DiMeo Schneider & Associates, Nonprofit Investment Stewards Podcast
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How Associations Manage Their Investments — With Ahmed Farruk

[00:00:00] Welcome to Nonprofit Investment Stewards with Bob DiMeo and Devon Francis from DiMeo Schneider and Associates. Bob and Devon are passionate about helping nonprofit organizations prosper, whether you oversee endowment foundation or retirement plan investments. This podcast exists to help stewards, improve performance, reduce costs and discover strategies that enable your charitable organization to prosper and advance its mission now onto the show.

Hello and welcome back to the Nonprofit Investment Stewards Podcast. I'm Bob DiMeo as always joined by co-host Devon Francis. Today's topic touches so many organizations and individuals, and in a way that's not readily apparent. In this episode, we're focusing on associations and how they manage their investments. I'm excited because we have one of our very own colleagues who is a true expert in this space.

[00:01:00] And before we dive in, let's turn to our co host Devon, how are you today? And what do you think about today's topic? I'm great. I'm so excited to hear from Ahmed. As you said, a true expert in the association space, today with us, we have Ahmed Farruk, Ahmed oversees the firm's Washington DC investment consulting efforts, and he works with many clients, including a lot of associations.

It is the co-leader of our association's practice and he's also the coauthor of a terrific benchmarking study for associations. We'll hear a lot more about that at the end of the podcast. Ahmed is also an active volunteer. He serves on the investment committee for the United Way worldwide, among other activities.

So it is wonderful to have you here. Ahmed. Welcome. Thank you so much. I've been looking forward to it. It's a pleasure to have you on the show, frankly, a pleasure to have you as a colleague. And before we dig in too deeply, please share a bit about how you ended up specializing in managing money for associations.

[00:02:00] And what is it about working with associations that you find so enjoyable? For the first part. It's not a terribly exciting story, but as you know, Bob, I went to UVA in Charlottesville and around my fourth year of college, I decided I wanted to be a quote unquote, stockbroker. I just enjoyed following the markets.

And I thought it married my studies in both economics and finance pretty well, that was my goal. And my fourth year of school, I did a work study program at the local branch of what was at the time Prudential securities. And the longer I spent in that branch and got to talk to a lot of the stockbrokers there, you know, the less I wanted to do it, you know, this was the mid-nineties.

It was right at the start of the Internet bubble. And I just didn't want to be staying at the office until nine o'clock calling people at home. Trying to get them to invest in the latest IPO.

[00:03:00] I'd found that I didn't want to do that. And I was, you know, starting to frankly, feel a little bit discouraged.

And my branch manager in the Charlottesville office said, Hey, you know, you're from McClain right now. Why don't you call up to the Prudential office in McClain? You know, there's a very small team there, but yeah. They're not kind of stockbrokers in the traditional sense. They do a lot of investment consulting and work with, uh, trade and professional associations.

And so it sounded like a good idea to me. And I went and talked to the folks there and, you know, almost 25 years later I'm still kind of in the association community. You know what I really like about it. And I think what makes it really unique is the nature of the volunteer leadership and the fact that you get to interact with different types of folks in different types of industries.

So in the morning, I might do a board presentation to the Federation of state medical boards.

[00:04:00] And everyone on that board is going to be a doctor. So there's a different dynamic there. And then in the afternoon, if I'm meeting with the school nutrition association, the people there run nutrition programs for public school districts, so a completely different skill set and a completely different experience.

It really does give you exposure to a number of different industries. That's great. Thanks so much. And you know, so much of finding the right career path, I think is, as you said, identifying what you don't want to do. And then ultimately it's the process of elimination that leads you to what you do want to do.

So we're glad you pivoted so much. Can you speak broadly about the types of associations that exist? I know you gave a couple examples, but if you could just expand upon that and then why they exist and how they generate revenue. If you think about the association space, there are kind of the mission-related associations I would call.

[00:05:00] So those would include groups like the American Heart Association or the American Lung Association. And they're focused on a very particular mission. Then you have trade associations, which are focused on promoting and the interests of a particular trade. So their members tend to be companies. So, the National Retail Federation for example, their members might be companies like Target and Walmart.

