The Skorina Letter

News, Interviews, Research for Institutional and Family Office Investors

• Retained Executive Search •

We recruit chief investment officers and senior asset managers for endowments, foundations, family offices and institutional investment firms

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The Harvard endowment: a never-ending story

The Harvard Management Company has severely chopped its staff since N.P. "Narv" Narvekar arrived in December 2016: from 230 to 130 FTEs. And, with so many ex-employees on the loose, it's now possible to piece together a clearer picture of how the Harvard endowment lost its mojo and how it's trying to get it back.

Benchmarks, mark-to-market, and Potemkin villages

Before current management terminated the old compensation structure, the huge salary packages at HMC stumped us. Every time we compiled our CIO compensation studies, we wondered how those paychecks could be so large when performance was so mediocre.

Some fault poor communication, siloed investment teams, and misaligned incentives, but we hear there were other issues – questionable benchmarks and bonuses paid "off-the-mark."

Here's how it worked.

Most of HMC's assets such as listed equities, fixed income and hedge funds, relied on public market prices. And the private equity and venture capital portfolios were invested with outside managers who were responsible for valuing the assets.

But the natural resources portfolio was owned directly by HMC and valuations relied on third party appraisers hired by the staff who, in turn, controlled the process.

There were performance benchmarks, of course. But staff set the benchmarks and beating those benchmarks depended upon valuations and valuations depended on a process controlled by the staff. In other words, the carry was paid off of unrealized marks on illiquid holdings and superior performance was all but guaranteed.

Even better, there was no easy way to argue against those benchmarks and valuations. As Matthew Klein wrote in the Financial Times about "private equity's mark-to-make-believe problem,"

If it's challenging to figure out what a thing is "worth" when some of the smartest people on the planet, armed with the fastest computers and the biggest datasets, are constantly discussing and betting on its value, it's downright impossible for investment managers focused on illiquid assets to assess the value of anything they own until they exit their positions by selling to someone else.

Not surprisingly, there was great enthusiasm for these investments within the endowment.

As one source put it to me recently, in Las Vegas, the house wins, but at HMC, the players made the rules.

Fun with FASB

Non-profits must show their investments at “fair value” per FASB 124 on their audited financial statements. That’s straightforward for publicly-traded securities. But things get cloudier for illiquid alternative assets with no quoted prices: so-called “level 3” items. And, it gets cloudiest of all for assets not in the hands of independent third-party managers.

Absent quoted prices the reporting entity must have some reasonable process for establishing those values and for adjusting them up or down from period to period. If they pass that sniff test, and management has signed off on the process, then the external auditors will probably not second-guess them.

We don’t doubt that HMC had a rational-looking basis for the numbers they printed; but when the process can be influenced by insiders, and those insiders could be said to have a monetary interest in the reported values, there is room for skepticism. We think the bare fact that there have recently been very significant write-downs under the new management and changes in the way compensation is paid should speak for itself.

Small boards and stretched responsibilities

Until July of 2011, the Harvard corporation board had seven members, the HMC board had eleven, and only a few of these board members sat on each other’s committees. This meant that communication between HMC and the school was stretched during one of the most challenging times in the school’s (and endowment’s) history.

Today, the Harvard corporation board is still small, with 13 members, and the HMC board is smaller, only 11 members. But they’re moving fast to improve the dialogue. [granted, board size in and of itself is neither good or bad]

Steps were first taken while Stephen Blyth was president by seating Mr. Blyth on the university finance committee and that practice continues with Mr. Narvekar. And university CFO Thomas Hollister now sits on the HMC board, so the timely flow of information between entities is improving. Still, these are small boards with big demands on volunteer members with day jobs.

Fortunately, the university administration, both boards, and endowment management are well aware of past stumbles and current challenges and working hard to improve the structure, process, and performance. Stay tuned.

Where do chief investment officers come from?

Every year there are about 50 to 100 US nonprofit (tax-exempt) and family office CIO searches and that number will climb as more ultra-high-net-worth families (over $100 million AUM) form offices, create foundations, and hire professional investment talent.

PwC forecasts a near doubling in global AUM over nine years, from $84.9 trillion in 2016 to $145.4 trillion in 2025, and predicts the US share of this global wealth pie to rise from $46.9 trillion to approximately $71.2 trillion over the same period.

