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MAKING A DIFFERENCE FOR NONPROFITS

Guiding and Leading Fiduciary Investments for Endowments and Foundations with Scott G. Thayer, CIMA®

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In this issue of *Investments & Wealth Monitor*, we focus on institutional consulting. To delve into this topic, we provide a profile of Scott Thayer, a long-time member and former chair of the Investments & Wealth Institute board of directors. Thayer has focused on institutional consulting throughout his career, as both a practitioner and an educator.


Scott G. Thayer, CIMA®

I&WM: Scott, thank you for sharing your journey with our membership. How did you begin focusing on institutional consulting? Why was endowments and foundations (E&F) the perfect fit for you?

Thayer: I started my career with EF Hutton in 1983. At that time the financial services business was one of brokerage and I felt there had to be a better way. I had just left my teaching career at Chico State University, where I was teaching finance and investments courses. I was most interested in capital market theory at that time and could not understand why there was no application practiced in advising clients. I also thought it odd that there was no real investment process that linked objectives to strategy and evaluated that strategy by performance. About the time I went through the CIMA program at Wharton, I got my first very small foundation account. It all just started to connect. The E&F market was interested in managing risk and monitoring performance to objectives. I focused on the early stages of educating clients on what is now considered a traditional "consulting process," and foundation and endowment boards and investment committees were very interested. As I began to grow my E&F business, I also found the tremendous personal benefit of serving the wonderful missions in the nonprofit marketplace. I had found a direction that just seemed to fit.

I&WM: How has the E&F market evolved over time? What are the unique challenges that it faces?

Thayer: In the early days of the 1980s, the consulting process was new, logical, and appealing to trustees who were starting to understand fiduciary responsibility. Educating trustees on a traditional consulting process using an investment policy statement, diversifying portfolios into multiple asset classes, performing due diligence on investment managers, managing risk, and then reporting on results was very innovative at the time. Most nonprofits were focused on funding their missions—developing a spending policy that related to an investment strategy was cutting-edge at the time. The application of modern portfolio theory and the idea that diversification potentially could increase returns and lower risk was well-developed in the academic market but not applied on the street.

The early challenges all related to education. First was getting nonprofit boards to create investment committees separate from their boards of trustees. Most nonprofit boards consisted of staff members of the institution and donors that had contributed to the institution—all passionate members interested in the mission of the institution but usually not experienced in investment management. Even universities did not structure their committees and investment processes in a prudent manner in comparison to today's standards.

As investment markets went through typical economic cycles, the early stages of behavioral finance could be observed as investment committees chased performance in good markets and became overdefensive in poor markets. Investment committees reacted to economic cycles with typical poor behavioral timing and then struggled with performance not meeting spending policy needs.

Another challenge was the method used by consultants in managing the consulting process. The early stages of consulting were founded on the principle that consultants were to provide fiduciaries information to make informed decisions. In other words, it wasn't the advisor's position to make direct recommendations—the advisor's job was to provide the information to the committee so it could make those decisions. Basic procedures for decisions on portfolio construction and investment manager selection became a long educational process with minimal efficiency. Consultants hid behind this fiduciary process, not being responsible for making

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more-direct recommendations. It would be some time before a collaborative consulting model would develop, eventually leading to discretionary models and the idea and application of outsourced decision-making using outsourced chief investment officer (OCIO) models.

The history of all these factors, along with the developments of more-sophisticated investment options in alternatives, the development of passive investing, and the need for global diversification, have all contributed to the advanced state of nonprofit advisory in today's market.

A good outline for the requirements necessary to assist in the prudent management of these organizations can best be described as follows:

- Develop an organizational structure that supports a separate investment committee of volunteers who have some financial background on investment matters.
- Have a well-documented investment policy statement that outlines the fiduciary process required by the Uniform Prudent Management of Institutional Funds Act (UPMIFA).
- Design a diversified investment strategy and spending policy that is sustainable to support the mission of that organization.
- Depending on the assets under management, the investment strategy should consider all asset classes including alternatives, active versus passive, environmental, social, and governance (ESG) investing, and possibly impact investing.
- A quarterly performance measurement system should monitor the objectives and spending policy versus various pre-established benchmarks within appropriate risk parameters.
- A collaborative or discretionary investment process should manage and communicate confidence in the management of these assets in the changing and volatile financial markets.

When this type of fiduciary best practices is applied, nonprofits have a much higher probability of meeting their investment and spending policy objectives.

***I&WM*:** Has the growth of the OCIO model changed the way that boards evaluate relationships? Do boards need or expect a more hands-on relationship?

