

Fiducient Advisors, Nonprofit Investment Stewards Podcast

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The Benefits and Pitfalls of OCIO Endowment Management — With Matt Porter

[00:00:00] Welcome to Non-profit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. 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.

[00:00:26] Now onto the show. Hello, and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo. Always good to be joined by co-host Devon Francis. Today, we tackle the use of OCIO or Outsource Chief Investment Officer for endowments and other nonprofit funds. We're excited to have one of mine and Devon's talented Fiducient partners as our guest.

[00:00:51] And we're about to gain a better understanding of the OCIO landscape. And why so many nonprofits are adopting this approach to investment management. [00:01:00] I know our guests will also touch on some of the challenges and even some of the potential pitfalls, but before all of that, Devon, so good to be with you. How is your day going?

[00:01:09] So far so good, Bob, the sun is shining and, uh, happy to be here with Matt Porter. Matt leads our endowment foundation practice at Fiducient. And I actually work very closely with him on our ENF business council. Matt has been with the firm for more than 20 years. And in addition to leading our ENF practice, he also chairs the investment committee and he serves on our executive committee.

[00:01:33] So, he is a very busy man. He's not only a loyal and important member of the firm, but he's also a dedicated family man who spends a lot of time with his two kids. And he's just an all-around great guy. So, Matt, thank you for being here and welcome to the show. Thank you, Devon. Thank you, Bob. Appreciate it. Glad to be here.

[00:01:50] Matt, we're just thrilled to have you on the show and before we really get into your expertise, maybe you can share just a little bit about how you landed in the space of focusing in the nonprofit [00:02:00] world and even more so OCIO endowment management. Sure, thanks, Bob. As I think about my time at the firm, I've worked on almost every kind of plan that we have, be it a pension plan, a 401(k) plan, endowments and foundations.

[00:02:14] But I found myself, as time went by, really identifying with the mission of a lot of our nonprofit clients, endowments and foundations, and what they were trying to do. And as you step back and think about the good work they do and how we can help in that work be it investment performance or helping them fulfill their missions.

[00:02:33] It really resonated with me. And I think where it finally took the turn where I said, this is where I want to spend my career was that a client, and I got pulled aside by the chief financial officer after a meeting. And he said, Matt, we're really struggling with the decision making here. We don't have investment experts on the committee.

[00:02:53] Do you think you guys could do this for us? And it, the bell ring in my head that said, wow, this is a really great business that we can in a [00:03:00] new way help clients better their mission and

be better at what they do. And so, it really made me think about OCIO in addition to the nonprofit space being where I wanted to the focus my career. You received a sign. Indeed.

[00:03:17] So Matt, for some of our listeners that may not be very familiar with this OCIO term, can you describe some of the terms and the differences between what's known as the traditional investment consulting model and then the discretionary or OCIO type approach? Sure, Devon. So, when we think about traditional investment consulting, it's what most people think about in our space.

[00:03:38] And it's where a firm comes in as a trusted advisor, gives advice, gives counsel, but all the decision-making authority and most of the work still falls on the client. So, we would come in, talk to them, they say yes, and then they take the rest of the work from there. In the OCIO space, a couple of terms you may hear that are a little different.

[00:03:59] It could be [00:04:00] called discretionary. It could be called delegated services. There's a number of terms that go with this. But the main difference here is that the decision-making authority is turned over to a third party. So, if an OCIO is engaged to work with a client, they then have the ability and the authority to pick investments, to process transactions, to do a lot of the work that was typically done by a client in the old traditional investment consulting model, which still is a huge part of our industry.

[00:04:28] But OCIO just transfers that authority legally through a contract or otherwise to that third party to allow them to do that work on behalf of the client. And Matt, talking about clients, can you share a bit about the types of clients that you work with and even more broadly that the firm works with in an OCIO capacity?

[00:04:48] Sure. So, the work can be done by a lot of different kinds of clients, but where we do a lot of our work can be with a university or a college endowment fund. It could be a charitable or [00:05:00] a private foundation healthcare system that might have operating reserves or board designated assets, or some large pool of funds, a civic or a cultural institution.

