



### Redefining Governance Structures

**O**ften referred to as “Implemented Consulting,” “CIO Outsourcing,” or “Discretionary Consulting,” there has been a recent trend

toward redefining governance structures for many large asset pools. This restructuring does not represent any true change of control, abdication of fiduciary responsibility, nor introduction of new service providers but merely a more optimal organization of existing resources. The investment management industry is continuously evolving. We view this “outsourcing” trend to be part of that evolution. This is no fad—it is simply, in our opinion, a better solution.

### About The Author

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Eric joined Clearbrook Investment Consulting in March of 2009 and heads Clearbrook’s newly developed Implemented Consulting business. He is responsible for all aspects of the Implemented Consulting platform including research and product development, targeted distribution, and operations. Eric has spent the last twenty-three years developing and managing institutional investment programs. He was most recently a Managing Director at Syndicate Advisers LLC, which he co-founded with AQR Capital Management and First Quadrant LP. Eric also held prior positions as President and Chief Investment Officer at Investment Solutions, Inc., and ASEA Brown Boveri, Inc. respectively. Eric received a BA from Hartwick College and an MBA from University of Connecticut. He is a CFA Charter holder (CFA).

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## The Case For Implemented Consulting

### A Typical Governance Structure

There are five distinct roles played in the management of large pools of assets (whether they be pension funds, endowments, foundations, not-for-profit organizations, or high net worth individuals).

**Asset Owner**—the asset owner might be a corporation, university or individual. They establish the plan or trust with specific objectives in mind (to satisfy a future liability or fund specific projects or spending intentions).

**Investment Committee**—the owner of the assets then typically appoints an Investment Committee typically composed of internal resources that are responsible for the overall management of the plan/trust/assets. These individuals most often are not “investment professionals” per se but are senior executives most familiar with the objectives at hand and are best suited to oversee the effort. While this Committee has many functions, its primary objective is to determine the long-term asset allocation that optimally satisfies the Asset Owners’ future obligations or objectives (in crude terms, how much to put in stocks, bonds and alternatives - the core of an “Investment Policy”).

**Investment Staff**—because the Committee is not comprised of investment professionals they will in turn hire an Investment Staff charged with day-to-day investment management responsibilities. Their job is to implement the

Investment Policy established by the Committee. Most often this Staff does not buy and sell specific stocks/bonds but rather identifies external investment managers to fulfill specific roles (e.g., US equity, large cap, growth manager). So in broad terms, if it is the responsibility of the Investment Committee to determine how much to put in stocks or bonds, it is the responsibility of the Staff to determine which stock/bond managers to hire and how much to allocate to each of them. The Staff is accountable in terms of implementing the Investment Policy established by the Committee.

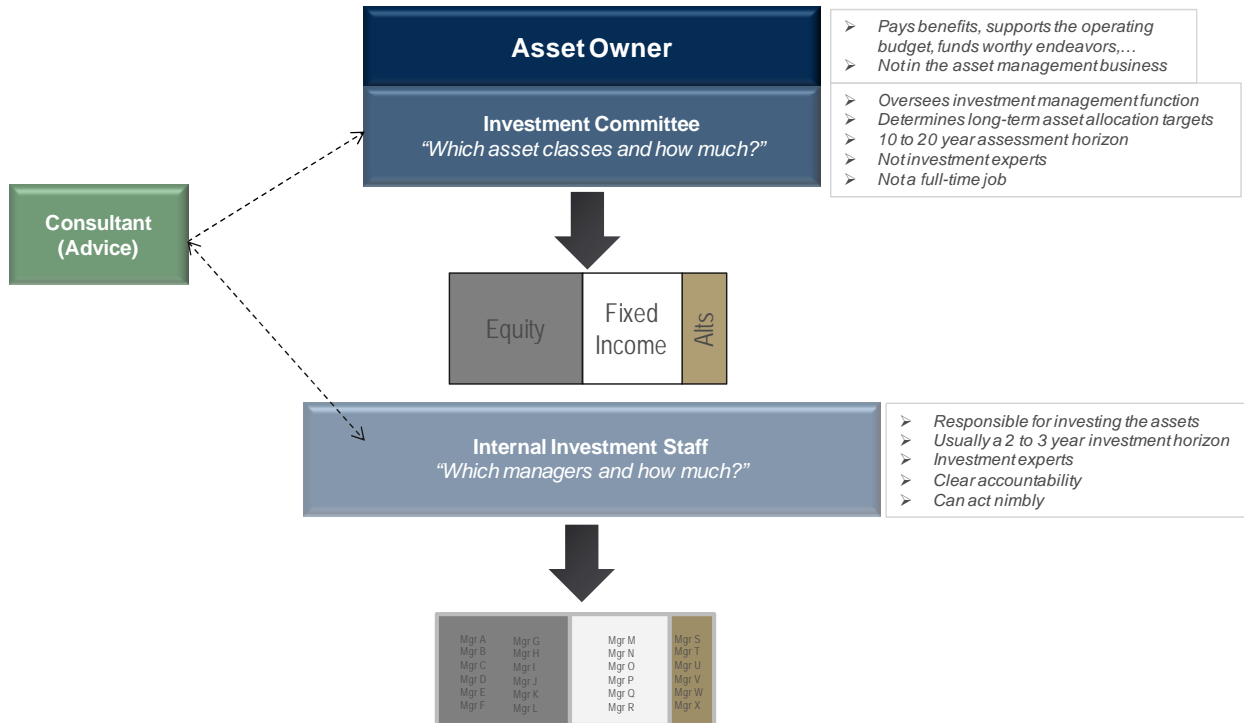
**Investment Managers**—these external Managers are hired and given specific mandates. They are responsible for actually buying/selling stocks and bonds. They may be “active managers” hired with the intent of adding value relative to a benchmark net of fees and costs, or “passive managers” looking to provide benchmark returns at minimal costs, or a combination of the two.