Thayer: The development of the OCIO model, where the nonprofit gives discretionary management to an outside investment professional, is a logical progression in the active management of nonprofit funds. Larger funds with more than $1 billion in assets have formed their own internal investment offices for many years. Full-time management, timely decision-making, with a focus on risk management and performance, has delivered better results than traditional consulting models for many good reasons. The consultative nondiscretionary model exposes the investment process to the difficulties of behavioral finance, where less-experienced investment committee members will not approve investment options they do not understand. Making decisions on a quarterly basis where education plays a strong role in the approval of investment options is not an efficient methodology.

The key to a good OCIO model lies in the discretion given in the investment policy statement. Discretion does not mean the institution does not maintain control of the investment process. Good policy will outline the asset allocation, liquidity, and risk parameters for the discretionary manager. Within those parameters the investment manager then can efficiently execute the investment strategy to best meet the policy's objectives.

The OCIO model is more efficient, but it does not change the requirements for communication with the investment committee and the institution's board. The OCIO model places a little more focus on performance, yet all investment strategies have cyclicality to financial markets. During periods of difficult performance, communication is even more critical. Even with discretion it is best to keep the investment committee informed on all decisions made between quarterly meetings. I also would suggest that keeping a quarterly meeting schedule is critically important. Some committees may suggest annual or semi-annual meetings once they have approved a discretionary model. It has been our experience that quarterly meetings are necessary to support the communication needed to maintain a good client/consulting relationship. Keep in mind that discretion is only approved within the guidelines of investment policy. Keeping the institution informed on all decisions made within policy supports the investment process.

Managing an OCIO model with good communication and performance monitoring to objectives is more efficient and easier to manage for the investment consultant. With OCIO, the consultant is managing an efficient investment process and implementing investment options that are approved in policy without behavioral consideration by the investment committee. Because the consultant takes on contractual fiduciary status, the fee structure is usually higher than the traditional consultative model. This allows for great business efficiency and focus on investment management. In our opinion, the OCIO model is a more-advanced investment operating model delivering better results for the benefit of the nonprofit institution.

***I&WM*:** You've been passionate about educating our membership about the opportunities in the E&F market for many years, and you've been one of the driving forces behind the new Investments & Wealth Institute Endowments & Foundations Consulting course. Why is this such a tremendous opportunity for our membership?

Thayer: The need for prudent financial advice to foundations and endowments

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is dramatic. According to the 2017 study of the National Association of College and University Business Officers, there is more than $700 billion under management for more than 800 universities. There are at least 198 universities with assets of less than $50 million each, totaling more than $5.7 billion. Foundation Center statistics record another 86,700 non-university foundations supporting various missions with assets of more than $860 billion. Needless to say, the marketplace is substantial. These organizations support myriad missions that provide tremendous social services to our society. We are fortunate to have an economic system that provides a tax structure that allows for philanthropic contributions that support grassroots social missions.

I have always felt that education and communication are key to investment management. In the early days of my career, we suggested an educational topic for 15–20 minutes in our quarterly meetings. This allowed us to raise the bar on our committees' understanding of investment issues and also allowed us to educate on topics they might not be comfortable with before we introduced them as investment options. This was important to the introduction of alternatives, emerging markets, distressed debt, etc., to a committee that was not perhaps that sophisticated on these asset classes.

The investment process for nonprofits is quite different than for private wealth management. Driven by the requirements of UPMIFA and the need for detailed investment policy, education on these issues is critical for advisors interested in making a difference in this marketplace. My teaching CIMA certification and lecturing for the Investments & Wealth Institute and other organizations has had a profound effect on my career. I have been fortunate to have those opportunities and have learned tremendously from the experiences. Throughout my career and even today I find the nonprofit sector in tremendous need of better investment management, especially in the lower asset levels, under $50 million in assets under management (AUM). There are numerous nonprofits in this AUM class that do not have a good understanding of UPMIFA, investment policy, and prudent investment strategies to meet spending objectives. Most investment committees are filled with donors and nonprofit staff with little investment experience. In onboarding a new nonprofit institution, our regular policy is to interview each investment committee member as we are developing or updating the investment policy statement. On one occasion, I found that several donors on the committee were there to learn about investing. A well-organized investment committee is not a club but an opportunity for committee members to assist by using their knowledge and the knowledge of the consultant in managing the fund's assets.

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With advanced education, the advisor can truly make a difference in guiding and leading the fiduciary investment process. The new Endowments & Foundations Consulting course outlines the fiduciary process and the necessarily more advanced topics for the management of nonprofit funds. In developing the course, we wanted to make sure the materials were detailed enough to have direct practical application for advisors. Therefore, in additional to the educational materials, appendixes are provided for advisors to use in their management efforts. Example investment policy questionnaires, policy statements, asset allocation studies, performance monitoring examples, and risk management illustrations are provided for advisors. This is not a traditional educational certificate program in that many of the tools for managing nonprofits' funds are provided for the advisor to take back to their businesses and directly use in managing nonprofit funds.

***I&WM*:** Many of the largest E&Fs have their own investment teams (Yale, Harvard, etc.), and we've previously discussed the growth of the OCIO model. What are the best opportunities for our members (i.e., size and segment)?