[00:05:11] Think about museums or symphonies or zoos. Senior living communities or continuing care communities, associations. We also do, it's a little different than the work that I do in the endowment foundation space, but we do a lot of work in this space with defined benefit plans and defined contribution plans in an OCO capacity as well.

[00:05:33] So what are some of the advantages of an OCIO relationship? So, there are a lot, I'm glad you asked that question. When we think about the non-profit space, and that really encompasses endowments and foundations and a number of other organizations. As we've worked with these types of organizations in the past, we see their staff and their leadership really have a couple of mandates they're trying to work with.

[00:05:58] One is they're [00:06:00] advancing the mission the best they can, but they also have to keep an eye on cost and keep them as low as possible. The boards are filled with incredibly passionate, talented, dedicated individuals that might not come from an investment background. So, an advantage can come in a couple of different ways.

[00:06:17] One is that you're allowing the experts to build a portfolio for you. Firms that are in the OCIO space, this is what they do all day every day, is build a portfolio, pick managers and put their

best ideas to work. But when you think about staff as well, the advantage can be the OCIO can pick up a lot of that extra administrative and operational work that will then free them up.

[00:06:40] Either the staff or the committee to focus on really what their job description probably says, which is, hey, let's advance the mission of the organization. And it gives them more time to focus on the strategy, the governance, the oversight of whatever of those client types I listed a moment ago, uh, that they work for, and really frees [00:07:00] them up.

[00:07:00] It takes that responsibility off their plate, and then they can get into a relationship where they're learning and growing with the investment portfolio, but don't have to spend the time they need to today, if they don't use an OCIO in doing that work. And one of the other things that actually springs to mind.

[00:07:18] And, you know, I think about my clients that I work with in this capacity, is the committee turnover. So oftentimes, we are the most longstanding member quote, unquote of a committee for, for our clients. So, I'm thinking of a university client that we have where we have served as the consultant through three presidents.

[00:07:44] Five or six iterations of the underlying investment committee. So, a lot of times when you have committee turnover, that leads to decision-making that is kind of short-term in nature. And so, if you employ an [00:08:00] OCIO approach, you avoid making those short-term decisions. So, I think that's another advantage that you know, that that could be pointed to. Absolutely.

[00:08:10] And following up on that, Matt, what are some of the specific duties that are actually offloaded by clients who use OCIO services? So, good question and an important question. When we leave aside the portfolio management constructions, I think about duties and tasks that are offloaded. They can be many, and it can really be customized by what the staff or the organization wants to do.

[00:08:32] But some of the typical responsibilities that can be offloaded are trading, cashflow processing, think about sending wires in and receiving wires, portfolio rebalancing. Markets do really well, we have to rebalance the portfolio. You don't have to ask that question. It just gets done by the OCIO. And a big one is private equity and hedge fund documentation.

[00:08:56] So anybody who's had to fill out a subscription document for a [00:09:00] hedge fund or a limited partner agreement for a private equity fund was really going to appreciate that that's offloaded. Can be the assumption of signing authority, investment management agreements can be signed by the OCIO, contracts can be negotiated and signed by the OCIO.

[00:09:17] Audit support. So, when that auditor comes knocking on the door, the OCIO can do most of that work on their behalf, paying invoices, things like that. Most administrative and operational functions can be offloaded with the proper planning and really good communication between the client and the OCIO. That's great. So, it really alleviates the vast majority of the administrative burden from the staff.

[00:09:41] And as you've mentioned earlier, frees them up to do what's more important to the institution. So that's great. So, let's talk a bit about portfolio construction. How does the Fiducient team approach building a portfolio for an OCIO client? Devon, I'm really glad you asked that question.

[00:09:57] In all my years of doing work, and it's [00:10:00] been with a lot of different kinds of clients, different size clients, I've never come across to clients that are exactly the same. So, we thought about and contemplated, as we built the OCIO business, do we have a off-the-shelf solution for clients or do we do something more custom? And really what we came down to from a decision standpoint is that custom is absolutely the way that we have to do this.

[00:10:24] Because every client has a unique need and we can build a portfolio that's tailored for their specific return targets, their risk targets. They may have liquidity needs that are important to them. They may have a litany of requirements or needs if they have to meet. These can include things like environmental, social, governance or ESG requirements.