**Consultant**—frequently external Consultants are engaged to assist in the overall effort – helping the Committee determine the Policy targets but also assisting the Staff in its efforts. *[Some Asset Owners do not engage Consultants at all. These tend to be very large organizations with large and experienced internal Investment staffs.]* It is important to note that Consultants have historically acted in a pure advisory capacity—making **recommendations** to the Staff or Committee.

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## A Traditional Investment Governance Model



This structure depicted above effectively puts the consultant outside of the organization. Indeed some lean on their consultant relationship more than others but final decisions are made internally, either by the Committee or Staff.

### The Structural Dilemma

This structure tends to work well. Roles are defined, distinct and there is accountability up and down the organization. However, for many Asset Owners an

internal Investment Staff is, in short, a luxury. All too often Asset Owners cannot afford to hire an Investment Staff or equally likely, cannot attract and retain seasoned professionals in the first place. This creates a void at the Investment Staff level. Typically, the Investment Committee will step in and serve both the Staff role as well as the oversight role in the organization. In these situations, Consultants are relied upon much more and do much of the Staff work, although decisions (both Committee and Staff) are ultimately retained by the Committee. (see illustration on next page)

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### A Flawed Model

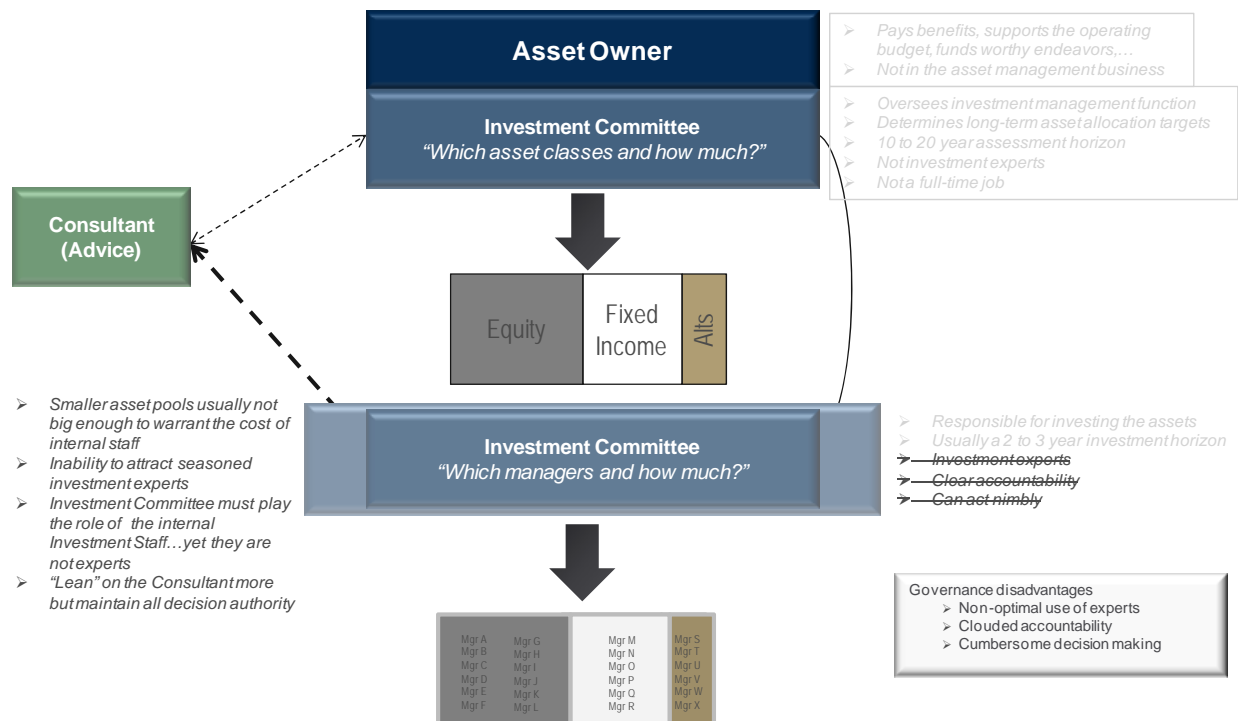
Let's examine why this model is sub-optimal:

