

6 keys to choosing the right outsourcer



today,
few OCIOs
that serve nonprofits are
total institutional partners

Six questions can help you find one who takes a holistic approach.



ot long ago, the definition and scope of an “Outsourced CIO” (or OCIO) was narrowly defined. It generally meant investment management—a traditional consulting model in which the process of interviewing managers was delegated to an outside provider.

Over time, however, as institutions’ internal staffs have been reduced and stretched, the definition of the model has expanded and evolved in kind. While OCIO was once regarded as merely an investment advisory function, it now can be about a total partnership that delves into deeper issues than an institution’s investment portfolio.

A TOTAL INSTITUTIONAL PARTNERSHIP

Simply put, value-added OCIO providers must no longer view an institution through a purely investment-related, or even finance-related, keyhole. Many institutions require a broader and deeper approach—a “Holistic OCIO” relationship that addresses wide-ranging institutional factors that extend well beyond investment management.

In many respects, a Holistic OCIO relationship is an investment partnership that one would expect to have within one’s own internal offices. The OCIO becomes an extension of the investment office, including:

- » Answering any and all questions regarding investment management
- » Assisting in any required education to the board and/or investment committee
- » Taking accountability for investment performance, ongoing oversight, and risk management
- » Working with other committees (e.g., finance, development), as well as senior staff, to ensure that all needs of the institution are understood

Many providers claim to offer a Holistic OCIO approach. Few actually do. In fact, finding an OCIO who can view your institution from a holistic perspective isn’t easy. Here are six key queries to pose to OCIO candidates to determine whether you’ve found one that places a priority on managing the total portfolio.

QUESTION #1: DO THEY LOOK BEYOND YOUR INVESTMENTS?

A Holistic OCIO relationship begins with an OCIO taking the time to understand the unique intricacies of your institution, and becoming involved in not only financial aspects but in the institution as a whole.

This means asking about more than returns and risk profiles, more than limitations and budgets, more than asset pools and portfolio management. It means beginning the conversation (and eventually, the engagement) further up the operational food chain by gaining an understanding of an institution’s mission, strategic goals and plan, business issues and concerns, and the role of the asset pool. Based on these myriad factors, the provider can conduct an analysis and develop an investment plan that includes a 5- to 10-year forecast as one of its components.

QUESTION #2: IN WHAT MARKET DO THEY SPECIALIZE?

As the OCIO model has evolved and expanded, a number of financial players have entered markets they frankly may not understand—such as nonprofit institutions.

Consider this: The key variable in a Holistic OCIO approach is the institution itself. Each endowment or foundation has its own strategic needs, objectives and mission. It is the OCIO’s responsibility to conduct the upfront due diligence to determine the interplay among each of those factors, understand the issues, and develop solutions to meet objectives.

Who would be more familiar with these matters than an OCIO who specializes in nonprofit institutions and has focused there for decades? Such a provider can offer optimal guidance on spending methodologies, donor management, debt management, and other factors. Not only does that experience flatten the learning curve to near zero, it also ensures that the OCIO will proactively ask the right questions and intuitively recognize problem areas that general practitioners may overlook.

QUESTION #3: DOES POLICY DESIGN GO BEYOND INVESTMENTS?

The traditional OCIO model focused largely on owning the investment pool. But a Holistic OCIO helps achieve institutional objectives by moving beyond mere investment policy and also addressing other components of policy design, such as:

- » *Operating policies*, which may include debt policies as well (e.g., do you have capital assets, such as buildings owned, on your balance sheet?)
- » *Investment policies*, including maintaining a risk/return profile that will achieve stated objectives, and rebalancing the portfolio as internal and external conditions dictate
- » *Budget policies*, in which the OCIO helps define formulas as well as long-term expectations for and analysis of liquidity, spending and payout patterns

QUESTION #4: ARE THEY COLLABORATIVE PARTNERS?

Because a Holistic OCIO touches an institution's functions beyond investments, the provider must team with more players than just the investment committee. A budgeting discussion, for example, may entail working directly with the finance office, determining how they campaign for and take stewardship of new assets.