Thayer: In the past, the OCIO model was only utilized by institutions with a billion or more in assets under management (AUM). This was the general AUM level necessary to support all the infrastructure required in managing an internal investment office. Larger university endowments found this attractive because the entire management office could work very closely with the university on the many spending and development issues of the institution. It was not until the investment management industry started to provide complete investment office services with discretion that the OCIO model started to be applied to smaller institutions. This outsourcing of all investment management functions under the guidance of investment policy on a discretionary basis made investment management much easier for smaller institutions. Today, consulting firms using OCIO discretionary models can be applied to nonprofit institutions with as little as $5 million in AUM. Models may vary considerably with size, liquidity, and policy objectives, but the OICO model can be applied to these models to very small institutions. The key to a successful OICO model is to have enough flexibility to meet the different needs and preferences of each institution. Inflexible models become just discretionary products applied by

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consulting firms as OCIO management. Keep in mind, discretionary management must be applied within the policy constraints of the institution.

The real "blue ocean" opportunity lies in the nonprofit sector where AUM is under $25 million. There are an infinite number of smaller nonprofits that need better investment advisory services. Experienced institutional advisors quickly raise their minimums above this level and therefore the competition is much less sophisticated. This is why the Endowments & Foundations Consulting course is such a benefit for advisors interested in learning the requirements for managing assets in this marketplace. Smaller institutions looking for more advanced investment management that do not have the capacity to build an investment office internally find the OCIO model very attractive.

For private wealth advisors looking to expand their business models, the nonprofit market provides a unique opportunity. Not only does it expand and diversify the advisor's business model, it increases the sophistication of the advisor's practice and helps differentiate the advisor in competition from other private wealth advisors. But there is one additional factor that is most important to me and that is all the wonderful nonprofit missions you can serve. There are many benefits in providing good investment advisory services to individuals in making a difference in their lives, but the expanded leverage in making a difference for the many nonprofit missions adds tremendous social benefit to our communities at large.

***I&WM*:** E&Fs will often ask for references. If members don't already have E&F experience, how can they get started?

Thayer: The best way to get started is to take the Endowments & Foundations Consulting course. Once completed, start small with perhaps opportunities under $10 million in AUM. Introduction to this market can come from your private wealth clients that donate and/or serve on the boards of these institutions. Market the fact that you have taken the course to your clients and community. Donate your time to join the investment committee of a local nonprofit institution—not for the purpose of becoming the advisor, but to get exposure to the investment process and all the dynamics that are involved in management by investment committee. Getting started involves building your nonprofit management resume. It will be easier to start with a consultative approach versus an OCIO model if you do not have an experienced OCIO track record. In addition, the consultative model provides you an opportunity to gain experience in all the behavioral issues that come with committee decision-making. Even with an OCIO model these experiences are extremely valuable to the advisor.

Another approach can be to find an experienced nonprofit consulting team to work with. Develop the opportunity prospecting your clients' nonprofit contacts and then refer that opportunity to an experienced team. Working with an experienced team will fast-track your learning opportunity.

Once you have a few smaller nonprofits under management you can begin moving up to larger AUM opportunities. Larger AUM is not necessarily better. The management issues are the same, but larger AUM does allow for greater diversification and the addition of illiquidity for asset classes that are not publicly traded. Most nonprofits want investment returns that meet their spending policies with stability and lower volatility. Alternative asset classes found through good due diligence can assist in accomplishing this goal.

Acquiring business in this market sector will take time. Be patient and blend the opportunities into your already established business model and the result will come.

I&WM: Thank you, Scott. Can you tell us a little more about the Endowments & Foundations Consulting program?

Thayer: Yes. The Investments & Wealth Institute recently created this new certificate program to teach advisors about investment management specifically for foundations and endowments. The program has been developed to educate and train advisors in all aspects of this market at an advanced level—it encourages but does not require CIMA and or CPWA certification. I personally encourage all advisors with an interest in expanding their businesses and differentiating their advisory services to look at this marketplace, because there is considerable personal satisfaction achieved in contributing to these important social missions.

The Institute's Endowments & Foundations Consulting course is segmented into seven learning modules, each of which includes readings, lectures, case studies, sample documents, and supplemental videos.

- Module 1: Fundamentals of Nonprofit Organizations
- Module 2: The Investment Policy Statement for Endowments and Foundations
- Module 3: Portfolio Construction for Endowments and Foundations
- Module 4: SRI, ESG, and Impact Investing for Endowments and Foundations
- Module 5: Performance Monitoring for Endowments and Foundations
- Module 6: Outsourcing and Discretionary Management
- Module 7: Serving Endowment and Foundation Clients

For a more information, visit www.investmentsandwealth.org/EFC, Contact Scott Thayer at sgthayer52@gmail.com.

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