BANK OF AMERICA

OCIO 2.0: Strategic investment outsourcing for nonprofit organizations

By moving to an outsourced chief investment office ("OCIO") relationship incorporating a true fiduciary standard, boards are striving to ensure that their organizations' investment portfolios are being managed according to the guidelines and goals they've set, while freeing time in the governance budget to use their fiduciary duty at a higher level.

Navigating the new reality

In the current volatile investment environment, nonprofit boards of directors, investment committees and staff face substantial and continuing challenges in carrying out their fiduciary obligations with respect to their organizations' long-term investment pools. Common issues include:

- Increasingly complex and stringent legislation and reporting requirements
- Higher expected standards in fiduciary management requiring new types of transparency
- A greater level of scrutiny from regulators, donors, beneficiaries and stakeholders
- The push to optimize the use of scarce financial and human resources

This difficult environment has been exacerbated by:

- The persistence of financial market conditions that have been characterized by exceptional macroeconomic policies affecting interest rates and the supply of money
- Higher levels of portfolio complexity driven, in part, by the desire to achieve prudent diversification
- Increasing financial demands in response to societal stresses and higher mission-related costs and needs

Most nonprofit boards or investment committees meet four or five times a year. While in the past this quarterly cadence may have been adequate to fulfill their responsibilities, the current environment, which frequently features sudden and large market moves in both positive and negative directions, renders this schedule, with its limited "governance budget" of time available to devote to investment matters, inadequate.

Optimal long-term investment performance requires that some individual or group be responsible for overseeing the portfolio on a daily basis. It also requires, for many organizations, greater specialization, accountability and clarity in roles to help limit the risks to the organization and its fiduciaries. To achieve this

Investment products:

Are Not FDIC Insured	Are Not Bank Guaranteed	May Lose Value

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result, nonprofit boards are revisiting the structure of their existing investment processes and investment manager relationships. By moving beyond a traditional consultant-led advisory structure, with its lack of fiduciary accountability, to a stronger and more intimate outsourced chief investment office ("OCIO") relationship incorporating a true fiduciary standard, boards are striving to ensure that their organizations' investment portfolios are being managed according to the guidelines and goals they've set, while freeing time in the governance budget to use their fiduciary duty at a higher level.

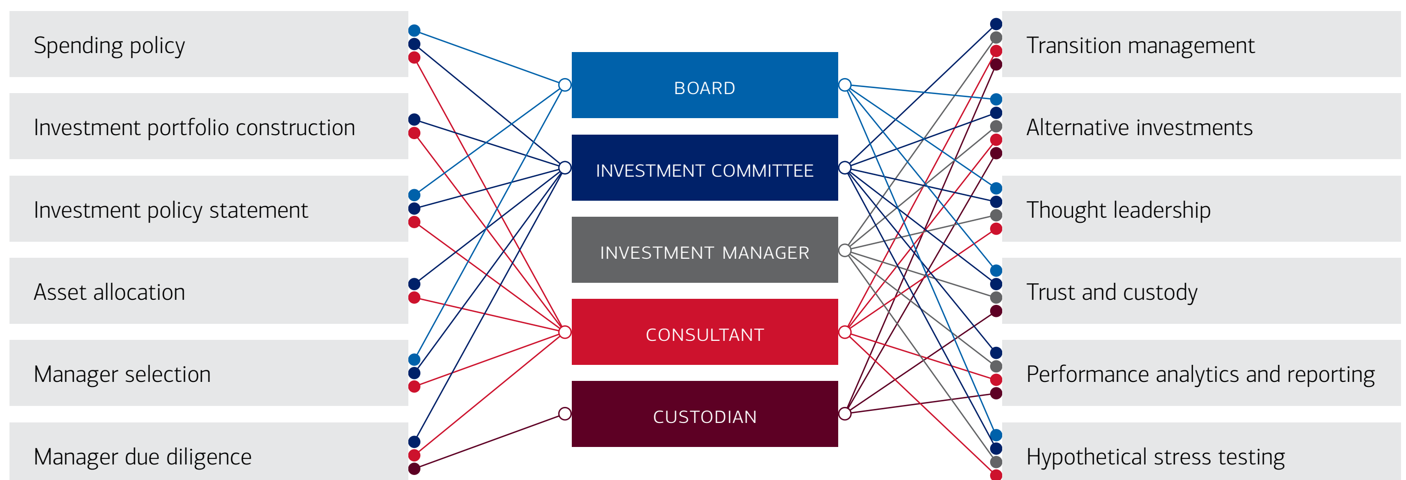
Such a structure can enable boards to focus on providing the strategic leadership, guidance and oversight that their organizations require. While outsourcing the investment function doesn't relieve the board of its fiduciary obligations — the responsibility for the hiring and oversight of the advisor remains with them — it provides them with a "co-fiduciary" with whom they can work and who can manage the investment process within guidelines set by the board.