But where will families and institutions find these investment heads? Asset owners want to know where to find good candidates, portfolio managers want to know what their chances are of landing a CIO job, and marketers for external money managers want to know whom to call.

Some families and institutions will select the OCIO option (outsourced chief investment officer) and place their assets with an outside firm, but most will choose internal management.

As search consultants, we recruit and fill positions within three broad categories: nonprofit institutions, family offices, and the for-profit investment world of Wall Street investment banks, insurance companies, mutual fund managers, RIAs, hedge funds, and consulting firms.

All public pension systems, most endowments, and many foundations, health systems, associations, charities and corporate pension plans publish their fund returns and we use that information to rank and identify the top performing funds, chief investment officers, and senior asset managers. Find the best performing funds and you are likely to find the best talent.

Most nonprofit funds over $1bn and about one third between $500 million and $1bn have CIOs. In 2011, we counted about 1,300 CIOs and heads of investments at tax exempt institutions.

Today we track about 1,100 chief investment officers and another 800 up-and-comers in the nonprofit sector as the increase in endowments, foundations, and other nonprofits with a billion or more in AUM has been offset by a drop in the number of corporate DB plans.

Family offices: the best CIOs you've never heard of

Family offices employ excellent investment managers. The trouble is, it's hard to find them. These investors seldom appear at conferences, in the media, or show up at public events because ultra-high-net-worth (UHNW) families like to keep a low profile.

Credit Suisse, in their Global Wealth Databook 2017, estimates that, in the US, there are 714 individuals with assets over $1bn AUM, 1,363 individuals with AUM of $500mil to $1bn, and almost 23,000 with AUM of $100mil to $500mil.

Much of this money is managed by banks, RIAs, trusts, and wealth management firms, but our best estimate is that one in five billionaires employ professional investors, which would give us 143 investment heads in the billionaire bracket.

In the $500 to $1bn AUM family category, we assume about ten percent, or 136, employ individuals managing family assets.

The $100 to $500 million AUM bracket is the hardest to calculate, but we assume that at least two percent, or 460 families, have at least one dedicated investment professional on staff.

That adds up to about 738 senior investment roles in the high net worth family office space. Both Jason Perlioni, the CIO at Johns Hopkins and Alice Ruth, CIO at Dartmouth, for example, were recruited from family offices.

Wall Street and beyond

The third major source of talent – the for-profit money management world of Wall Street investment banks, insurance companies, mutual fund managers, RIAs, hedge funds, and consulting firms – presents a challenge to recruiters because, while it has by far the large pool of potential candidates, not all analysts, traders, or investment bankers have the right skillset for a CIO role.

CIOs manage people and invest with outside firms. Asset managers select securities, buy companies, and do deals. Those financial professionals who attempt the transition to the nonprofit and family office sector often find that they do not have the temperament or experience for what often becomes a management and administrative role.

(See our interview with Kim Lew, CIO at the Carnegie Corporation, on how she manages her time.)

There are notable exceptions, of course. David Swenson, CIO at the Yale endowment came from Lehman's corporate finance group, Jagdeep Bachher, CIO at the UC Regents was COO at the Alberta Investment Management Corporation (AIMCo), and Joseph Dowling III, the CIO at the Brown University endowment ran a hedge fund and managed his own money before joining Brown.

And just this month, Kelsey Deshler -- head of manager research at BlackRock and former research head and portfolio manager at Credit Suisse – joined Carleton College as CIO, a rare hire from a Wall Street firm. But, of the thousands of hopefuls in financial services eyeing the grass on the other side of the fence, few manage to jump the line and secure a nonprofit position.

That's a pity, because there is plenty of talent in the for-profit sector. Goldman Sachs, Morgan Stanley, Lazard, JP Morgan, AllianceBernstein, Citi, Bank of America, Prudential, NY Life, et al., employ hundreds of investment professionals managing multi-asset portfolios.

Moreover, there are 364 independent wealth management firms with AUM over one billion who employ sophisticated investment teams.

And let's not forget the 77 firms on my annual outsourced chief investment officer (OCIO) list. They all have one or more seasoned investment heads.

All in all, we probably have 1,000 senior managers with hands-on multi-asset investment experience in the for-profit sector and close to 1000 more up-and-comers. That's a sizable number of potential candidates and job openings. Recruiters never sleep.

When we gather together all nonprofit CIOs, family office heads, and for-profit multi-asset investment leaders, and add another 2,000 succession-ready deputies – we count a CIO candidate pool of about 5,000.

