INVESTMENT GOVERNANCE MODELS FOR CHARITIES:

WHAT WORKS BEST FOR YOUR ORGANIZATION

I'm a huge fan of our wonderful charitable sector. That's no secret. Charities always try to do the right thing and most of the time, they succeed. Where would our civil society be without our charities – our food banks and shelters; our hospitals, colleges and universities? Big charities and small charities, each one contributing to the fabric of our wonderful country.

But when it comes to the fiduciary oversight of their assets, especially their investments, I'm quite sure that charities could be doing a better job.

When charities don't give their investments the attention they deserve, it's a very big deal. First, those that have a fiduciary responsibility to the charity (i.e., its Board of Directors) must ensure that they are acting in the best interests of the organization. Without proper attention, these individuals could be exposing the charities to unnecessary risk.

Second, if investments are not getting appropriate attention, the overall performance of the portfolio may suffer. An inappropriate asset mix or a consistently underperforming investment manager invariably means that the charity is leaving money on the table, money that will ultimately be used to support the mission of the organization. Everyone knows how challenging it is to raise money from donors. Every investment dollar left on the table is another dollar that the organization may need to raise through other sources of funding.

There are essentially three fundamentally different structures that charities use to manage their investments:

1. DO-IT-YOURSELF
2. VOLUNTEER
3. PROFESSIONAL

Each structure presents inherent advantages and disadvantages. Each comes with a fundamentally different approach. But at the end of the day, I would suggest one should resolve this issue by asking myself the following simple question. IF I WERE A MEMBER OF A CHARITY'S BOARD OF DIRECTORS, WHICH STRUCTURE WOULD PROVIDE WITH THE PEACE OF MIND OF KNOWING THAT I HAD FULFILLED MY FIDUCIARY DUTIES?

DO-IT-YOURSELF

There are really two types of charities that typically follow the Do-It-Yourself Investment models. The first type of charity is one with a very small investment portfolio, likely $100,000 or less. In this case, given the size of the portfolio, many charities will simply deposit these funds into a conservative investment vehicle such as a Money Market Fund, T-bill or a conservative, balanced Mutual Fund. Frankly, as long as the investment isn't overly aggressive, there isn't much risk associated with this approach.

The second-type of charity is at the other end of the spectrum. Charities with very large investment pools (typically of $500 million or more in investable assets) can hire staff (like a Chief Investment Officer) to provide internal oversight, management and reporting. While the fiduciary responsibility still lies with the Board, the staff team is involved in manager selection, monitoring, reporting, asset mix and other factors.

THE VOLUNTEER MODEL

The volunteer model is probably the most widely used by charities in Canada. In this structure, an Investment Committee (which is sometimes part of a broader Finance or Audit Committee) is often comprised of industry "experts" and is involved in the oversight process. This Committee, which typically reports to the Board of Directors, meets several times per year (four seems to be the typical number) to discuss the charity's investments.

The organization's Chief Financial Officer (aka Finance Director, etc.) will typically sit on this Committee. During each meeting, the Committee often reviews the performance from the previous quarter and makes decisions for the next. This Committee is usually involved in the process of selecting the firm's investment managers.

THE PROFESSIONAL MODEL

In this model, the charity employs an Investment Consultant/Outsourced CIO (OCIO) to manage the entire investment process. The role of the OCIO is to assist the Investment Committee in setting the strategic direction for the charity's investments with the goal of managing fiduciary risk.

The OCIO guides the selection of managers and the ongoing evaluation. It also provides consolidated reporting, lessening the burden on organizational staff. The OCIO doesn't replace the Investment Committee. Rather, its role is to ensure the Committee focuses on strategic issues that are critical to directing the future of the organization's investments.

So which model – DO-IT-YOURSELF, VOLUNTEER, OR PROFESSIONAL represents the best choice? Part of the answer of is a reflection of the size of the organization's investment pool and the time commitment of the organization's volunteers (namely, the Investment Committee).

Very Small Investment Pools (<$100,000)

Given the limited risk exposure (due to the small amounts), I would suggest that a highly simplified DO-IT-YOURSELF investment structure might be the most prudent option. Depending on the objectives, placing the capital into a short-term vehicle (T-bills; money market fund) or a simplified balanced investment fund.

You aren’t likely to find inexpensive management at this level. Alternatively, pooling your investments with other charities (perhaps with the local community foundation if it offers this service) can be a terrific option.

Small Investment Pools ($100,000 to $10,000,000)

For the smaller investment pools, a VOLUNTEER structure can work well. At this level, the economies of scale likely don’t warrant professional support. The Investment Committee can provide appropriate oversight with the support of staff.

Very Large Investment Pools (at least $250,000,000 and above)

Again, a version of the DO-IT-YOURSELF structure works well here, albeit with a very different kind of structure. At this size, the charity may very well want to consider hiring its own Chief Investment Officer. This staff member would provide internal oversight, consolidated reporting and a deep knowledge about the investment sector and risk management.

They still may wish to bring in an OCIO firm to support some aspects of their work (portfolio analytics, reporting, peer group analysis) but most of the work is done in house.

Mid-to-Large Investment Pools ($10,000,000 to $250,000,000)

At this level, the attention to risk is critical and very real. Selecting a weak manager or an inappropriate asset mix could result in big dollars being left on the table. While a charity’s Investment Committee can still play a critical role, the traditional model of quarterly meetings just isn’t enough to provide the level of oversight that a charity at this level requires.

For portfolios in this broad range, incorporating Professional oversight into an organization’s investment management process seems to be the best of both words. Professional oversight doesn’t replace the experienced and dedicated Investment Committee; rather it allows the Committee to focus its energy on strategic issues such as new asset classes or asset mix decisions.

Investment Consulting firms that provide Professional oversight should pay attention to the entire fiduciary process – investment strategy, asset mix, manager selection, reporting, and ongoing oversight. Firms that understand the unique needs of charities can help the charity through all stages of investment management, focusing the Investment Committee on strategic decisions and freeing up staff time to deal with other operational issues.

So there you have it. Charities need to focus on delivering their important programs and services to their constituents. By employing the right investment oversight, charities can stay laser focus on what matters most – the fulfillment of their respective missions.