- ◆ First, the Committee is not composed of "investment experts." While conversant, they are typically not fluent in the, often nuanced, aspects of the Staff's functions. This is at times difficult for Committee members to readily admit but as it is often said, while it's important to know what you know, it's more important to know what you *don't* know.
- ◆ Second, Committee members have "day jobs." Management of these asset pools is not a part time effort – something that should be "monitored" on just a quarterly basis. Global markets are fast moving and complex and while we don't espouse the day-trading of large asset pools, opportunities arise more often

than on the last day of every third month. Having the ability to be nimble is critical to investment success.

- ◆ Finally, this modified structure often creates confusion in terms of accountability, specifically between the Consultant and Committee now serving as Staff. If something in the portfolio goes "bump in the night," there is a propensity to finger point. The Consultant is relied upon more but if, for example, a manager does very poorly, the question of who's on the hook for the original hire decision can become clouded. The Consultant invariably takes the hit as they are motivated to retain the relationship but this can create uneasy relationships which are to be avoided.

### The Dilemma—Filling The Void



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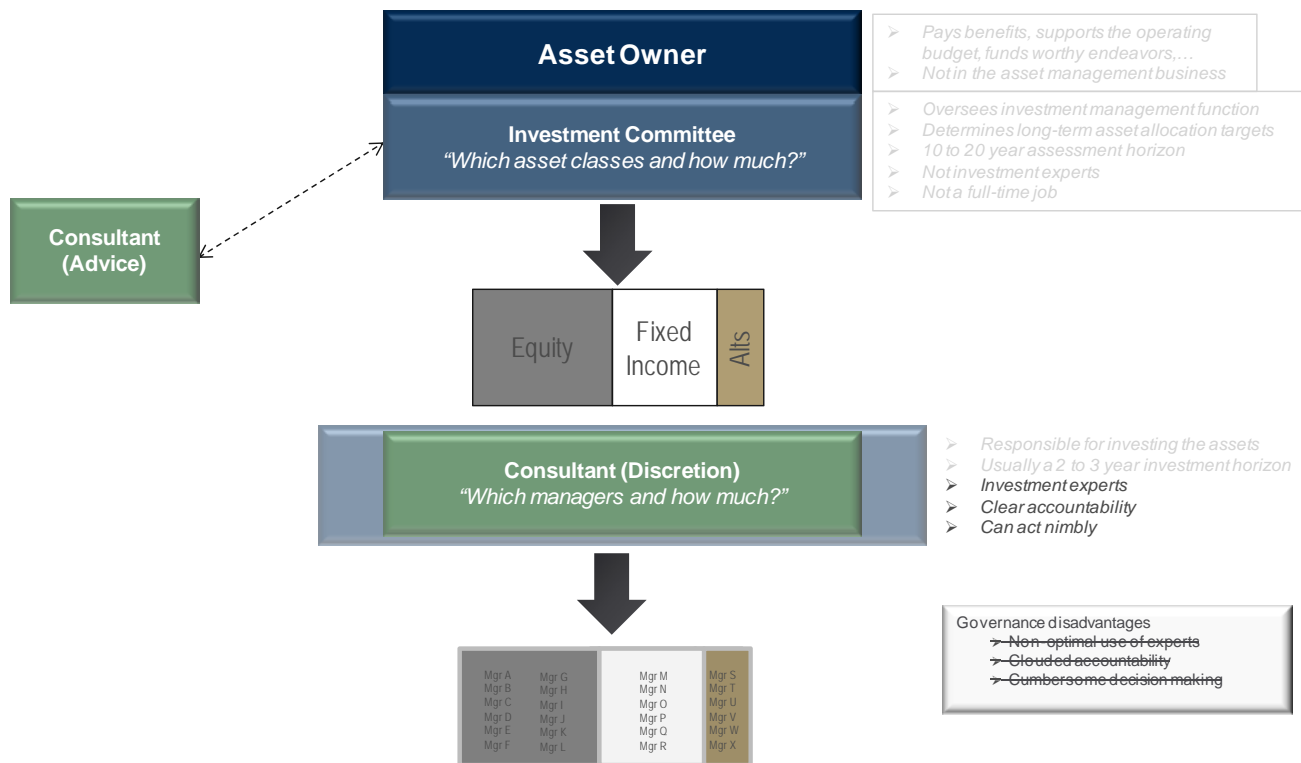
### Redesign

Many Asset Owners, both large and small, have begun to recognize these governance inefficiencies and are embracing the notion of “implemented consulting”. They are increasingly adopting this new paradigm and modifying their organizational structures. As is illustrated below, they have “promoted” their Consultant and formally charged them with the roles and responsibilities of Investment Staff. The Consultant most often still retains its traditional advisory role as it relates to assisting the Committee determine their strategic path and establishing an Investment Policy. These are critical

long-term decisions based upon the Owners’ appetite for risk and financial wherewithal. We believe that a Consultant should help guide the Owner through the process but ultimately should leave those final decisions to the Asset Owner.