The case for outsourcing

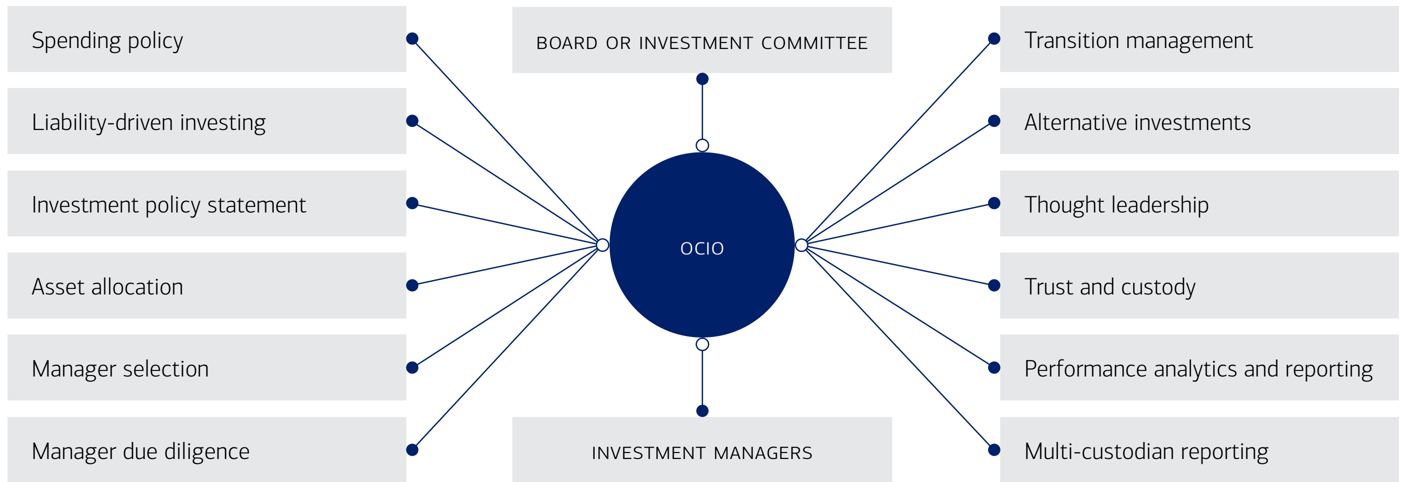
As a volunteer body meeting only a few times a year, a nonprofit board or investment committee should, in principle, seek to optimize its governance budget by identifying those key tasks that constitute its highest and best use. The degree of specialization required for prudent and effective management of complex investment portfolios, however, goes beyond the resources and expertise of most organizations. To take one example, an adequate due diligence function requires evaluation of both the investment process of a manager and its various back-office operations, such as trading, accounting and reporting, with periodic subsequent on-site visits also required — tasks that few nonprofits can undertake on their own. The existence of these risks, and the realization that their governance budget is inadequate to managing them prudently, is among the factors motivating boards to outsource these responsibilities and to share with an OCIO the fiduciary responsibility of managing the investment portfolio.

For these reasons, among others, the OCIO model is being adopted by an increasing number of nonprofit organizations. In the higher education sector, for example, the *2022 NACUBO-TIAA Study of Endowments* states that 46% of participating colleges and universities reported using an OCIO, up significantly from 34% in fiscal year 2010, the earliest year for which data are available. Endowments with assets below $500 million were most likely to use an OCIO, but even among larger endowments, the practice is not unknown.[1]

As the chart below illustrates, in the absence of an OCIO structure, investment management responsibilities can frequently overlap between the board or investment committee and a variety of service providers.



The OCIO approach streamlines this structure and improves risk management by coordinating all investment-related aspects in a single resource.



Roles and responsibilities of an OCIO

As of 2021, nonprofit organizations representing $674 billion[2] of institutional assets had adopted the OCIO model, with significant growth projected over the next five years.[3] The OCIO industry is widely diversified, with providers ranging from large global financial services firms to small boutiques with a handful of staff. The OCIO model itself is further characterized by a high degree of customization, with respect to both the type of assets being managed and the degree of discretion being granted. For some nonprofit organizations, the OCIO may only oversee investments, such as less-liquid alternatives, that are thought by the board or investment committee to be too complex to be adequately overseen by the staff. For other organizations, the OCIO's mandate may extend to the entire range of assets in which the portfolio is invested.