And then you've got your professional associations where the members themselves are individuals. So, like the AI CPA or the CFA Institute, there's a lot of medical groups like the American Society of Anesthesiologists and they're designed to help make sure that the members of that particular organization do well in their careers advance in their careers.

Some of them do certification, continuing education conferences to really keep those people sharp, but also advocate for [00:06:00] their interests and for the interests of their profession. And how do they generate revenue on it? There's a variety of different ways, but it really boils down to, I would say kind of four areas.

One is membership dues. That's a big one. Second is certifications. Many of these groups also offer certification programs such as the CFA Institute sponsors the CFA certification. Third is sponsorship and advertising. So, if you read the magazine for the American, the AAA American Automobile Association, you're going to see all sorts of advertisements in there and that's a source of revenue.

And then finally, I probably shouldn't have listed it last, but in annual meetings. So, if you're a member of a, and I think all three of us are the investments and wealth Institute, they have an annual conference where you can go and get education. There are registration fees associated with that, but also sponsorship opportunities.

So [00:07:00] you walk the exhibit hall to learn about new products and managers that could help your clients. All of those folks have paid for the opportunity to be there and connect with you. So, there's of course others, but I would say those four are the big ones. And Ahmed, if you head down that continuum of generating revenue slash earnings, talk a little bit about why associations would have investment portfolios.
Associations will typically build an investment portfolio. Number one is kind of rainy-day funds, and I'll give you some examples of how we've helped our clients. Access and leverage their investment portfolios, but one is his rainy-day funds. The other is to really more be strategic about a future opportunity is, and historically a rule of thumb has been that an association tries to keep at least 50% of their operating budget in reserve.

[00:08:00] So if their operating budget is 10 million, they're going to target 5 million in reserves. That rule of thumb has gone a little bit by the wayside. The benchmarking study, you referenced, you know, we ask about this question and you'll see that the larger the association, the more they'll keep in reserves associations with budgets of 20, 30 million, they may keep a hundred, 150% of their annual budget in reserves.

And I think the past few years has been a great example of why associations build and maintain reserves. Obviously we've worked with a lot of groups too, as they've struggled with the downturn during COVID to draw into their reserves to supplement operations. We have a client that we worked with that was making a strategic acquisition. So they were acquiring another association and they did so by using a combination of both debt, as well as their investment reserves.

[00:09:00] And so we help them model out exactly how much it made sense to take from debt versus for instance, their reserves. We had another Association that recently moved buildings and they wanted to upgrade their infrastructure. They used their reserves to fund a portion of that. It really adds to the flexibility of what you can do from a strategic perspective, but also acts as a rainy-day fund for, for years, like 2020. So a variety of associations and purposes and investment objectives.

I'm certain what might their portfolios look like? Risk assets versus non-risk assets, that sort of thing. This is a conversation that we really try to walk associations through in a very thoughtful and careful manner because they truly need to understand how much they can set aside for long-term.

[00:10:00] And once we have a conversation of how much they really need their three levers, if you will, their inflows outflows and required rate of return, oftentimes we settle on multiple portfolios.

So in association may have a short-term reserve for an intermediate term fund, which doesn't take a lot of risk. But it's designed to be the first line of defense, if you will, if they need to dip into reserves to supplement operations and they can do that without wondering, or worrying what's happening in the markets and not going to take a loss in order to do that.

So, having an intermediate term reserve is a, is a nice safety blanket, if you will. But then the long-term reserve is typically positioned for long-term growth. It's not perpetual money, so it's not tied up in a lot of illiquid assets, but typically a 60, 40 type allocation. Then again, asset allocation is one of the things we ask about and break down in, in the benchmarking study too.

[00:11:00] That's helpful. Thanks Ahmed. And you mentioned the three levers, which obviously we've talked about as really the cornerstone of our work with endowment and foundation asset pools. So it sounds like that's a similar approach. We know that that's a similarity. What are some of the key differentiators between associations and other nonprofit investors such as, you know, traditional endowment or foundation.
I think it really boils down to two. One is the perpetual nature of the assets. A university endowment is designed to be perpetual and permanent that has implications on not only how you invest the portfolio, but what types of investments go in there? Vis-a-vis things like illiquid assets. So you have a permanent time horizon. Associations don't have that luxury. They want to invest for the long-term, but they understand that they need the ability to dip into these assets whenever they must in as much they have to do.

