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TIAA

Endowment & Philanthropic Services

Outsourced Chief Investment Officer considerations

The role of the Outsourced Chief Investment Officer (OCIO)

Boards of Directors, as part of their fiduciary obligation, are responsible for ensuring the longevity and sustainability of their organization—and its ability to meet its mission objectives long after individual board members have served their term. Many boards, in acknowledgement of the scope of these responsibilities, and limited capacity to address the day-to-day complexities necessary for financial stewardship, are engaging third-party institutional financial management firms to address investment responsibilities on their behalf, commonly referred to as the Outsourced Chief Investment Officer model.

When organizations implement an OCIO model, the board, along with its investment committee, engages a third-party investment manager to address:

- Investment policy statement design or review
- Asset allocation
- Portfolio construction, implementation and rebalancing
- Investment manager due diligence
- Liquidity management and spending policy guidance
- Risk management
- Investment accounting and performance reporting

Under an OCIO model, the third-party manager assumes investment stewardship on behalf of the board. While this doesn't remove the board members' responsibilities as fiduciaries, it does allow the board the ability to rely on financial professionals to address the substantial work necessary to select, monitor and adjust investments.

Common reasons for working with an OCIO

Nonprofit boards engage OCIO services for a variety of reasons, which typically correspond to one or more of the following categories:

- Investment management expertise
- Time and due care
- Best execution
- Continuity of investment team
- Regulatory compliance
- Donor transparency

Boards today are acutely aware that issues in any one category can be problematic. A few of these categories taken together typically prompts board members to seek dedicated expert services.

The benefits of working with an OCIO

Provides dedicated, timely investment management expertise. Swiftly moving financial markets require active portfolio oversight and proactive positioning.

Most boards are composed of individuals with diverse backgrounds, strengths and outside obligations, who have volunteered their time to serve. And while some organizations have sophisticated investment professionals on the board, these individuals often have substantial outside engagements. They could make the investment decisions necessary for the organization's portfolio; but timely implementation, administration, ongoing monitoring and proactive adjustments are often well out of scope of the individuals volunteering their time.

Board meetings typically occur on a quarterly basis. Even if your board is extremely engaged and meets monthly or more frequently, it is still difficult to dedicate the ongoing resources necessary to address investment portfolio responsibilities, a part of board members' fiduciary obligation.

Finally, most board decisions are executed by committees—and experienced investment committee members managing the organization's investments on a periodic basis can become problematic for the portfolio over time, creating a cumulative lag/reactive impact.

It's difficult for boards to execute timely transactions and apply appropriate oversight of their investments.

Why OCIO?

OCIO providers polled identify a lack of internal resources (**58%**), a desire to improve a governance process (**58%**), and the need to improve risk-adjusted returns (**31%**) as the top-three reasons investors seek an outsourced CIO service arrangement.

31% Seeking improved risk-adjusted performance	**3%** Opportunities for an open-architecture platform	**28%** Seeking stronger advisory relationship (i.e., garnering more out of existing relationship)
58% Lack of internal resources	**28%** Seeking operational and administrative support	**58%** Improve governance process
25% Lack of expertise in specific asset classes	**28%** Seeking transfer of responsibility	**25%** Cost efficiencies

Source: Cerulli Associates (*U.S. Outsourced CIO Function 2017*: Identifying Emerging Opportunities Across Institutional Investors)

Analyst Note: Participants were asked to select the top three reasons why institutions choose to outsource

Maintains continuity of investment team. If one or several key individuals are responsible for investment decisions on behalf of the organization, the board has significant key-person risk if that person/those individuals become incapacitated or relinquish their position on the board. If boards elect to hire an internal individual and staff to address Chief Investment Officer capabilities, the key-person risk is amplified, as that person is held out as the head of investment stewardship and decision making. Retention and attrition are ongoing issues that become part of the board's responsibility, in addition to direct oversight of those investment person(s).

Mitigates regulatory risk and addresses donor transparency. Complexity in the regulatory environment and scrutiny by donors continues to increase, which has led boards to consider OCIO models to ensure both compliance as well as rigorous investment discipline. Under an OCIO model, the investment committee continues to focus on the strategic decision making necessary to safeguard the organization's assets and its ability to continue the stated mission.

The OCIO provider addresses the appropriate investment due diligence, risk management and adherence to regulatory requirements necessary to comply with various financial oversight bodies.

Key considerations

There are many common reasons why institutions choose to work with an OCIO, however, there are often equally as many unique reasons as well. Answering the following questions can help an organization's board members and investment committee assess how an OCIO provider could work with the institution to augment resources and support strategic goals.

