CAMBRIDGE ASSOCIATES

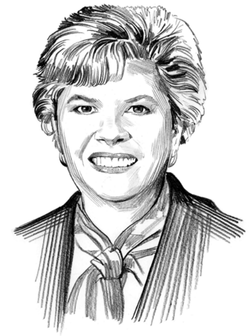
THE DECISION TO DELEGATE

Four Investment Committee Chairs talk about why their committees chose OCIO

Beauregard Fournet is the Investment Committee Chair for the Louisiana State University Foundation.

Mike Hirai is the Investment Committee Chair for the University of Hawaii Foundation.

John Laupheimer is the Investment Committee Vice Chair for the Trustees of Reservations.



Valerie Sill is the Investment Committee Chair for Longwood Gardens.

In a world of increasing investment complexity, the challenges of overseeing a well-diversified institutional investment portfolio are also increasing.

More and more, boards and investment committees are actively debating whether it better serves their organization to manage the day-to-day portfolio decisions or to delegate those responsibilities and focus on portfolio oversight.

We had a conversation with investment committee chairs from four institutions with assets ranging from $200 million to more than $850 million in order to understand why they chose to delegate decision-making on their investment portfolios – and to reflect on that decision today.

HILLARY RIBAUDO: THANK YOU FOR TAKING THE TIME TO PARTICIPATE. LET'S START BY GROUNDING READERS IN HOW YOU'RE ASSOCIATED WITH THE INSTITUTIONS FOR WHICH YOU SERVE AND EXPLAINING THE INSTITUTION'S MISSION.

MIKE HIRAI: I finished up my undergraduate degree at the Shidler College of Business and so that is my affiliation. Our mission is to support the various programs within the university, as well as supporting research and the students at large. And the unique situation that the University of Hawaii has is we are the only public university in the state, and we support a number of community college campuses as well.

BEAU FOURNET: I grew up in Louisiana and went to LSU along with my wife and ended up working in the hedge fund industry and was largely still connected to university through coming back for football and baseball games. There was a board that deeply loved LSU and wanted to serve the university but felt like they lacked investment management expertise. They asked if I would start providing feedback to them. And that was the beginning of my involvement with the board of the foundation. Our mission is to support the university, to be the best university possible to serve the people of the state of Louisiana and surrounding areas through a great education at the lowest price possible.

JOHN LAUPHEIMER: I've been involved with the Trustees of Reservations for seven years. I was a trustee of Fruitlands Museum since 1985. And seven years ago, we asked the Trustees whether they'd be interested in integrating with Fruitlands, and they were. Trustees is a very, very old land conservation organization here in Massachusetts that cares for nearly 50,000 acres. We have inherited, been given, or actually integrated with substantial cultural properties so we really have felt a substantial secondary mission to make sure that all these properties that we care for are open and available to the public so that the citizens of Massachusetts, as well as anybody passing through, has the opportunity to enjoy what we care for.

VALERIE SILL: I had relocated to the area to become CEO of DuPont Capital Management in 2004 and my predecessor, the prior CEO of DuPont Capital Management, had been in the same role chairing the investment committee and served as a trustee of Longwood Gardens and so the board was looking for a replacement. They talked to a few of us at DuPont and, luckily, I was selected.

Longwood Gardens represents the living legacy of Pierre S. Dupont. His goal was to bring joy and inspiration to everyone through the beauty of nature, conservation, and learning. With Longwood, they created a world where beauty is accessible to everybody. And they're leaders and innovators in the arts and sciences, and, of course, in horticulture. Longwood presents extraordinary experiences to bring pleasure, to foster well being, and to spark imagination amongst the people visiting the gardens. They enrich the society through learning and training programs. They conduct a lot of research. They really oversee the stewardship of the land and they're heavily involved with the local community.

THANKS FOR THAT BACKGROUND. NOW LET'S GET INTO IT. WHAT WAS THE PROBLEM YOU WERE TRYING TO SOLVE IN CONSIDERING OCIO?

VALERIE: I remember it was back in 2008 where we sat down to build a 40-year master plan. I thought, wow, 40 years, that's really ambitious. It's very helpful that we've done that. The plan is called "Creating a World Apart" and outlines a framework for Longwood's vision to help make future decisions.