Unfortunately, there is a speed bump in the road for those wishing to move to the other side. Few non-profit funds hire from the for-profit sector and vice versa. Take the University of Virginia (UVIMCO), for example. When the school went looking for a CIO, they did not look far, recruiting Robert Durden from Texas Children's Hospital, Houston, another nonprofit. Board members are not rewarded for taking chances.

The only recent exceptions were Kelsey Deshler, noted above, and Brian Pellegrino, the head of the UPS pension, who moved to the Georgia Tech foundation as CIO. But he was living in Atlanta, home to both UPS and GT, and on every recruiter's top ten pick list.

Fortunately, family office heads are usually more open-minded when hiring a CIO. There is no bureaucracy and when they like someone, they don't ask for permission.

Recent CIO moves (2017-2018)

Chief Investment Officer	Current Institution	Former Institution(s)
-	-	-
Kathleen R. Browne	Denison University	**Mgn Dir:** Wellesley College
-	-	-
Jason Bull	University of Georgia Fdn	**Mgn Dir:** Emory University
-	-	-
Sanjay Chawla	FM Global (insurance)	**CIO:** Raytheon
-	-	-
Kelsey Deshler	Carleton College	**Head of research:** Blackrock

-	-	-
Robert Durden	University of Virginia	**CIO:** Texas Children's Hospital, Houston
-	-	-
Richard Gardiner	The Johnson Company (family office)	**CIO:** Neuberger Berman Trust Company
-	-	-
Kirsten Landers Glantz	Phillips Academy	**Dir Investments:** General Motors AM
-	-	-
Jonathan Grabel	Los Angeles County Employees' Retirement Association (LACERA)	**CIO**: Public Employees Retirement Association (PERA) of New Mexico
-	-	-
Mark Hamilton	Hirtle Callaghan (OCIO)	**CIO Asset Allocation:** Oppenheimer Funds **Investment Dir:** AllianceBernstein
-	-	-
David Harkins	UC San Francisco	**Head of equities:** University of Pennsylvania
-	-	-
Britt Harris	UTIMCO: U Texas (+ Texas A&M) Investment Management Company	**CIO**: TX Teacher Retire Sys
-	-	-
Lawrence Kochard	Makena Capital Management	**CIO:** University of Virginia
-	-	-
David McAuliffe	UC Berkeley	**Sr Investment Officer:** University of Washington
-	-	-
Brian H. Pellegrino	Georgia Tech University	**CIO:** UPS
-	-	-
Jason T. Perlioni	Johns Hopkins University	**CIO:** Pritzker Group AM (family office)
-	-	-
Alice A. Ruth	Dartmouth College	**CIO:** Willett Advisors (Bloomberg family office), **CIO:** Gordon, Betty & Moore Foundation
-	-	-
Rick Slocum	Harvard Management Company	**CIO:** The Johnson Company (family office) **Sr Dir:** U Pennsylvania
-	-	-

Scott Wilson	Washington University	**CIO:** Grinnell College
-	-	-
Chris Winiarz	Lakeview Capital Management (family office)	**Investment Officer:** UC Regents

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What we're reading

Private Equity Laid Bare, by Ludovic Phalippou

Ludovic Phalippou has been teaching private equity for ten years at Oxford University (2010-present) and the University of Amsterdam and now he has self-published a private equity (LBO) textbook. It's an informative and detailed reveal of the industry, using lectures and course material he has developed over many years teaching and consulting.

He covers the LBO bases, warts and all; partnerships and taxes, valuation techniques, fees, debt levels, bankruptcies, capital calls, and much more.

This is a solid read, aimed at those who have an interest in the nuts and bolts of an industry which manages over $5 trillion in assets and employees roughly eleven million people in the US through PE sponsored companies,

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The Skorina Letter

Each issue explores how the world's most accomplished asset managers think and invest. Original content includes profiles and interviews with industry veterans and research on compensation and investment performance.

Our insights and commentary come from our clients - board members, CEOs, chief investment officers - and the global investment community within which we work as executive search professionals.

Institutional investors operate at the crossroads of capital, talent, and ideas, shepherding over seventy trillion dollars in global assets. It's a constantly evolving spectacle and The Skorina Letter gives readers a ringside seat.

Prior issues can be found in "archives" on our website, www.charlesskorina.com