OCIO CASE STUDY
DUE DILIGENCE

PlanPILOT

EXECUTIVE SUMMARY

Oversight of the asset management of institutional asset pools, including foundations, endowments and reserves, is becomingly increasingly complex. The events of 2020 expanded the need to have rock-solid fiduciary governance in place, as boards, committees and finance staff are challenged to re-visit their asset management approach, especially when it is outsourced to an OCIO provider. It is all the more necessary to carefully assess the asset allocation, investment options, expected returns, risk management metrics, the supporting servicing and, of course, fees. Their collective impact on meeting the spending and liquidity needs of an institution is paramount in assisting an entity to function and fulfill its mission.

The following discussion summarizes the approach PlanPILOT took with a mid-sized educational institution, highlighting the objectives and key issues encountered, the actions taken, and outcomes produced to enhance their OCIO oversight.

The institution wanted to address several key objectives:

1. Perform long overdue due diligence on the incumbent versus competitors,
2. Review its strategic asset allocation,
3. Consider additional investment options,
4. Build-out the risk management, and
5. Benchmark services and fees.

The institution was successful in this process as you will see in greater detail below.

PART 1–EVALUATING GOVERNANCE OVERSIGHT PROCESS & OBJECTIVES

The institution's endowment and reserve assets were overseen by its Investment and Finance Committees, finance staff, as well as high level oversight by its senior leadership and board. Like many institutions, when they hired their current provider the process was informal, no formal due diligence had been performed since, and they recognized the need to take a more comprehensive approach to assist in meeting their fiduciary role and responsibilities.

Current State

- Long-standing OCIO provider; some performance and service dis-satisfaction
- Due diligence not performed after the initial, informal selection
- Fees had recently increased
- Recent change in school president; contemplating donor fundraising initiative

Objectives

- More formal, objective due diligence
- Benchmarking of services and fees versus OCIO competitors

Key Decision Points

- Whether to continue to outsource or change to manage the portfolio internally – the Investment Committee included people who worked in the asset management industry who had the expertise to manage the asset pools themselves, but they needed to assess how feasible that would be in the future as the make-up of the Investment Committee changes and in light of the added risk
- Whether to perform the OCIO due diligence exercise internally versus hire a search consultant to lead it – the Investment Committee had industry expertise as noted, but the finance staff had concerns about how much work would need to be done over a multi-month's search

PART 2 – EVALUATING ASSET ALLOCATION & INVESTMENT IMPLEMENTATION

The institution was prepared to engage in active discernment of the direction of its asset allocation and investment mix decisions. They were acutely focused on the return and risk projections, the opportunity for alpha to meet growth objectives, and the potential impacts of the investment program decisions on the institution's liquidity and spending needs. The implementation of these decisions is where the rubber meets the road in OCIO management.

Current State

- Emphasis on a static strategic asset allocation
- Focus by the incumbent OCIO on passive management and a value style bias
- Very limited use of any private and alternative asset classes
- Risk management concerns on the impact of allocation and implementation decisions on spending policy

Objectives

- Assess OCIO's asset allocation methodology, assumptions and expectations
- Evaluate OCIO's use of passive and active management, and their approach to alternatives, considering the potential for alpha
- Broader incorporation of ESG (Environmental, Social, Governance) & DEI (Diversity, Equity, Inclusion) criteria

Key Decision Points

- Whether to rely primarily on strategic asset allocation, which has been accepted in the industry as accounting for 90% of the return and risk profile of a portfolio versus employ a more active search for alpha
- Identify if, how and when alpha, net of fees, could be expected to be generated on a consistent and meaningful basis in a projected low return environment and within acceptable risk levels

PART 3 - ASSESSMENT OF ADMINISTRATION & SUPPORTING SERVICES

The institution had a long-standing relationship not only with their existing OCIO provider, but also with their custodian. Changing these relationships would introduce complexity in reporting and transactions that would have to be carefully evaluated and implemented (e.g., gift stock processes, waiting for K-1s to complete tax reporting). Some supporting services, such as donor fund-raising and advised funds, were also of interest. These ancillary aspects of the relationship need to be determined in light of the impact on the finance and development staffs.