By the time we got to the 2015 time frame, we had done quite a bit of transformation of the investment portfolio. We had really increased our allocation to private investments. We had broadened out the diversification of some of the equity strategies as well as fixed income. Quite a bit of work had been done really to improve the asset allocation to build that better mousetrap—but we built a pretty complicated mousetrap. And at the time, we had five members of our investment committee—all very devoted to Longwood—but we all had full-time jobs too. We would review the private investments individually before making the decisions and it just became overwhelming. The committee had a discussion about this and we felt it would make sense to consider moving to the OCIO model, primarily to free up our ability to focus on the strategic aspects of asset allocation. We know all of those investments very well and were very close to all of it, but we started to lose sight of the bigger picture, the need for strategic thinking around the overall set of asset classes we were investing with, the strategies we were employing. There was a lot of work that needed to be done on the strategic high level that we just didn't have time to cover.

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JOHN: We had a lot of the problems that I think any charitable investment committee has, which is natural turnover. If you look back four years, you might find that only half the members on the current committee are members today. For any sort of volunteer organization, it's very hard to keep the kind of longevity and positions that perhaps could be considered chores. Roughly 12 members who met four times a year makes it very difficult to act timely for investment decisions. So when you have things take place that require some nimble decision-making, it's hard to get that together when you're only meeting four times a year. And then because the various investment ideas came into the portfolio either from current members of the committee or past members of the committee, it was hard to figure out oftentimes why we own something that was in the portfolio, what the original decision-making process was, and frankly, whether that was still a valid investment case.

And so I felt that all basically boiled down to a problem of accountability, and that it was really hard to know why we own something. To put it bluntly, whose fault it was that we owned it when it wasn't a good idea. And what we ought to do about it because it could often be the case that the person with the most knowledge about that particular idea was no longer at the table. A number of us made the case that we really need to split out the roles of investing and governing. Our real mission is as a governance committee and it is to oversee the investments and make sure that they're being properly managed and less so to be the actual investors of that money. Investing is hard, being a good investor is actually quite difficult.

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BEAU: Our performance had frankly been disappointing to the committee members, both on an absolute basis, as well as a relative basis, to our benchmark and our peer group. Whenever results are disappointing, you're more open to making changes and they asked for my feedback. And I believe that the endowment was subscale to have sufficient investment talent on the team, which even with the consulting model, you need investment talent. And I felt we needed to be multiples of the assets we have to be able to do that. And so felt strongly that the OCIO approach was the best approach. And importantly, the board deeply loves the university and there's a very high level of humility and a realistic understanding

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of the gifts we bring to the table. And two of us had recently joined the board that had relevant experience and they placed a lot of trust in us to do the work we felt was needed to come to the right conclusion.

MIKE: I've been involved with the investment committee and the foundation for about a decade. And over that period of time, I've observed the investment process that the committee and the board has gone through. We started off with a very modest endowment and it has since grown quite significantly. It was more of a situation where I don't think that the committee itself—although we have some very experienced investment professionals on the committee, that they were really putting in the time and effort needed to make very informed decisions.

I think one of the very important pieces of this puzzle was the interaction of staff. We have a capable CFO and his team and they were not really comfortable with the responsibilities that they had to do day-to-day, whether it was making cash available for capital calls, overseeing the administration, or the asset servicing of the pool of assets.

OKAY, THERE'S CERTAINLY SOME CONSISTENCY IN THE PROBLEMS FROM A GROUP OF COMMITTED VOLUNTEERS TRYING TO DO THE BEST THING FOR THEIR INSTITUTION. SO, WHERE DID YOU GO FROM THERE?

BEAU: The first thing was understanding what we brought to the table if we were going to play that role. And I think the things we brought were insufficient: expertise, a lack of time, and a lack of flexibility to make timely decisions between board meetings. And then the other thing is with a $450 million endowment, you could not develop the team that you needed. We felt that by bringing in an OCIO, we would get the scale benefits recognizing that an OCIO team supports some other endowments. We also felt there were advantages others could bring through discounts and fees by being a much larger contributor which would help further drive down costs. And then we could really focus ourselves on providing oversight rather than making investment management decisions.