OCIO relationship and structural considerations

- What expertise do current endowment staff and investment committee members bring to the table and what gaps need to be filled?
- Will the increased investment opportunities an OCIO offers align with the institution's social values?
- How will the OCIO's portfolio construction and asset allocation expertise lead to better expected returns?
- Will the investment committee be comfortable working with a particular OCIO?
- How will the OCIO help to manage and reduce portfolio and operational risks?
- Will the OCIO's investment expertise and strategy support the institution's cash flow needs?

Making the right choice for the institution—OCIO benefit assessment

The OCIO relationship can offer the flexibility to customize the arrangement to the needs of each institution. Boards, through self-evaluation, often review the following capabilities to establish the need for an OCIO provider.

Capacity to focus on what matters most. Successful boards focus on strategic decision making and leverage the diverse talents of board members to execute against strategic plans. Once an investment policy statement and spending policy are in place, the board can focus on its nonprofit duties, which may include program sustainability, project and program creation and expansion, and capital planning and allocation. Engaging OCIO capabilities creates a powerful force multiplier, expanding the capacity and effectiveness of the board. By using outside investment expertise, boards can pivot their talent and acumen to focus on growth, sustainability and capital-raising on behalf of the nonprofit they serve.

Continuity of investment capability. An OCIO model provides a stable Chief Investment Officer function for organizations as boards, investment committees and even, in-house investment professionals transition members over time. OCIO providers may offer a variety of investment leadership structures. At the core, having investment professionals continuously available allows boards to focus on strategic decision making.

Depth of experience. Board members come to organizations with a variety of strengths. Even boards with senior investment professionals as members benefit significantly from an OCIO model. OCIO providers have a breadth and depth of expertise across every asset class, and experience customizing numerous portfolios to meet institutional client needs. Often, CIOs hire OCIO capabilities to address specific investment sleeves of the portfolio for when it might be too difficult for them to obtain and maintain experienced staff—such as private equity or emerging (new) managers, and activist and impact segments. Whether it's knowledge of and access to a myriad of alternative investment choices, or a desire to explore and implement Environmental, Social and Governance (ESG) investment solutions, an OCIO model provides significant value to the investment committee.

Cost savings. Large organizations may consider hiring their own internal investment staff. It's important to consider not only key-person attrition risk, but also the corresponding cost to hire and retain dedicated investment professionals with the expertise to serve your organization well.

Operations and reporting. Critical functions OCIO providers address daily include all investment operations and administration on behalf of client organizations. These functions span trading, settlement, treasury and custodial services. Investment committees rely on the OCIO to provide financial and performance reporting that is clear, concise and timely—and enables transparency for the broader board, institutional leadership and key contributors.

OCIO vs. an investment consultant

Working with an OCIO involves a more comprehensive partnership than a traditional investment consultant. Specifically, an OCIO provider can address both investment and fiduciary responsibilities to improve transparency, expand investment opportunities and accelerate decision making. An OCIO provides a complete solution, whereas the consultant model tends to stop short at asset allocation and portfolio construction advice—leaving board members, with a wide array of backgrounds not necessarily grounded in investment management, to make the ultimate decisions for the portfolio.

OCIO and cultural fit

Cultural fit is especially important for an effective partnership between an institution and an OCIO. Like all organizations, nonprofit institutions want to achieve the highest returns possible within established risk constraints. Yet nonprofits also have unique needs and cultures, and it's important to work with a company that understands them.

Nonprofit organizations have a number of different stakeholders—from donors to students to grant beneficiaries. Managing a nonprofit endowment requires the ability to satisfy a wide range of priorities and to communicate information that is accessible to individuals with financial and nonfinancial backgrounds. A nonprofit's OCIO provider should be familiar with the organization's priorities, values and stakeholders. For instance, nonprofit governing boards may be interested in broader measures of success than pure return, or may seek more detailed information about labor, social or environmental factors underlying certain investments. The right provider will be sensitive to these needs and offer solutions tailored to help meet the institution's requirements.

Institutional investment committees continue to play an important role when working with an OCIO provider. The investment committee is responsible for monitoring the services and performance of the selected provider. Equally important, an OCIO arrangement frees up the investment committee to spend more time on high-level policy issues and the unique challenges facing their institution.

The OCIO model can benefit organizations and institutions of every size by providing a more sophisticated and comprehensive approach to managing investment and fiduciary responsibility.

How we can help

TIAA offers a full range of OCIO services to organizations of every size, from less than $10 million to $1 billion plus. We have the investment management experience to meet any institution's needs. With 100 years of experience managing the retirement assets of professionals in academic and other nonprofit institutions, we understand the culture and values of nonprofits—and the importance of managing investments responsibly to help institutions carry out their missions.

Learn more about TIAA's OCIO services for endowments and foundations and our family of providers at **TIAA.org/endowmentsandfoundations**.

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