WORTH KNOWING

THE GOVERNANCE BUDGET: ALLOCATING INSTITUTIONAL RESOURCES EFFECTIVELY

U.S. Trust Philanthropic Solutions

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By asking the right questions and breaking down governance responsibilities into quantifiable metrics, fiduciaries can design a governance budget, opening opportunities to assess the governance structure's strengths and challenges.

Nonprofit institutions throughout the United States are intimately familiar with the process of creating a fiscal operating budget. Whatever their mission or focus, institutions rely on the budgeting process to ensure long-term fiscal viability. Some apply paradigms beyond dollars and cents; for example, an investment committee may approach investment allocations by limiting asset class or sector exposure through risk budgeting. Budgeting frameworks can also be applied to evaluation and planning with respect to human resources, in order to optimize organizational design. Budgets are innately appealing because they lend clarity, promote accountability, and can heighten organizational effectiveness. In a world of limited resources, it pays to be thoughtful about where and how critical resources are allocated.

I. ASKING THE RIGHT QUESTIONS

While governance may at first glance appear to be more qualitative than quantitative, three broad governance categories lend themselves to quantification:

Talent and Expertise

- How many potential, qualified, and strong candidates are available to chair the investment committee?
- What risks, limitations, or obstacles do term limits create in ensuring consistent leadership and direction for the committee?
- How many individuals are dedicated to investment governance controls and insight — full-time, part-time, external, and internal?
- How much is invested in internal and external governance resources, such as internal or retained counsel?
- What amount of time is spent developing internal talent?

See last page for important information.

Risk and Oversight

- How many hours do committee members have to spend on the institution's portfolio each week, month, or quarter?
- How many times must committee discussion and debate occur in order to make decisions regarding investment matters?
- How much time does the committee have to evaluate and discuss economic scenarios, sector-related risks, and market trends that could affect the portfolio?

Leadership

- How much time and attention does the committee spend on developing and evaluating strategic goals and objectives for the investment pool?
- How frequently are the Investment Policy Statement and Spending Policy reviewed to ensure that they are aligned with the organization's overall strategy?

By asking these questions and breaking down the investment committee's governance responsibilities into quantifiable metrics, committee members can design a governance budget. Such a budget opens opportunities to assess the governance structure's strengths and challenges, and provides key metrics for consideration.

For the investment committee, creation of a governance budget constitutes a rigorous thought exercise rather than an exact science. The process should allow the committee to gauge its ability to address its highest and best use of time, talent, leadership, long-term strategic initiatives, and fiscal priorities. It can create clarity, promote accountability, and heighten effectiveness, thereby helping the committee to deploy its knowledge, expertise, and oversight in the most efficient way possible.

II. APPLYING ANSWERS

When the investment committee assesses its governance structure, the initial report may be positive. The committee members may feel that they benefit from the bright minds, astute investment skills and professional approach of their colleagues, acting as a cohesive group to oversee investment policy, asset allocation, and investment selection. They may observe that roles and responsibilities are clear, returns are in line with expectations, communication is consistent, and harmony generally prevails.

A high-functioning board and investment committee are positive accomplishments; yet some probing questions can yield useful answers:

- **Have things always been this way?**
- **Would a historian of our institution come to the same conclusion?**
- **Can we ensure that the harmony, effectiveness, and synergy will continue?**

Most institutions, when pressed, can remember a time when things were not so favorable—when the investment committee's interactions were strained or guidance and decisions seemed out of synch with market conditions. Perhaps there were times when the committee relied on discrete pockets of expertise, but lacked a holistic and nimble approach to the capital markets. Oftentimes, even with the smartest minds devoted to the task, it is difficult to make timely and effective decisions on a consistent basis.

In other situations, the institution may be confident about its current board and committee structure and function, but may anticipate difficulties ahead due to projected leadership turnover. Or it may report general satisfaction with governance, but believe it must "ride out" some of the current volatility in the markets. In yet other cases, the institution may feel that the board and committee both furnish valuable investment guidance and crave more of it. Limited to quarterly meetings, board leadership can be constrained by timing and frequency.

Each of these scenarios can benefit from a governance budget. As a quantitative evaluation of talent, expertise, risk, oversight, and leadership, a governance budget offers a clear snapshot to help the committee determine if its goals and objectives are attainable. Like a manager of a high-performing sports team, a committee can ask if its members are individually contributing in a way that optimizes their talents, considering questions such as:

- Are the members working as a team?
- Are they focused on the strategic priorities and goals of the institution?
- Are they optimizing the talent and expertise on the committee to reach return and spending goals to advance the mission and fulfill strategic priorities?

Given limited time and resources, a committee can only benefit from a directed and thoughtful analysis of resources relative to goals.

Investment committees may struggle with investment oversight due to limited committee and institutional resources. Investment outsourcing can help to optimize resources from a budgetary standpoint and can alleviate pressures felt by staff and board.