JOHN: The argument I made is that we either needed to cut the committee down to four people who are going to commit to being in that role for five to ten years and meet 12 times a year, in which case I thought it might make some sense to actually be in charge of making the investments themselves, because then you're meeting often enough and you have the kind of continuity to do it. Or that we needed to move to a situation where we continue to meet four times a year with 12 people. And that our job there was to hire an OCIO and to govern them and make sure that they were doing a good job. When they weren't doing a good job, we'd be in a position to say, "geez, we don't think you're doing a good job. What are you going to do about it?"

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SO, WAS EVERYONE IN FAVOR OF ADOPTING THE OCIO MODEL OR WERE THERE CHALLENGES IN BUILDING CONSENSUS AMONG BOARD MEMBERS?

BEAU: On the board side, there was none. We certainly asked ourselves, how do we think the university will feel about this. And so we spoke with the right people at the university as well as considering how our donors would feel. Ultimately, the university was supportive. It was a very short conversation.

VALERIE: Everyone was very much in favor. And I think a big part of that was the amount of time that the investment committee members were spending on overseeing the endowment's investments, particularly the private investments.

JOHN: I was actually quite surprised, I had a private conversation with the then chairman of the of the investment committee, and I said, "I'm really adamant about this." And he said, "It's the right approach but I just don't see it happening. I don't think the votes are there." We had an all-day offsite meeting to address this issue. My main point was that we needed to be accountable and that if we thought about our responsibilities, governance was a more important responsibility than playing investors. And so made that point as pleasantly as I was capable of. I was quite surprised because two other members who I had not heard anything from in the run up actually chimed in on my side on that. And then just rather quickly it turned and that was great.

MIKE: I think in general, this discussion has been going on for years. I had thought that we would have made this move earlier, particularly because everybody on the committee or as trustees, they all have their day jobs. They all have additional responsibilities with other organizations. And so, quite frankly, the volume of materials that needed to be reviewed, it's a lot to ask of these individuals who are also helping to fundraise, they're helping with other functions that are very important to the foundation. They actually were very much in favor. Staff was a little hesitant at first. I think now that they've gone through the process, they're supporting it with open arms.

WHAT CRITERIA WAS MOST IMPORTANT TO YOU AND THE REST OF THE BOARD AND COMMITTEE IN CHOOSING AN OCIO?

BEAU: We did hire a consultant to help us work through that process to make sure that we had an RFP process that was broad and was thoughtful and led toward a good decision. And as far as the specific factors that we were considering there were several: the first was we did not want to consider any outsourced OCIO that we felt had a conflict of interest. And so if they were doing direct investment management and products that they charged fees for, we would not consider them for the role. Or if they had other commercial revenue sources by supporting people who they allocate capital to, such as doing IPOs for private equity firms or venture capital firms. The next thing is we wanted somebody that had experience in endowment money management and not just broad money management. A third thing we wanted to really understand the specific team assigned to the account to make sure that not only do they have the right experience, but they have the right culture fit. The one thing I'm confident of is over the long-term horizon, we will have disappointing years and a good culture fit allows for trust to be maintained in the midst of short-term blips.

Another important thing is how the positions were held and it was important to LSU that the individual investments, be it a private equity or public equities or other alternative strategies, were held directly by LSU. Some outsourced CIOs create commingled funds. It might be an overall commingled fund or a commingled fund by asset class. And I was really uncomfortable with that because I want my succecessors, if the time ever comes to make a change, to be able to have a relatively uncomplicated divorce and then remarriage to another OCIO. And so that was important.

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MIKE: We looked at the organization, their stability, and their experience within the space. We had some very high hurdles for these firms to meet, particularly as it came to length of time in the business, their assets and their management, and particularly their expertise in the various areas that we're invested in. The portfolio has grown over the years from being not as focused on alternatives or private investments to where it's a very significant portion of the portfolio and so that requires a very deep team within the OCIO practice. And then lastly, it's who would be assigned to our account — the personnel, the experience of the individuals who are servicing and facing the committee, the board, and the staff.

AND CAN YOU TELL ME ABOUT SOME OF THE BIGGEST CHANGES YOU'VE SEEN SINCE SWITCHING TO THE OCIO MODEL?