By inserting the Consultant into the organization, imbuing them with the responsibilities normally borne by expert internal Staffs, the Asset Owner has eliminated their governance disadvantage. The experts are now appropriately situated, roles are once again well-defined and clear accountability has been restored.

### A Redesigned Model



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### Final Thoughts

To help frame the overall breadth and direction of the Implemented Consulting model, consider a noteworthy survey on investment outsourcing, performed by consulting firm *Casey Quirk* in December, 2008. The survey found that between 2004 and 2008, the US Institutional Outsourcing Market was poised to more than double, with assets nearing the \$200 billion mark, and more than 1,200 institutional investors participating in fully discretionary programs. The survey further estimated future growth to reach \$510 billion by 2012, with more than 2,000 institutional participants.

Today we are seeing these numbers realized, as institutions begin to adopt this model and investment outsourcing goes increasingly mainstream. Over the past year, the \$833 million University of Colorado Foundation, the \$540 million DePauw University Endowment, and the \$4 billion Cleveland Clinic Foundation have adopted the implemented consulting model. The Dayton Children's Hospital sought better returns for their combined \$300 million pension, foundation and operating assets and outsourced the entire program last summer. Gettysburg College also reviewed options for its \$215 million endowment last fall and opted to outsource the \$165 million long-term investment portion of the fund.

As mentioned previously, we strongly believe that the implemented structure represents a superior design and will result in a widely accepted governance “best practice” model going forward. We believe there is a compelling, intuitively pleasing, logic to this structure and feel it is long overdue.

So what are the impediments that could prevent Asset Owners from adopting such a model? At Clearbrook we

feel there are two potential hurdles:

*Loss of Control*—Although more perception than reality, we believe there is a need to educate investors to better understand what this structural redesign entails and to allay any loss of control fears they may have. A forthcoming Part II to this paper will speak to the execution of a governance redesign adoption. Yet regardless of the execution choice, we see the Asset Owner/Investment Committee as continuing to maintain their responsibilities and control over the aggregate effort exactly as they do today. Just as anyone who engages an investment manager to buy and sell stocks or bonds for them but has no input in terms of each stock/bond that is bought or sold, but retains ultimate “control” over the hiring and firing of that manager, the Asset Owner/Investment Committee can terminate their consultant at any point as well—just as they can today.

*Consultant Hesitancy*—Secondly, not every Consultant wishes to assume the responsibilities of a fully implemented investment program. For those that are hesitant we actually feel this is quite telling. Clearbrook is a boutique firm with experienced consultants who are enthusiastic about this structural redesign. We think it makes sense for our business but more importantly, makes sense for our clients. The end result of this governance redesign has to be improved performance—increased returns and better risk control—otherwise this is simply restructuring for the sake of restructuring. We *want* to be held accountable and are confident in our abilities. We embrace the increased scrutiny and cannot help but wonder why others would not feel the same. At Clearbrook we welcome the opportunity to speak with our clients about the potential for a well-rounded, fully discretionary investment program.

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## ***Why Consider Investment Outsourcing?***

- ◆ Superior utilization of existing resources
- ◆ Improved efficiency
- ◆ Improved accountability
- ◆ The potential for improved returns
- ◆ Better risk management

Clearbrook Investment Consulting can work with both large and small institutions, family offices, and high net worth individuals, to better understand your investment organization and to help you structure a sound, fully discretionary program to help you meet your financial objectives.

### **Who We Are**

We are an independent investment advisory firm whose core business is to provide investment and strategic advice, investment solutions, and related wealth advisory services to institutions, individuals and financial intermediaries worldwide. As of June 30, 2010, Clearbrook Investment Consulting, a subsidiary of Clearbrook, had nearly \$30 billion in client assets under advisement.

### **What We Do**

We offer a range of investment services and solutions to institutions, family offices and private clients, and financial intermediaries. We focus on professionalism, innovation and transparency for our clients.

- Investment Consulting and Advisory Services
- Strategic Advisory Services
- Institutional Quality Manager Research
- Implemented Investment Solutions
- Access to a Broad Array of Money Managers
- Turnkey Operational and Administrative Support

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