

## More Institutions Outsourcing Portfolios

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Institutional investors of all sizes are increasingly likely to outsource management of their portfolios as they search for ways to ride through the difficult market, Casey Quirk says in a new report Monday. The firm says that assets from U.S. investors outsourcing their entire portfolio have more than doubled over the last four years, from \$97 billion to \$195 billion as of year-end 2008. Adding assets from investors engaged in partial outsourcing agreements boosts that number \$5 billion higher.

“It’s everybody. The demographic had largely been weighted in the smaller side of the institutional market,” says Kevin Quirk, partner at the firm, adding that outsourcing institutions in the past typically held less than \$1 billion in assets. “But an interesting trend is that we’re seeing an increase in the number of larger investors who are outsourcing.” Endowments and foundations represent the primary source of growth.

Institutional attention is likely to push the investment outsourcing market to \$510 billion by 2012, Casey Quirk says, representing 13% of assets and a quarter of U.S. investors. As of year-end 2008, the firm estimates that all outsourcing agreements – total and partial – represent at least \$200 billion in assets from 1,250 institutional investors.

The attention is prompting some firms to bulk up their outsourcing businesses with new hires and new products. Those with no outsourcing capabilities previously are expanding to compete for some of the new business. Those firms will become increasingly important intermediaries for asset managers.

Outsourcing is similar to retaining a traditional investment consultant, but gives the outsourcing firm most, if not all, discretion in investment decisions and bases compensation on assets and performance. Traditional consultants usually receive a retainer and project fees. Quirk says that’s an appealing trade-off as the market turmoil continues.

“People on the investment committee feel safer and more confident,” Quirk says of investors who decide to outsource. “The hope is that the investment returns over time will more than take care of the cost exchanges.”

Some need help handling the increased alternative investments or esoteric strategies many investors have jumped into in recent quarters. A growing number of investors, Quirk says, will probably use outsourcing as a way to manage investments amid internal staffing reductions.

“There is no doubt that there are a lot of conversations among fairly sizeable institutional investors about the point they should consider outsourcing instead of having their own staff,” he says. “Increasingly, that conversation comes up. But it comes up as what’s the

best way to professionally manage the assets. It's a component of a larger discussion that includes these increasingly larger investors."

Many are fighting for a piece of that business, Quirk says, with investment consultants and dedicated outsourcing providers as the two main types of firms aggressively expanding capabilities.

"Ironically enough, we're seeing increased business activity in the market as we speak. And we think it's related to the market conditions. These market conditions set up quite nicely those who want to pursue outsourcing," Quirk says. "I think the riskiest thing these firms might do is not to take a chance right now."

Ben Poor, director at Boston-based research consultant Cerulli Associates, has seen increasing demand for outsourcing, too. In a recent study culling data from the second quarter of 2008, the firm found that almost a quarter of investment consultants say they expect full-discretionary relationships, in which manager selection is outsourced, to be the most popular business among defined benefit plan clients five years from now. That compares to 17% when the consultants were asked about their defined contribution business outlook.

Poor says much of the outsourcing will allow internal staff members at institutions to focus on other things than the day-to-day aspects of portfolio management. But he believes at least some of the shift to outsourcing will lead to internal staff members being fired.

"I don't have a lot of observations about the actual reducing headcount, but I think that's going to happen. The once iron-clad Teflon don of the Harvard University endowment, for example, is losing quite a bit of money. There's a recognition that we're all in a world of hurt," he says. "Just as you've seen many large asset dealers cut staff, definitely the same thing is going to be true for some of these institutions."