[00:10:47] They may have some portion of the portfolio pledged to a rating agency and those have to be treated differently. They may have DEI, or diversity, equity and inclusion objectives. They want to have really incorporated into [00:11:00] how they build their portfolio. Those are just a few of the things that are considered here, but we thought that custom for each client is the right way to make their goals front and center and be able to accomplish those in, in the best way.

[00:11:16] Matt, when we talk about the investment committees and such, we're working with a university hospital, various endowments, charitable organizations, many of them are comprised of really sophisticated, smart, talented individuals with a lot of investment experience and knowledge. And I think there might be a misunderstanding out there about, oh, if we go OCIO, you know, we're completely resigning or don't even have a need necessarily.

[00:11:43] Can you talk a little bit about how committees and clients stay engaged in things like setting target returns, defining risk, overall asset allocation and things like that? Sure. This is not in a relationship like this. It's not a set [00:12:00] and forget it, don't pay attention to the portfolio anymore.

[00:12:03] Committees are vitally important to the process of establishing goals, understanding what target returns are, what are the purposes of these portfolios? And so, when we begin work with a client, there's a very robust discovery process that we go through before we do any work at all. And we start with questions like this.

[00:12:22] What's the purpose of the portfolio or portfolios? You have a number of clients who will work with a number of different asset pools within the organization. Each one might have a unique need. What's the time horizon? Are there any short or intermediate term considerations that we should be aware of? Some client might hire us and they might say, or it could be an existing claim.

[00:12:42] They might say, we have a capital project that we're going to do in 12 months. The markets have been rocky. We need to really be mindful that those dollars are there when we need them. So, it's something that we need to be aware of to account for as we build portfolios. What's the spending policy? Is it appropriate?

[00:12:59] Is it [00:13:00] realistic? Should we help think through what that looks like? Are there any portions of a portfolio that are pledged to restricted in some way? And so, we've got to make sure that we understand all those dynamics and they can be fluid. And we think back to last year when the pandemic hit, having that conversation about goals and objectives and risk and risk tolerance.

[00:13:26] We might have it at the front end. And when you talk about risk tolerance, when the markets are strong and trending up, that's an easy conversation, but risk tolerance when the markets get rocky

or they're trending down, can lead to a very different result. And so, when the pandemic happened last year, the rapidity of the way the markets moved down was pretty startling.

[00:13:46] And I've been doing this for a long time. And remember when this happened during the great financial crisis and when the internet bubble from 20 years ago was, was part of the conversation. Clients can have a very different reaction in a committee meeting, [00:14:00] even in an OCIO setting, and say, wait a second, we need to really rethink. What we want to do here in our job or in any OCIO job is going to be, to have that conversation about risk and about long-term goals.

[00:14:12] And if we change through panic decision-making or a difference of opinion around a table about what to do in different market conditions. Uh, it really has an impact on the long-term ability of that asset pool to successfully reach the goals that the committee is trying to reach. So that's a conversation when we take these responsibilities over, we engage the committee all the time about what's happening, what's changed.

[00:14:40] Is there something else we need to know? And if not, the portfolio can continue to move forward as it has, and we don't need to change the objectives, but if something has changed, and it can be small, it might lead you a different approach, but communication, education and a real understanding of what are we doing?

[00:15:00] [00:15:00] What does it mean? And how should we proceed? It has got to be an important part of that relationship of an OCIO back to an investment committee, and having those sharp investment minds or minds that really understand the mission of the organization are really important to that input process so that we can build and create the best portfolio and relationship possible for that client.

[00:15:27] What stories or examples can you share regarding an OCIO structure working particularly well? Well, there's a lot of them. And this is my favorite part of the OCIO space is watching what the work does allow for our clients to be able to do. But I do have a client, there's a couple of them, but I have a client.

[00:15:45] That's a, it's a sizeable Midwest university and they'd never worked with an OCIO in the past. And they came to us and hired us as an OCIO. And immediately, there were a number of things we thought we could do and work with them and collaborate [00:16:00] with them on. But there were divestment projects. There were really different ways to structure portfolios.