BEAU: The first thing with the investment strategy is, while the strategy hasn't changed, our consistency with the strategy has increased dramatically because we're not looking at short-term performance to make course corrections on long term objectives. We also have day-to-day full-time focus on making investment decisions through an outsourced OCIO who is doing that as a full-time job, as opposed to a board getting together quarterly, and then having to struggle to get together more quickly than that. So those are probably biggest changes and it's allowed us to really change our focus to broadly understanding investment management.

Whenever we go and ask supporters of our university to contribute to our mission, we're asking them to place a lot of trust in us. And that's something that we take very seriously.

MIKE: From an investment committee level, we have some very experienced individuals on the committee. From their perspective, our discussions have now been more focused on aligning benchmarks to our objectives and larger picture issues rather than being focused on XYZ company within a certain risk bucket and trying to figure out if those are the best managers that we should be using. So from that perspective, I think the discussion has gone a lot more higher level.

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VALERIE: We spend more time on governance and oversight as compared to the day-to-day monitoring and looking at the choices of investment managers and monitoring performance day in and day out. So we've had much more time to look at a higher level to think about things like sustainable and impact investing, to think through how much do we want to have in the private investments versus say public equities. For Longwood staff, they're much more focused on their mission and vision and executing the master plan as opposed to spending a lot of time on the day-to-day management of the endowment. We've had the opportunity to explore new ideas like DEI, ESG—so it's been very positive.

We're coming through a market environment now where we've had significant interest rate hikes. We haven't seen anything like this in 40 years. These are difficult markets to navigate. A lot of times the committee members come in with a particular background in equities or fixed income or private investments and so, we don't know the whole picture. I think it's really important to consider that.

JOHN: I think the place where we noticed it most significantly was when we saw major changes in interest rates. The portfolio was able to be rebalanced in ways that we simply would not have been able to do in a timely manner before. It would have been weeks before things would have been worked out. The meetings are much more enjoyable because we spend much less time talking about things the whole committee doesn't have a particular expertise in. Secondly, we focus on what I think is the right thing: portfolio balance and positioning and whether we are in line with our investment policy statement. And where we're not, we make sure it's intentional and there's a strategy behind it. So I think the whole discussion tends to be around things that are productive. And then finally, I think, we just see changes happening to the portfolio on a timely basis that make sense.

AND IS THERE ANYTHING YOU MISS ABOUT MAINTAINING DISCRETION?

BEAU: Honestly, none. We have an executive session with every meeting and I always go back to how important it is that we accomplished the mission of our absolute and benchmark return objectives. And seven and a half years into this, we've been able to meet those benchmarks and do it in a way that we think is more sustainable rather than a short-term blip. I think that there are enough people on the committee that see some of the poor decisions on the private side that are still in the portfolio, so we have a subtle reminder every three months of some of the mistakes we've made in the past.

MIKE: I'm an "in the weeds" kind of guy, having been a portfolio manager and chief investment officer throughout my career. I really don't miss that because looking at the number of firms that we use and the managers that we use, and to be able to keep up with all of the different firms, performances, and organizations is a rather daunting task. It's a full-time job. I'm relieved that the committee doesn't have that responsibility because we got to the point where we were just basically rubber stamping recommendations when we should have been discussing more detailed information about the selections that we were making. But now, we've handed that responsibility off.

VALERIE: I remember when we made the switch. It became effective in 2016. And I remember thinking I felt sad about not being able to look over the individual investments myself. I'm kind of an investment geek and I grew up as an equity analyst so I love getting hands around the nitty gritty of each company. But when I think back now, I'm so relieved I don't have to do that.

HOW WOULD YOU SAY YOU'VE ALLOCATED YOUR TIME AS A TRUSTEE DIFFERENTLY NOW THAT YOU HAVE AN OCIO?

BEAU: For the investment committee, we have a rotation of educational topics we're providing in each of our meetings. And so there's a much longer-term rhythm to what we're doing as opposed to looking at individual investments and trying to make decisions. And we're spending a lot less time reviewing the trailing three-month performance, which is not appropriate when you have an evergreen investment objective with an endowed model. For the broader board, I go back to our main objective, to raise funds and other resources to support the mission of the university. Any time we could shift from other things to that is a real win. As an overall board, we're able to shift a lot more of our focus to supporting the fundraising needs of the university.

MIKE: It's allowed us to spread our wings and pay attention to more projects that I think are equally important.