WHEN SPECIALISTS TRUMP GENERAL PRACTITIONERS

An OCIO who specializes in nonprofits can instinctively recognize myriad issues that a general provider cannot. A few examples:

Operating assets. If an institution's operating assets are part of the endowment or fundraising pool, a liquidity stress test is required to guard against cash flow issues and ensure a smooth spending payout formula—which can, in turn, dictate a portfolio's asset allocation.

Debt. An institution's debt needs, capacity and covenants can materially affect long-term planning. So debt must be managed as a portfolio, with diversified timing, structures and maturities.

Enrollment. For academic institutions in particular, enrollment is a financial issue because it contributes to the asset pool and, ultimately, the strategic plan. An expanding student body, for instance, has physical plant ramifications that can materially affect a plan.

A key to success in making this collaboration work is defining and delegating roles and responsibilities between the institution and the OCIO. That means first defining the board's expectations and demands, then determining what functions the investment committee chooses to delegate to the OCIO.

A Holistic OCIO relationship also extends to the back office—offering formidable back-office resources and capabilities that go well beyond investment management. For example, they may

CONTINUED ON PAGE 5 »

A HOLISTIC OCIO RFP CHECKLIST

Once an institution decides to search for a Holistic CIO, it usually leads to a request for proposal, or RFP. Here are some critical areas to consider.

Interviewing and selection. Be decisive about the governance model and/or type of provider you wish to adopt.

- » Educate the investment committee on types of governance models and providers.
- » Generate a short list of three to five providers.
- » Identify the most important criteria to you, then evaluate and rank your short list of providers using a scorecard format.

Financial strength and commitment to outsourcing.

Since the provider you choose will assume a higher degree of fiduciary responsibility, assess each provider's financial stability.

- » Does the provider come from a low-margin environment?
- » Does the provider hold adequate capital reserves to support their business efforts?
- » Does the provider possess the capital requirements to build out internal investment management, risk management and quantitative analytical teams, as well as the infrastructure needed to support these initiatives?

Risk management. Establish a fiduciary checklist to determine the providers' ability to manage risk.

- » What are the providers' programs and procedures, including technology and software systems, to continually monitor and manage risk in client portfolios?
- » Do they have a dedicated and independent risk management team?
- » How is risk management conducted across the firm? Is it enterprise-wide?
- » How do operations, legal and compliance initiate and conduct risk management?
- » What level and frequency of transparency do they offer?
- » Which systems and applications do they employ to monitor and oversee security positions and counterparty risk?
- » Can they stress test and model portfolios in real time, or do they "look through the rearview mirror"?

Experience in alternative strategies. With alternative strategies comprising a greater share of institutions' investment portfolios, it's important to gauge a provider's expertise in this area.

- » What is their level of investment expertise and dedicated resources?
- » Do their analysts have CFAs *and* actual investment management experience?
- » Do they have a deep, long-tenured team with extensive alternatives investment management experience?
- » Do they have the depth of expertise to go beyond high-level due diligence and understand the idiosyncratic nuances of alternative strategies—and how those positions will impact the portfolio under specific market conditions?
- » Do they employ quantitative analytical teams and/or in-house systems for monitoring true exposures and volatilities in alternative strategies?
- » Can they consolidate all underlying positions to quantify where concentrated risks lie in the total portfolio?

Flexibility and independence. Ascertain each provider's level of flexibility and independence to determine if they're the right fit for your institution.

- » Do they offer only one-size-fits-all, or can they customize a solution to meet your needs?
- » Are they restricted by a short list of approved managers?
- » Do they limit due diligence to managers who meet criteria for their entire client roster—high net worth, ERISA, nonprofit, etc.?
- » Do they have to prioritize which clients gain access to top managers?

Performance and long-term track record. With many new providers entering the outsourcing space, it's crucial to evaluate track records and determine how much discretion they exercise.

- » How much experience do they have in managing a fully discretionary arrangement?
- » Do they show performance based on model portfolios?
- » Will they assemble a hypothetical portfolio of "approved" managers?
- » Have they managed portfolios under specific risk and return guidelines?
- » Can they provide performance histories that are representative of actual discretionary portfolios—not just hypothetical or model portfolios—and shown net of all fees?