Similarly, the degree of investment discretion granted to the OCIO may vary from organization to organization. For example, some nonprofits may allow their OCIO to hire and dismiss managers for listed liquid stocks and bonds but retain hiring and firing authority for other, less liquid strategies, requiring the OCIO to request specific approval for those managers. At the other end of the spectrum, some organizations may grant their OCIO full discretion to hire and dismiss managers within the entire range of permitted asset classes and strategies set forth in the organization's investment policy statement, or may even allow the OCIO to make changes to the target portfolio based upon return goals and risk constraints that have been agreed to in advance. It's not uncommon for the OCIO relationship to evolve over time, beginning with a more restrictive approach and gradually moving to a structure under which the nonprofit grants more discretion to the OCIO, as the board and investment committee become more comfortable with the OCIO and its team.

In the *2022 NACUBO-TIAA Study of Endowments*, the following activities are described as typical of an OCIO:[4]

- Investment policy statement development
- Strategic asset allocation
- Tactical asset allocation
- Manager research and selection
- Implementation and trade execution
- Rebalancing
- Performance reporting and reviews

These services, however, are only the core of the OCIO offering.

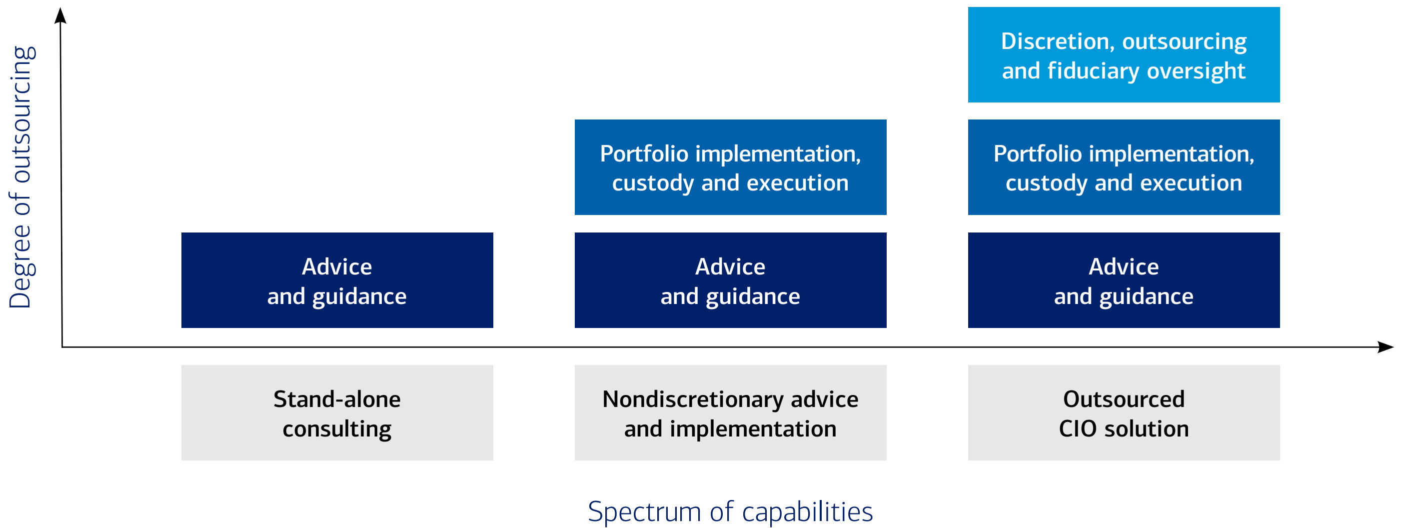
As the model's popularity has grown, nonprofits are demanding more from their service providers, seeking a holistic strategic partner with the additional resources to help them solve challenges or assist with broader business model or risk management issues. Some leading providers, including Bank of America, have added further elements to create an "OCIO 2.0" offering that includes many services for which nonprofits would otherwise have to retain and pay outside providers. In an OCIO 2.0 relationship, the investment provider becomes an integrated partner that functions as an extension of the nonprofit's board and staff, assisting and providing guidance with issues such as:

- Strategic planning
- Finance and budgeting
- Governance and risk policies (e.g., conflict of interest and gift acceptance)
- Board training, self-evaluation and strategic mission-related consulting
- Facilitation of board retreats and trainings
- Leadership development and succession for board and staff
- Fundraising (e.g., transformational gifts and planned giving)
- Alternative revenue streams

This high degree of strategic and operational integration leads to a collaboration rather than a traditional "outsourced" approach between the OCIO and its client, giving the nonprofit access to resources outside the traditional range of investment portfolio management. Further examples of ways in which a successful OCIO 2.0 relationship can help an organization include addressing business model issues, strengthening operational management and improving strategic planning, potentially enabling the organization to relieve some of the pressure on its investment portfolio.