VALERIE: We get to take more time to think about where do we think the excess returns could come from. Do we think we should add private credit into the alternatives portfolio? What should we do about emerging markets equities? So I feel like they're much higher-level discussions. We've spent a lot of time on our sustainability and impact investing and really defining what is it we would like to accomplish there? How do we think about this? How do we benchmark our progress here? We did identify very particular areas of SII or strategic impact investing that we were very interested in, things like clean water initiatives, clean energy, education, there are others as well. That was very valuable because we could start to embed this within the investment portfolio. And we never would have had the time if we hadn't moved to the OCIO model. We still would have been debating the merits of one manager versus another.

IS THERE ANYTHING YOU'D DO DIFFERENTLY IF YOU COULD DO IT ALL OVER AGAIN?

BEAU: There were certainly steps in the process where you could look back and say, maybe we didn't need to have that step, but they were relatively small steps. I think it was the right decision to outsource.

MIKE: We used an OCIO consultant, and I think I would have placed a lot more attention on the selection of who helped us with the search.

VALERIE: I don't think there was much because we did have a very thorough RFP process where we interviewed the different firms competing. That was critical, of course, because that's how we learned about the candidates, their capabilities, and what it would be like to work with their investment teams day-to-day.

WHAT ADVICE WOULD YOU GIVE TO AN INSTITUTION CONSIDERING THE OCIO MODEL?

BEAU: First, assess the investment expertise of your staff or your committee and the amount of time that you could contribute to making the decision. Do you have flexibility to jump in for the decisions that happen throughout the process? And then, what's the financial cost? How much are you paying right now? I think there's a belief that going to an outsourced CIO model is more expensive than other models, and the truth is it's often cheaper and if not, it's quite comparable. I think through that, you'll start to see whether or not you have the expertise, the time, and the flexibility.

VALERIE: I think you have to take a longer term view and remind yourselves that the markets go through cycles and not everything works in every cycle. It's important to have a partner you can rely on to help you think through the different market environments you're in. A lot of the not-for-profit institutions have volunteer investment committees and people have busy day jobs. So when the market is under stress, you're typically under stress in your day job as well as for the endowment that you're helping work on. I think you want to have somebody who's there to help you get a bigger picture, and you can still get that through a consulting relationship, but it's hard when you're making the decisions. It's easier when you're governing your OCIO and they're making the decisions. It's just a lot simpler over time.

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MIKE: I think a lot of organizations throughout the world can benefit from an OCIO model because the firms that they're going to select are going to be able to devote the time and effort that's really needed to do the best job they can. Now there are good OCIOs and bad OCIOs. I think it's really a function of the organization finding a team and a firm that they have trust and confidence in and that they feel can understand their own unique needs, goals and objectives, and that they have the resources and the wherewithal to actually help to achieve those goals and the investment results that they desire.

JOHN: One question I would ask an organization is how often do you meet? How consistent is your decision-making body? And how willing are you to hold yourselves accountable for the performance that you generate? And if you meet often, and the body has been consistent, and the results are generally good, and you hold yourself accountable when they're not, you can decide what you want to do. I don't think that's true for most investment committees that are working with nonprofits.

THANK YOU FOR YOUR TIME TODAY. DO YOU HAVE ANY LAST THOUGHTS TO ADD?

VALERIE: You don't realize it when you're doing it all yourself. You think, well, we can keep doing this. But it's just too difficult and I think there are bigger picture issues, particularly with sustainable and impact investing initiatives, that take a lot of work. You really have to spend time determining what makes sense for our institution because that will vary for everyone. You have to decide, how much do you want to allocate there? How do you think about this? And that will be a very dynamic, ongoing discussion. We would never have had the time for it if we hadn't switched to the OCIO model, so I'm very happy.

BEAU: We want to be not simply good at managing money. We want to be world class. We owe it to our donors when we ask them to let us steward their money, rather than them continuing to steward that money. And it's made me feel a lot better about the promises we make to our constituents. The entire process has been far more enjoyable as we move to an oversight role rather than a day to day investment management role.

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MIKE: For the first time in my experience with the foundation and being involved with the investment process, I really feel good about the decision that we made.

JOHN: I spend much more time thinking about big picture things as opposed to individual investments, which means I spend much less time being angry that I don't have enough information to make a decision that I'm being asked to make. So honestly, I just enjoy being on the committee much more.

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