[00:12:00] So that creates a different dynamic in terms of how much you can invest in certain areas. The second difference is something that I've kind of observed over the years, which is what I would call kind of the difference between the donor and the member. Maybe Bob I'll use you as an example of this differentiator. So Bob, you went to Bradley and Bradley has a university endowment, and perhaps you've donated to that endowment and you want that endowment to grow.

You want it to serve as many students as it possibly can, and allow as many people to enjoy the Bradley experience tomorrow, if that endowment doubled in size, you would. Probably be very happy. And in many circles, particularly in the university area, endowment size is almost kind of a bit of a bragging right?

[00:13:00] Like my endowments bigger than yours, like in the same way you might trumpet your college football team. So the donors want those assets to grow, but if you take your donor hat off Bob and consider yourself as a member of an association, like the investments and wealth Institute, if their reserves doubled or tripled in size tomorrow, you might look at that differently.

You might say, okay, well, wait a second. I'm a dues paying member of this organization. Rather than sit on all that money. Why don't you maybe reduce my dues or reduce conference registration fees or get an enhanced quality of speakers at the conference, or maybe create a new service for your members. And, and you're going to look at those assets differently.

An association that's building an investment portfolio needs to consider that dynamic versus kind of a more charitable endowment or foundation that doesn't necessarily have that same dynamic going on. That's wonderful insight. And it really compels the investment committee, finance team, whatever it may be along with the investment consultant and other advisors to, to really strike what sounds like an important balance between.

[00:14:00] The size of the endowment and sort of the ongoing value add to the organization and to its members. So, so thank you for that. We probably won't leave general investing and reserve funds and so on completely, but I think it would be helpful because we've probably got executive directors and other leaders at associations who not only oversee general investments, but retirement plans.

So what's the current landscape. With respect to retirement plans within association space. And then are there any key challenges there? It has only been about 25 years where nonprofits could actually have a 401(k). And so a lot of associations still have a 403(b) I think. The challenge that many associations have is that most associations are actually small.

So if you look at ESA, he did a study in 2019. There's about 63,000 associations that they tracked through 990 data.

[00:15:00] And about 5% of them had revenues of between 10 and 20 million, 5% of them had below 10 million. So most of them have revenues below 10 million. So as a result, they have smaller staff. They have challenges in obtaining the best pricing. Our suggestion as they kind of exercise their roles as fiduciaries for the plan that they're offering their participants is to try and find ways to minimize fees. And in many cases really consider like a 3(38) structure because they do not have the internal capabilities that much larger groups have. They can put some of the fiduciary responsibility on selecting and monitoring managers on another party. But I would say size is kind of the biggest issue that most associations have in the retirement plan space. That's helpful.

[00:16:00] And just in case listeners aren't aware of the internal terminology in the industry, 3-38 is a discretionary advisor. It is referring to an organization that would work with an investment advisory firm who takes ownership over decisions such as deciding on the fund menu and that sort of thing. So that's, that's important insight and it's the statistics that you detailed are really quite interesting that the majority of these associations have revenue below 10 million have very small staff. And of course it is difficult for smaller organizations to get some of these benefits of scale that we see in larger institutions. So that's helpful. Thanks.

[00:17:00] Would it be fair overall to say that many associations are focused on social responsibility and inclusion. And I suppose this would apply more to the mission related associations. And if so, how have those values translated to their investments? Do you see greater use of ESG investing in your mission-driven association clients?

So it's an interesting question. It's actually one of the things that we survey in the ASA benchmarking study, if you're in the association community, it's very apparent that diversity and inclusion is really important. Many of the top leaders in the association space are women. You see a lot of people of color and LGBTQ, and certainly there are strides to be made.

But I would say that if you looked at the association community, as compared to the for-profit community or the corporate world, there's been much more progress in things like that.