[00:16:07] The addition of private equity, and changing the way they think about liquidity and what a portfolio looks like in collaboration with them over some time. And it didn't happen overnight, but it took a number of years. And then also watching the work the staff was doing internally before we got there.

[00:16:25] Removing that work from them and then allowing the conversation to be much more productive about how the portfolio should function, how we can structure a custodial relationship to make it more efficient for the client, for our interaction as their OCIO with them. And then fast forward that a number of years to see the success that's been shown in the investment results.

[00:16:48] The satisfaction I think the internal staff has with the way the relationship works and the time they now have to focus on duties inside the university, inside the college to [00:17:00] focus on treasury functions, finance functions, and other things that they, they didn't have as much time to do.

[00:17:06] And it allowed their staff, really, breathing room to move forward. So, it's really been a success, uh, with a lot of work on both sides, but it's been certainly a success that we're really proud of as an organization. Boy, that's fun, Matt, and you and Devon and I know just how professionally satisfying it can be to be in that sort of relationship.

[00:17:25] So thanks for sharing that. Maybe you can also share, because you mentioned earlier, it's not a one size fits all and traditional remains a large part of our investment consulting and advisory practice. So, when is an instance or a circumstance where perhaps it does not make sense for a nonprofit to use the OCIO model?

[00:17:48] Really good question, Bob. There's a couple of things that come to my mind and the, probably the easy one is if a group, a foundation, an endowment in some of the organizations is large enough that they have a pretty [00:18:00] robust internal staff, or if the committee is full of investment professionals that want to keep that authority.

[00:18:07] That, that just doesn't make sense. I think about endowment funds that are three or four or \$5 billion or larger, and they've got 15 people on staff internally, that probably doesn't make sense to consider that in that space, but maybe another spot where it might not make sense is if an organization just isn't comfortable turning over authority.

[00:18:27] They're so used to doing it themselves. They're not ready to do that. They shouldn't just give it over and then be worried, be thinking about all the things and really want to run the process, even if they've turned the authority over. And we've seen this in a couple of examples where we have traditional consulting relationship with clients.

[00:18:47] We introduced the concept and I want to be clear here that there is no, you should do this, or you should do this from our perspective. You should, you can be traditional investment consulting as a client. And that's perfectly fine for [00:19:00] a lot of clients. OCIO is fine for a lot of clients, but in some cases, OCIO might be better for a client, but they just don't realize it yet.

[00:19:09] And so through process of helping them understand how we can relieve burden, improve the process, make it more efficient, it can be an evolution to ultimate OCIO objective they may have, or may not. So, I think about a couple of examples of that. If it's really large, probably not the best solution for them, but if they don't understand OCIO and need more education, there's no sense in trying to push that internally, but allow them to understand what that looks like at some point over a longer period of time.

[00:19:40] So, Matt, you've talked a lot about our customized approach. So, as we think about, you know, maybe traditional versus OCIO, is there any sort of in-between scenario that a client might be able to access? Let's say they're not comfortable going to a fully discretionary relationship right away. Is there, is there kind of a middle ground? [00:20:00] Absolutely, Devon, there's a middle ground.

[00:20:02] We started an initiative within Fiducient. We call it the investment office. And that is really set to do a lot of work that that middle ground could be. So, if you think about the two ends of the spectrum we've discussed, one being traditional investment consulting, client does everything, full discretion. The OCIO does everything.

[00:20:21] Investments, administrative, and operational duties. There is a middle ground and we call it implemented services, which leaves the investment decision, making authority with the client, but

allows for our implemented services or investment office team to assume a lot of those administrative and operational duties on behalf of the client.

[00:20:42] So it really does strike a balance that removes that administrative burden from a client and still allows for the organization to retain the investment authority. And I think you could probably take even a step further where we have some clients who might say, I want to have [00:21:00] all the authority rest with your firm as the OCIO, except for private equity or hedge funds, because we've never used them before.

[00:21:09] I don't feel comfortable yet turning that over to a different organization. Can we retain final rubber stamp approval for those until we get comfortable with it? And we've done that as well. So, I would say the first middle ground is implemented services and it's really the way we come to market for a lot of our clients now, or new opportunities now, is we take on a lot of the operational and administrative duties in the investment office.