The outsourced CIO model has evolved. Choose wisely, and you will have a trusted fiduciary partner who takes a broader and deeper approach to your institution that extends well beyond investment management.

» CONTINUED FROM PAGE 3

offer a team of operations and custody professionals who collaborate with the custodian of portfolio assets, handle capital calls and work with auditor valuations.

QUESTION #5: ARE THEY THOUGHT LEADERS?

A Holistic OCIO stays constantly on the cutting edge of market and industry trends, conducting ongoing research and calling your attention to its findings on a regular basis. This is critical in implementing investment policy, because it informs the strategies, asset allocation and policy goals that the OCIO and institution develop together.

It's not only today's trends that the OCIO must monitor; it's tomorrow's as well. The marketplace changes. So do internal goals. Strategies require adaptation and enhancement over time. And when it does, the OCIO must provide the very latest industry information from which to make critical adjustments to portfolio and policy (another reason that a nonprofit specialist OCIO is so important)—and to execute in an efficient, cost-effective manner.


QUESTION #6: HOW DO THEY CONSTRUCT A PORTFOLIO FOR YOU?

When it is time to build your portfolio, a holistic approach pays true dividends. A Holistic OCIO recognizes that the construction of the portfolio hinges on multiple factors, including long-term investing goals, liquidity needs, in-house resources and other institutional mandates.

In aggregate, those variables will dictate not only the components of the portfolio but of the investment program as well. Would the institution benefit from separate accounts, hiring individual, dedicated managers? Is a funds-of-funds approach more appropriate? Institutional commingled funds, passive index funds, and/or exchange-traded funds (ETFs)? The decision drivers are not just financial issues. A Holistic OCIO brings a total institutional perspective to the portfolio construction process.

HOLISTIC OCIO: A WISE CHOICE

The outsourced CIO model has evolved. Once, it was merely an investment advisory function. Today, however, OCIO is about a total partnership, one that expands the aperture beyond an institution's portfolio.

Choose wisely, and you will have a trusted fiduciary partner who takes a broader and deeper approach to your institution and addresses myriad factors that extend well beyond investment management. That's how you benefit from a Holistic OCIO. 

DISCLOSURE STATEMENT

Commonfund *Insight for Strategic Investors* (“*Insight*”) has been prepared and published by The Common Fund for Nonprofit Organizations and its affiliated companies (collectively, “Commonfund”).

Any mention of Commonfund investment fund(s) within *Insight* is not intended to constitute an offer to sell, or a solicitation of an offer to buy, interests in such fund(s). Offerings of any interests in funds (or any other securities) may only be made by means of formal offering documents, such as *Information for Members* (for endowment funds) or the applicable confidential placement memoranda. Investors should consult the offering documents and any supplemental materials before investing. Read all materials carefully before investing or sending money.

Statements made by third-party authors, interviewees or by Commonfund authors in *Insight* that pertain to any class of security, or that of a particular company(s), may not be construed as an indication that Commonfund intends to buy, hold or sell such securities for any fund, or that it has already done so. Mentions of successful companies should not be read to predict the future performance of those companies or of any fund.

Economic and investment views presented by any authors within *Insight* do not necessarily reflect those of Commonfund. Views advanced by third-party authors may be based on factors not explicitly stated in *Insight*. Views contained within *Insight* (including views on asset allocation or spending policies, as well as investment matters) must not be regarded as recommendations or as advice for the reader’s investment use. Additionally, all economic and investment views presented are based on market or other conditions as of the date of this publication’s issuance, or as otherwise indicated. Commonfund disclaims any responsibility to update such views.

Investment managers utilized by Commonfund may or may not subscribe to the views expressed in *Insight* when making investment decisions for Commonfund funds. The views presented in *Insight* must not be interpreted as an indication of the trading intent of managers controlling Commonfund funds.

Past performance of any Commonfund fund is no guarantee of future results. Securities offered through Commonfund Securities, Inc. (“CSI”), a member of FINRA.