[00:18:00] So you would think that because they're so values-based that you would see a very heavy usage of things like socially responsible investment strategies or ESG.

But you don't really. So if you look at the benchmarking data, only about 10% of the folks that are surveyed are implementing any sort of a strategy like that. We're seeing growing interest. So the number of folks that are interested is probably another 20% and that's up from a few years ago, but the vast majority report that not only are they not using ESG strategies, but they have no interest in using the ESG strategies.

It does seem like a bit of a, of a inconsistency there. And in working with associations, I kind of have. Uh, and talking to them through this conversation, I have my own theory as to, as to why that's the case. And I think it's because, if you think about a mission-related organization that is fairly straightforward.

[00:19:00] So if the American Lung Association says we're not going to invest in tobacco stocks, no one is going to ask why that makes complete sense given their mission. But if you work for a professional association and you think about whose money it is, it's their members. And most associations, like I said are small, so they don't have the resources to implement a customized investment strategy.

So their option is typically kind of off the shelf, socially responsible mutual funds. In those instances, they end up fighting battles that probably aren't important to them, but they also have to think about their membership, right. Their members. Run the gamut of kind of their political preferences or their views on things like fossil fuels.

And there is no cohesive mission, right? The profession is the mission that does make it a challenge when you're.

[00:20:00] Taking money that is the result of member dues and investing it, but then making choices that might be in conflict with 50% of the people that put that money in there. That's an important thing to note is that you end up with these off the shelf investments, sometimes fighting battles that you're not really interested in.

And one of the things that we've talked about when we had our ESG mini-series is there is no one size fits all solution to ESG investing, what is responsible and right to one organization is very different from what's responsible and right to another organization. And then of course, when you get into the, the concept of membership organizations, you've got a wide variety of members and it just becomes that much more complex, even though it's just a theory.

I, I think you're probably onto something. I think you're right. Ahmed. Do you have a whet [00:21:00] our appetite with the benchmarking survey, we'll jump to that in just one moment, but we all know that everyone is dealing with the pandemic and it's, it's many, many challenges that just were completely unforeseen.

How has that primarily impacted the association space and what are some of the greatest challenges that associations are contending with? Given the pandemic. Yeah, it's been difficult. I think the biggest one is event cancellations. So a big part of the association's revenues are our annual meetings. If you can't have in some associations, that is the single largest source of their revenue, they have a big annual meeting.

And if you can't hold that, that becomes a big problem. Particularly if you didn't have event cancellation insurance, cancellations has been huge that has translated over to declining sponsorship revenues. Even though some of these associations have pivoted to more of a virtual environment, it is harder to reach out to a sponsor for sponsorship dollars.

[00:22:00] For a virtual event because those folks want personal connections with the members and the attendees of that event, a sponsorship has been the challenge and then personnel as well, when the paycheck protection program came out, it was. For nonprofits, it was 501 C3, but not 501 C6 and many associations are 501 C6 is they didn't get that. And so you've had to see, we've seen in many groups, consolidation in staff and so more and more folks are having to do more things with less resources. And I know the association industry has been lobbying very heavily. Two in the next round of stimulus, get the C6 is the same sorts of protections or benefits that C3 skip.

[00:23:00] But there have been a lot of challenges for membership groups and probably makes the reliance on investment portfolios and such all the more important again, we've talked about this benchmarking survey and you coauthor a wonderful regular benchmarking survey for the association sector. Tell us about that and its purpose.

The benchmarking study came out about six years ago. And it was one of those necessities, the mother of invention type deals, where we had a lot of associations that would ask us, Hey, how do we compare to other groups of our size? And a lot of the benchmarking data that's out there, whether it's NACUBO or whether it's, um, exponent or council on foundations.

It's geared towards other nonprofits, more charitable foundation endowment types, and the average size of those groups far eclipses what the average size of an association is. So there wasn't a lot of relevance in that data. And so the next step is, well, we can tell you what some of our other association clients are doing, but that's not an entirely unbiased universe either.