[00:21:33] And leave the decision-making with a client or we can tweak and tailor the way that our solution might work on the investment side as well. It's really customizable. And it's a discussion with the client, the committee, the staff, to see what fits their needs the best today. And then to continue to have that conversation down the line, to see if those needs have changed, or if there's a [00:22:00] better way to service what that client might look like.

[00:22:02] So lots of answers to that middle ground, and it's pretty wide, but absolutely there's a solution there. Yeah, some flexibility. And I think that's very helpful. And Matt, you have provided so many terrific insights. I really appreciate the way you think about this and frame it. Are there any final takeaways that you'd share with nonprofit leaders who oversee an endowment or a foundation or, or some other charitable organization pool of investments?

[00:22:28] Sure, Bob, as I think about OCIO traditional consulting and how they relate to a nonprofit organization, one of the first questions we get is, is OCIO more expensive? Is it worth it? And when I've seen the impact it's had on some of our nonprofit clients that are operating with lean staff and they have objectives and goals, they have to meet.

[00:22:50] And they're doing double duty. An OCIO solution can really work well for that client. And if you think about it, there is an extra cost because there's more [00:23:00] work on a firm like ours. But when you also realize that staff doesn't have to hire an extra person, they're able to focus more time, energy, on the things that they are really in their job description today, an OCIO solution can really provide relief.

[00:23:16] For an organization, for a staff, for a committee that might not be comfortable building that portfolio on their own. And it can create a relationship that's built on trust, that's built on great communication, great guidance, education along the way. We've always looked at this, when we work with a client who want an educated, confident committee member is much more effective in their job, and through an OCIO solution, we can relieve that staff of burden, build a great portfolio for them.

[00:23:46] And then, also have a relationship built on trust that enables that, that committee to move aside from that authority and that need to do that work and focus on the advancement of their organization. So, [00:24:00] doesn't have to be in any one of those three sleeves that I've described, but there is a solution that's right for each organization and it could be different as time goes by.

[00:24:09] But I think understanding the different models and the different ways you can engage with a third-party advisory firm is really important, and having that discussion, I think, can lend a lot of value to the long-term success of any nonprofit organization. Matt, that makes perfect sense. And I'm thinking particularly in this extremely tight and challenging labor market, how OCIO services, you know, should be a real consideration for any charitable organization that's struggling with staff.

[00:24:39] Indeed. So, before we wrap up, we always like to end on a personal note. We highlighted all of your Fiducient responsibilities at the beginning of the show. So, I think everyone knows you don't have a lot of free time, but if you do manage to catch an hour or two here or there, what are some things that you enjoy [00:25:00] doing outside of your work responsibilities?

[00:25:02] Oh, you highlighted it early, Devon, but I've got two kids. They're 14, almost 14 and 10. They're swimmers and they're active. And I really enjoy spending time with my family. If it's just me, I love to go out and play around to golf. I love to get on my bike and ride and go hike and just be outside. So, family time and spending time doing some really fun activities outside is where I like to spend the free time that I have.

[00:25:29] That's great. Well, thank you so much for joining us today, Matt, you have provided such a wonderful insight. If folks want to learn more or to access resources, contact you, where should they go? They can go to our website which is fiducient.com and reach us through there or they can go to our website and track down my number.

[00:25:50] I'm happy to talk to anybody, uh, about, uh, the, these services at any point in time. Hey, Matt, thank you so much for being on the show. You've provided wonderful [00:26:00] insights. It was really great to have you. Thanks, Bob. Thanks for having me. Thanks, Devon. And thanks so much to our listeners. I will echo Matt's suggestions.

[00:26:08] There are lots of great resources on our website. We'll include it in the show notes. And in particular, you might want to take a look at our steward newsletter obviously meant for nonprofit organizations, but there's an article from earlier this year that Matt wrote, which provides great overview of Fiducient's OCIO services.

[00:26:24] And we'll include that in the show notes too. 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. Click the subscribe button below to be notified of new episodes and visit fiducientadvisors.com for more information.

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