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OCIOs Bet on ESG Know-How to Win Over Nonprofits

As more nonprofits look at outsourcing their investment programs, those that can help provide access to ESG products may have a leg up, according to a recent Cerulli Associates report.

By Justin Mitchell

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Environmental, social and governance expertise is increasingly becoming a trump card for outsourced chief investment officers, or OCIOs, looking to gain traction with nonprofits in a crowded marketplace.
Nonprofit institutional investors, such as foundations and endowments, are seeking OCIO services at a "higher-than-historical rate," according to a recent report from **Cerulli Associates**. The demand for ESG, as well as a desire to diversify portfolios, has led to explosive growth projections in the space, and fierce competition as OCIOs duke it out to win clients.

Endowments and foundations are more likely to care about ESG than other kinds of investors, said Cerulli Associate Director **Laura Levesque**, and one of the reasons they are hiring OCIOs is to get help in that department.

"From that perspective, having a really strong ESG philosophy as an OCIO provider, and a really good understanding and communication of what the investment philosophy is in the underlying portfolios they use is going to draw out a much better response from the asset owner," she said.

Callan is seeing heightened interest in ESG from foundations and endowments, with many emphasizing the diversity, equity and inclusion element of these factors, said Senior Vice President **Kevin Joy** during a recent webinar with **Chestnut Advisory Group**.

"We are seeing it typically in the non-discretionary areas, more specifically, but it is starting to be talked about in some of our delegated relationships as well, and those specifically tend to be in the nonprofit space," he said.

When looking to attract new clients, it is necessary for OCIOs to have ESG capabilities, even if the prospective investor just wants to talk about it, said **Steven Sandler**, a senior managing director at **Acansa Investment Management Group**, an OCIO that serves mostly endowments.

“I suspect any group that doesn’t have a strong facility with ESG is going to be at a disadvantage, regardless of whether a client has an ESG directive,” he said in an email. “There hasn’t been a single endowment or foundation we have talked to in the past two years that didn’t have ESG somewhere at the top of their list of subjects for conversation.”

Still, even though ESG is a frequent topic of discussion in the nonprofit space, there are plenty of endowments and foundations that do not have a special focus on ESG, said **Anna Dunn Tabke**, a principal at **Alpha Capital Management**, an OCIO search consultant.

“We don’t see a ton of nonprofits who are specifically selecting on this,” she said. “It's something that people talk about a lot more than they actually decide [on] an OCIO on.”

Once a nonprofit decides to create an actual ESG program by putting these considerations into their investment policy statements and start building a portfolio, it is “absolutely crucial” for an OCIO to help an investment committee, Tabke said.

Even if an OCIO has the expertise, it might be hard to “scale” ESG programs for nonprofits because the model calls for tailoring portfolios to each client’s specific vision for their ESG program, Tabke said.

“The challenge they have to think about is … can you really come up with a solution that services all or even a majority of those visions without compromising?” she said.

The way to circumvent capacity issues like that is for OCIO firms to avoid creating or investing in commingled products, which assume “one size fits all,” Sandler said.

“There are dozens of ESG factors that we use to evaluate an investment, and how one chooses to prioritize those depends on the investor’s institutional values,” he wrote.

One major area of interest for endowments and foundations is private investments, the Cerulli report noted, so OCIO platforms with “strong ESG positioning” in their private markets program might have an advantage. According to the study, 79% of OCIOs anticipated their clients would add more private equity and 69% thought that for other private assets.

Still, most ESG capacity is focused on public equities as opposed to private markets, said **Phil Edwards**, a principal at search consultant **Curcio Webb**. Therefore, Edwards said he would not recommend using ESG as criteria to select an OCIO provider for private markets investing just yet.

“The primary reason for investing in private assets for a lot of foundations and endowments is the higher potential return,” he said. “I think [OCIOs] would need to demonstrate that by conditioning these investments on some sort of [ESG] factor, that it doesn’t hamper the ability to achieve those returns.”

Overall, investors are embracing ESG as an important part of the industry, while many OCIO firms are still viewing it as a “necessary evil,” said **Frank Szymanek**, a senior consultant with search consultant **North Pier**. That is an opportunity in itself, he said.

“The better firms will really embrace [ESG], make it part of their service offering, and be able to distinguish themselves based on that,” said Szymanek.