[00:24:00] Cause they're doing and following the same advice that we're giving you. We came to Osos to ASAE and said, look, there's a gap here that you are ideally positioned to fill, given who you serve. And so that's where the study was born and they had the infrastructure in place to get folks to participate and produce a nice report.

And we could lend the investment expertise on interpretation of data and what questions to ask regularly in what. Maybe you don't need to ask regularly. It's been going on for, I think this was its sixth year. It's a relatively popular study and I think it's the largest association specific investment benchmarking study that's out there.

That's really impressive. Can you give us a sense for what some of the data points are? The questions that are asked in the study, and then also if you could share some of the key findings in the most recent study.

[00:25:00] We tend to segregate questions in three areas. One is governance. So how are associations structuring their governance?

Their governance structure. Second is performance. We collect performance on a calendar year basis and segregate it by assets. And then the third is investment strategy. So, asset allocation, whether you're using index funds versus active managers, whether you're using socially responsible investment strategies, the questions are segregated primarily into those.

Larger three areas this year, we added a special supplement on COVID. So, what have associations done with their reserves in response to the COVID economic downturn, which I think will be really interesting, you know, when, when the study ultimately comes out and there's just a lot of interesting information in there, uh, that you can tease out just to summarize.

[00:26:00] As I noted, we do segregate by asset size. So if you look, there are discernible trends that correlate to asset size. So larger associations are more likely to draw on investment reserves. They're more likely to have a more growth oriented. Investment portfolio, the tend to have higher investment returns over the long run.

They tend to be more aware of the investment expenses that they're paying that that they're paying. And they tend to have from a governance perspective, more likely to have a dedicated investment committee or an investment subcommittee. Whereas smaller groups might just delegate it to the finance committee or staff.

[00:27:00] One of the things that we, what I have seen, which isn't surprising, but it's interesting to see in, in print is that when you ask associations, whether they are feeling that their investments are meeting their investment objectives and you segregate that data. Between folks that have an investment policy statement and don't have an investment policy statement.

The difference is pretty remarkable. So about 80% of associations that say that their investment reserves are meeting objectives, have an investment policy statement. If they're not only 40% of those groups are our belief that their investment reserves are meeting their investment objectives.

There's just a lot in there that I think, not only related to COVID, but longer-term trends are interesting reading for associations. A wealth of knowledge, that could be so insightful to association leaders. And, and frankly, you've been so insightful here today Ahmed, we're so grateful and I know our listeners will enjoy it before we let you go.

It would be great to learn a little bit more about Ahmed, the person, and frankly, as we are dealing with the pandemic in these most unusual times, can you identify a pandemic silver lining or two that you've experienced? Absolutely.

[00:28:00] I think for me, it is, you know, more time with my family. I have a daughter who will be nine in February and more time with my wife as well.

And, it's interesting. The other day, my daughter is doing distance learning. She has a lunch break around noon. And so sometimes I'll go down and at the counter in our kitchen, you know, she and I will sit together and have lunch and I could have never done that more time with family, is a definite silver lining.
That's great. I, I feel the same way. The ability to catch up during the day is such a blessing. And I think we're really fortunate from that perspective again, and we are fortunate to have you as a colleague, as Bob said, you really are a wealth of knowledge. And I think that your specialized expertise in the field of associations in particular is just so vital to our firm and to the work that we do on behalf of our clients.

Thank you so much. We really appreciate you joining us.

[00:29:00] Today, if folks want to learn more about the work that we do on behalf of associations, or if they'd like to get in touch with you, where might they go for that information? Well, certainly they can visit DiMeoschneider.com and the associations tab on our website. There's a lot of knowledge there. They can certainly email me at afarruk@dimeoschneider.com or find me on LinkedIn. I'm pretty active there as well.

Ahmed, thank you so very much. We greatly appreciate it. Now for listeners, the show is still relatively new and our audience has grown nicely, a special thanks to our listeners.

If you have topics or guests you'd like to recommend, please reach out to me or Devon on LinkedIn. So to all you good stewards. Thanks for investing time to help your nonprofits prosper. We'll connect with you soon on the next episode. Thank you for listening to the Nonprofit Investment Stewards Podcast.

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