FIVE QUESTIONS TO ASK ABOUT YOUR INSTITUTION'S GOVERNANCE BUDGET

1. As it is currently structured, can your investment committee deliver the holistic and timely investment guidance that your institution needs?
2. How frequently does your investment committee meet? Is it adequate relative to your investment needs?
3. What are the gaps in the expertise of your investment committee?
4. How nimble is the committee in making effective and efficient decisions?
5. How much time is being spent thinking strategically about the organizations investment goals and objectives versus tactical day-to-day decisions?

III. GOVERNANCE AND INSTITUTIONAL EFFECTIVENESS

There is no one correct solution or structure when it comes to governance; every organization is unique and has distinct priorities, culture, and mission. The good news is that governance structures are inherently customizable, resulting in a spectrum of options.

Customization is particularly relevant to an investment committee's defined fiduciary role and oversight activities. In the past, an organization or its investment committee would typically have used one of three models in structuring its investment process:

- Making investment decisions in-house using a combination of committee and staff resources;
- Engaging a consultant to advise on investment selections in a non-fiduciary capacity; or
- Delegating investment decisions to a fiduciary partner or manager that acted in a discretionary capacity — a role now commonly referred to as an Outsourced Chief Investment Office (OCIO).

In recent years, nonprofit institutions have faced significant challenges: changes to laws and regulations, cuts in government funding, increased demand for services, and difficulties in maintaining the purchasing power of their investment pool. As a result of these headwinds, institutions are becoming more concerned with the likelihood of achieving their strategic goals.

In response to this new reality, institutions overall and investment committee leadership specifically are becoming more dynamic in tailoring their investment governance budgets for maximum effectiveness. Governance structures are evolving to meet the challenges, spurred in part by the complexity of the investment markets, the need for protection from losses in volatile environments, the risk management challenges of complex portfolios, and the finite nature of institutional resources.

IV. OUTSOURCING ALTERNATIVE

Use of outsourcing has increased among institutions in recent years due to the flexibility the structure affords. Under this approach, the investment committee retains control of key investment parameters and decisions, but delegates tactical allocations and day-to-day operations to a fiduciary partner. By so doing, the committee members can use their time to focus on strategic initiatives or specific challenges within the investment strategy.

The investment committee can also work collaboratively with the OCIO to pursue investment opportunities in keeping with the institution's Investment Policy Statement while capitalizing on advantages that the OCIO can offer. This model enables a balanced investment governance budget within which the board or committee members are able to focus on strategic direction, framework, and goals, while benefiting from the OCIO's exhaustive research, ongoing monitoring and oversight, access to investment opportunities, and economies of scale. Many institutions begin with a phased approach, in which the OCIO is allowed greater discretion as the institution becomes more accustomed to working with a fiduciary partner who serves as an extension of its staff and committee members.

Some committees are wary of the OCIO model, concerned that they will surrender too much control. However, these fears are often ungrounded. In the same way that every institution is unique, the OCIO model can be customized to each organization's and committee's specific objectives and needs. Instead of being relegated to the back seat, the board and investment committee can work side by side with the OCIO partner on investment decisions, influencing ongoing asset allocation and maintaining fiduciary oversight of investment selection and risk assessment.

The OCIO model can enhance mission fulfilment in three main ways:

- **Timeliness:** Rather than rely on a decision-making process that is quarterly or monthly, OCIO staff can undertake continuous monitoring of investment opportunities, risk, and performance. This real-time analysis can facilitate a more timely tactical decision making process in the fast-moving investment world.
- **Expansiveness:** While investment committee members often bring deep understanding of a particular investment sector, market, or niche, they may not have the broad-based expertise to navigate varied market environments. Typically, an OCIO draws upon more plentiful resources, achieving economies of scale.
- **Vision:** Investment committee members are intimately acquainted with the unique mission and challenges of their institution. This familiarity makes them the ideal stewards to tackle long-term issues that can have an inordinate impact on an institution's longevity, stability, and mission. By expanding their focus beyond investment management, an investment committee can address an institution's needs more holistically and strategically, extending their mandate to include thematic investing, fundraising, sustainability, competitive differentiation, long-term planning, and institutional risk.

V. CONCLUSION

Institutions will benefit from drawing up their own governance budgets and assessing how they are positioned to achieve their goals relative to their current governance structures. Good governance requires an extensive commitment of time and resources—a daunting proposition for most organizations. By candidly evaluating the gap between their idealized future and their current reality, committees can become better able to quantify the readiness of their organization to face challenges in a changing investment environment.

Reallocating an institution's governance budget can unleash a ripple effect on multiple areas of organizational effectiveness.

FROM THIS...	TO THIS...
Intermittent attention	Continuous monitoring
Market reactive	Market anticipatory
Investment driven	Holistic framework for growth
Pockets of expertise	Rounded perspective
Short- and medium-term vision	Long-term vision