** The definition and scope of outsourcing is broad. In the big picture, it means that a consulting or investment firm assumes responsibility for asset allocation and implementation, acting in the same capacity as the professional investment staff retained by the largest endowments. But the spectrum of actual services is wide, ranging from fully customized asset allocation and implementation to one-size-fits-all standard portfolios. In fact, some providers of outsourcing services, such as funds-of-funds, only focus on the alternative investments portions of endowment funds.

- **Alternative assets and the outsourcing trend.** Between 1990 and 2005, Cambridge Associates' endowment clients' mean asset allocation to traditional equities and bonds decreased by 4.1% and 19.1% respectively, while the mean allocation to alternative assets increased by 26.2% to constitute over one-third of these clients' total portfolios. This shift added significant asset class and manager complexity to client portfolios. As a result, many endowments are seeing limitations in their oversight approach, especially if it is heavily dependent on infrequent investment committee meetings. One of the solutions, in addition to hiring additional professional investment staff, has been to turn to outsourcing.
- **“Fiduciary fatigue.”** Having successfully managed portfolios through a long period of positive returns, investment committees now face a different set of challenges as they navigate a period of severe stress. For many, maintaining current spending in the face of sharp declines is a huge hurdle, as are new valuation methodologies. Some committees are realizing they just can't meet often enough to position their portfolios in a high-volatility environment and provide sufficient oversight. One might call this overwhelmed and exhausted condition “fiduciary fatigue.” Committees in this position are likely to consider outsourcing some or all of these investment functions. When they get to this point they should ask themselves what the best use of their limited time is, i.e., how much they want to remain involved in making decisions and in what decisions. Many are choosing to focus on asset allocation strategy and are delegating the implementation and manager selection to others.
- **Pitfalls and limitations in outsourcing.** Fiduciaries should take care in understanding the strengths and limitations of the various outsourcing models and understand that one cannot delegate fiduciary responsibility. It is important to recognize the true all-in costs of outsourcing, lock-up provisions and the level of portfolio customization. Some providers just offer a single, one-size-fits-all or model portfolio, while others offer some customization in the asset allocation level, implemented through a series of proprietary funds-of-funds or feeder funds. In some cases, there can be long lock-ups and complex transition issues if the fiduciary decides to terminate the advisor. In addition, it is important to understand the level of key man risk.

In addition, Ms. Urie can discuss:

- **Which institutional investors should move to an outsourcing model.** There is no one right governance model. Endowed institutions experience many different economic, cultural and social circumstances, as well as geographic and hiring constraints, precluding the prescription of any one approach as a prerequisite to success. For some endowments, that might mean no outsourcing at all.
- **Types of outsourcing providers.** There are a range of investment outsourcing providers: manager-of-manager programs; funds-of-funds; former CIOs offering a diversified model portfolio; investment managers overseeing a broad-based or balanced mandate and investment consultants, like Cambridge Associates, that are accustomed to providing independent advice and research and often offer outsourcing services on a customized basis, frequently implementing strategies through customized funds.
- **The institutions most likely to turn to outsourced options.** It's likely that institutional investors with assets between \$100 million and \$1 billion will move to outsourced solutions in the biggest numbers.

- **What endowments should pay for CIO outsourcing.** The cost of oversight varies with the scale and complexity of the portfolio. There are economies of scale in oversight: While 10 or 20 basis points spent on oversight costs for a very large institutional investor might be prudent, that would be woefully inadequate for a smaller entity. Trends toward increased allocations to alternative assets have created a danger that institutions may be spending too little on endowment oversight, rather than too much, since there is a wide dispersion on manager returns, and added resources are required for proper oversight of these investments.
- **The amount of discretion the CIO outsourcing providers should have.** The right amount depends on the preferences and needs of the institution and its trustees. In some cases, it makes sense for the investment committee and staff to take a very hands-on approach, including being involved in all investment decisions. Other institutions and committees will find it best to delegate just about everything -- and just approve the highest-level portfolio policies, such as strategic asset allocation targets. The right amount of discretion is often arrived at after a great deal of discussion and initial work together.
- **Where fiduciary responsibility lies in an outsourced situation.** The board of trustees always retains its fiduciary responsibility, regardless of the outsourcing and governance model employed. While the board may delegate investment-related decisions, it exercises oversight over the decision-makers. In the outsourced CIO model, the service provider also takes on fiduciary responsibility.

About Cambridge Associates

Founded in 1973, **Cambridge Associates LLC** is a provider of independent investment advice and research to 850 institutional investors and private clients worldwide. It delivers a range of services, including investment consulting, outsourcing services, independent research and tools across all asset classes, and performance monitoring. The firm also produces proprietary private equity and venture capital benchmarks which are widely regarded as the industry standard for these asset classes. Cambridge Associates has 950 employees and offices in Arlington, VA; Boston; Dallas; Menlo Park, CA; London; Singapore, and Sydney, Australia. Cambridge Associates is recognized as a thought leader, innovator and advocate for institutional investors. For more information about Cambridge Associates, please visit www.cambridgeassociates.com.

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