The importance of a fiduciary relationship

Not all providers are positioned to be able to provide a genuine OCIO 2.0 fiduciary service. For this reason, when choosing an investment provider, it's important to distinguish among the types of firms that exist in the industry. Investment management relationships can essentially be grouped into two categories: advisory and discretionary. The differences between these two types are set forth in the table below.



Advisory relationships are characterized by the basic service of making investment recommendations. These recommendations may include such items as strategic asset allocation, tactical asset allocation, manager selection and the oversight of the recommended managers once they're hired by the organization. Discretionary relationships, on the other hand, are characterized, as we've noted above, by an acceptance by the OCIO of a delegation of responsibility to make investment decisions as a fiduciary on behalf of the nonprofit.

Furthermore, even among those firms with discretionary authority, the term "fiduciary" can be used in multiple ways. OCIO providers frequently refer to themselves as "fiduciaries," but in reality, the fiduciary standard, while it's the foundation of a consistent, disciplined investment process, is much more than simply a standard of investing. In industry promotional materials, the term "fiduciary" is widely (and incorrectly) used to describe the role of any broker-dealer or investment advisor; it's essential to understand, however, that there are three distinct standards of care that are applied by government regulators, depending upon the type of investment firm being used.

A **broker-dealer** need only determine that an investment recommendation for an institutional investor is "suitable" for the investor at the time it's made. For an **investment advisor**, there's an additional requirement that the investment remain "suitable" for the institution and its portfolio on an ongoing basis. The third and most relevant category for our discussion, the **trust fiduciary**, is held to a much higher standard, which states that it must manage the investment portfolio prudently on an ongoing basis consistent with the purposes, terms and other circumstances of the fund and the nonprofit organization. Bank of America, as a trust fiduciary held to this high standard, fits this last definition.

Bank of America as an OCIO

Bank of America is a leading provider of OCIO 2.0 services, with over $70 billion in discretionary OCIO assets for nonprofits and more than $49 billion in additional philanthropic assets.[5] Our services include not only a dedicated specialist team of client managers and investment advisors providing portfolio implementation and monitoring, but also an experienced consulting group with broad and deep strategic knowledge to advise nonprofits over a range of topics, including board governance and fundraising. Our OCIO 2.0 approach is, we believe, distinctly different, offering a level of specificity, breadth and reliability designed to reflect holistically a nonprofit's needs and priorities.

Our services are delivered through Bank of America Private Bank, one of the oldest and largest managers of philanthropic assets in the United States. With locally based offices situated throughout the country, we provide nonprofit clients with a team that works to understand an organization's needs and that can serve it with care and integrity. At the same time, we bring to our work the size, scale and strength of Bank of America, conferring manager access, top-ranked research and technical expertise that we believe set us apart.

Conclusion

As nonprofit boards and investment committees struggle to advance their organizations' missions in an increasingly volatile and demanding environment, the use of OCIOs has continued to grow. The trust fiduciary standard, the strictest in the industry, holds providers who meet it to a high degree of responsibility. Those providers who, like Bank of America, are able to supplement their investment offerings with strategic consulting and administrative support, are leading the development of a new "OCIO 2.0" level of service to nonprofits, their boards and their stakeholders.

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[1] *2022 NACUBO-TIAA Study of Endowments*, National Association of College and University Business Officers, 2023, p. 74.

[2] *U.S. Outsourced Chief Investment Officer Function 2022: Industry Efforts for Standardization Kick Into High Gear*, Cerulli Associates, 2022, p. 38.

[3] See note 2, above.

[4] *2022 NACUBO-TIAA Study of Endowments*, National Association of College and University Business Officers, 2023, p. 75.

[5] Source: As of December 31, 2022, Bank of America's Global Wealth and Investment Management (GWIM) group had approximately $70.3 billion in client assets for institutional nonprofit clients and $49.5 billion in additional philanthropic client assets. Client assets consist of the following assets of philanthropic clients held in their GWIM accounts: assets under management (AUM) of GWIM entities, client brokerage assets, assets in custody of GWIM entities, deposits of GWIM clients held at Bank of America, N.A., and affiliated banks and assets in custody included in AUM.

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