Current State

- Existing transactional execution, reporting and servicing was familiar and well-established
- Current OCIO reporting was basic
- OCIO had a preferred custodian relationship
- No donor activity support

Objectives

- Assess transactional, reporting and servicing capabilities of other OCIO providers
- Identify more in-depth reporting of performance attribution and risk measures
- Evaluate different custodian relationship and the anticipated servicing and fees impact
- Consider potential impact on donors- gift instructions, donor advised funds

Key Decision Points

- How to evaluate an OCIO provider from not only an investment lens, but also with minimal disruption of reporting and operations to finance and development staffs
- Whether services like donor support were valuable enough to influence the choice of OCIO provider

PART 4 – FULL TRANSPARANCY ON FEES

The institution was already paying reasonable fees given the largely passive and public market exposure of its existing asset pools. Broader use of active management in the search for alpha, and greater supporting services, were expected to raise the costs. **The key assessment criteria is not simply to minimize costs, but to have a reasonable expectation that one will receive value for those costs incurred.**

Current State

- Relatively low advisory fees on the existing portfolio, but recently raised modestly
- Relatively low manager fees given the large use of passive strategies
- Custodial fees included as the OCIO's preferred provider

Objectives

- Obtain competitive fee quotes for comparison, including advisory, manager and custodial fees
- Carefully assess the potential added benefits versus any higher costs
- Establish appropriate fees for the OCIO relationship going forward with full transparency

Key Decision Points

- Whether the anticipated alpha of a more robust investment approach would likely result in returns net of additional fees projected
- Determine ability to document and report on full transparency of fees

PART 5 - PROCESS EMPLOYED AND OUTCOMES ACHIEVED

Now let's take a look at what steps PlanPILOT and the institution took leading to a constructive outcome for them.

Actions Taken

- The Investment Committee discussed and determined to continue to outsource to an external OCIO firm to manage its asset pools rather than manage them internally
- The Investment Committee discussed the benefits and costs of retaining PlanPILOT to lead the due diligence process; key factors included:
  - Expertise in performing due diligence
  - Broad and deep familiarity with OCIO firms
  - Objectivity in assessing the fit of potential firms
  - Perform the heavy lifting to allow the Committee to focus on the strategic point-of-view
- The Committee completed PlanPILOT's goals and objectives questionnaire to assist the consultant in executing the due diligence process

- The Committee already had some firm names for inclusion in the search, as well as some questions it wanted to be addressed, and discussed these along with the OCIO names and questions generated by us, reaching a mutual agreement on proceeding
- An RFP (Request for Proposal) was conducted by PlanPILOT with 8 firms, including a review of the incumbent, utilizing industry leading technology
- Finalist meetings were held with 4 firms selected by the Investment Committee with coordination and guidance from PlanPILOT
- A scorecard developed by PlanPILOT was used to capture each Investment Committee members' assessments of each firm and assist in the development of a consensus point-of-view
- Reference checks were conducted by PlanPILOT on the preferred provider
- The Investment Committee made its decision to hire a new provider, which scored the best across the multiple criteria the Investment Committee agreed were the most important
- The decision was dependent on approval by the Finance Committee, and subject to review with the board and senior leadership
- The decision was followed by contracting and the development of a transition plan with the OCIO
- Follow-up calls were conducted by PlanPILOT with each of the other firms participating in the process to provide feedback and maintain strong relationships with all the firms involved in the RFP

Outcomes and Key Metrics Achieved

- New OCIO firm was selected based on the robustness of their strategic asset allocation process, complemented by limited and well communicated tactical positions
- More use of active strategies is expected, along with a modest and thoughtful approach to alternatives, in the search for alpha and growth potential
- ESG and DEI considerations will be considered in the underlying manager selection
- The OCIO firm will fully assess the return and risk expectations' impact on the institution's spending policy and risk tolerance
- The investment policy statement will be refreshed according to allocation and implementation decisions made
- The new firm also provided detailed samples of more robust reporting of performance, including comparisons to benchmarks and peer groups,

measurement and attribution of the alpha generated, and risk management measures

- The new provider will assist with education of the institution's key constituents, as well as with donor related activities
- Reporting and servicing will be more robust overall assisting the finance and development staffs
- Advisory fees were negotiated by PlanPILOT to be comparable to the existing provider with only modest increases
- While manager fees will range slightly higher than the current arrangement given the greater active management, there will be full transparency
- The Investment Committee agreed to review the OCIO selection and execution at least annually, with formal benchmarking review planned in 3-5 years

CONCLUSION

As is illustrated, institutions like this benefit by adopting a formal due diligence process for the selection of an OCIO provider followed by necessary on-going OCIO monitoring. Thoughtful process leads to better, intended outcomes. Effective oversight, led by a highly qualified consultant like PlanPILOT, serves the institution in meeting its fiduciary roles and being the best stewards of its valuable assets. This in turn can lead to better donor relations and development opportunities.

If you would like more information or guidance on OCIO due diligence services, please contact PlanPILOT *at* info@planpilot.com *or* (312) 973-4911 *or* visit our website http://planpilot.com/landing/ocio/