CLIENT CASE STUDY

Solving merger & acquisition complexity with an OCIO partner

How we helped a health system evolve their investment program in alignment with their enterprise-wide strategic plan

Managing Director of Market Leadership, Lisa Schneider, recently joined Al Salvato, Senior Vice President of Finance and Chief Investment Officer at *Thomas Jefferson University (TJU)*, for a discussion on how TJU developed an integrated resource allocation framework to balance total enterprise risks. Below, we share highlights from their conversation and additionally explain how we were able to help streamline efficiencies in TJU's investment program, resulting in significant cost savings for the organization.

About TJU

Thomas Jefferson University is a large, private academic health system composed of nationally ranked hospitals and academic programs. With more than 30,000 employees, 4,400 faculty, 8,300 students, and 1,680 medical staff, these constituent organizations work together to provide quality patient care, as well as education to future healthcare professionals. The investment office is led by Salvato, who oversees more than $4 billion of non-qualified and qualified assets and $2.2 billion of defined contribution assets.

TJU's Challenge

TJU has been steadily growing larger in size since the mid-2010s, acquiring or merging with four other healthcare organizations and one university, and taking on the management of additional assets. With this hefty organizational expansion, the investment program more than tripled, from $1.3 billion to over $4 billion in non-qualified and qualified assets. This meant that TJU had a mix of defined benefit plans, extended working capital pools, short-term pools, and long-term pools to manage. Each asset pool played a different role within the investment program, which required unique strategic asset allocations, investment objectives, liquidity profiles, and time horizons.

The addition of each subsidiary organization's multiple, unique asset pools resulted in a highly complex (and complicated) structure for the overall organization's CIO to navigate, as illustrated in **Exhibit 1**.

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“As institutions came into the mix, they brought with them different debt profiles, risk profiles and investment portfolios,” Salvato explained to Schneider. “My challenge then became, how could I better structure the overall portfolio to be responsive to the risks present on the balance sheet?”

Exhibit 1: Legacy investment program - Umbrella organization

Subsidiary organization 1	Subsidiary organization 2	Subsidiary organization 3	Subsidiary organization 4
Long-term pool	Long-term pool	Long-term pool	Defined benefit plan
Defined benefit plan	Defined benefit plan	Defined benefit plan	Short-term pool
Short-term pool	Short-term pool	Short-term pool	
	Extended working capital pool	Extended working capital pool	

At its height, there were 14 asset pools within the organization’s investment program. With the organizational expansion, the complexity of aligning each pool’s investment objectives with the umbrella organization’s new financial goals increased dramatically. Moreover, each pool had its own unique suite of investment strategies—including commingled funds, separate accounts, and proprietary funds from a third-party consultant. At one point, Salvato was singlehandedly delegating to over 130 managers across $4 billion of capital.

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Solution

In order to rationalize and simplify the complex legacy portfolio structures, Salvato developed a strategic resource allocation (SRA) framework. The purpose of this framework was to catalog all the material enterprise risks that could impact the health system, capture the potential ways the health system could respond to those risks, and define an investment approach that sought to effectively quantify and manage those risks.
This framework was designed to:

1. Identify potential claims on liquidity from the organization’s operations, spending, debt, and investments;
2. Assess the organization’s ability to carry risk given its available financial resources, including unrestricted cash and investments
3. Provide a holistic view of organizational risk, thereby allowing the CIO to assess the implications of a risk-adjusted investment deployment strategy on the organization’s overall financial health

By shifting to this framework, TJU has been able to satisfy both the need for balance-sheet resiliency and long-term growth. The organization can meet anticipated liquidity needs in the short- and medium-term by tapping into its working capital and intermediate pools, while seeking higher returns by taking on more illiquidity risk in its long-term pool. “This is the true beauty of this structure—it allows for the organization to sleep better at night *and* have the opportunity to increase illiquidity to achieve its desired return profiles,” Salvato said.

The entire approach, he explained, is very much a balancing act between demands on the operating and investment sides of the organization. “Ratings agencies love this framework, as it helps them see how we’ve positioned our resources to support liquidity needs,” Salvato remarked, adding that he can see the lightbulbs going off in analysts’ heads during TJU’s annual reviews with credit ratings agencies.

Once the framework was in place, TJU had to address the operational challenges in evolving its investment program to support this approach. The key challenge, Salvato said, was to create a synergy between all of TJU’s different investment accounts so that money could be more easily deployed.

“To address this, I envisioned a solution that would help me manage this complexity by streamlining the investment program and simplifying investment operations. I also desired detailed and transparent analytics, direct investments in top-tier active and passive managers, and the ability to delegate reporting and administrative functions to an outsourced CIO (OCIO) provider. All of this was intended to improve implementation, mitigate risk, and reduce costs—while increasing manager oversight,” Salvato explained.

Ultimately, TJU sought a partnership with an OCIO, in which the OCIO would assist with operational burdens; help manage multiple vendor relationships; set up a new, flexible portfolio platform; provide access to top-tier managers; and dynamically tilt the portfolio as needed—while allowing Salvato to have the final say over which manager(s) to hire, terminate, or adjust.

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The objectives

Salvato said there were seven key objectives TJU had when hiring Russell Investments as its OCIO:

- **Asset pooling:** Streamlining of 14 asset pools worth $4 billion
- **Ability to structure investment program to support their strategic resource allocation framework.**
- **Relationship pooling:** Simplification of a complex vendor relationship network

- **Added layer of manager oversight**: Direct access to a broad universe of active and passive investment managers and delegation of portfolio implementation
- **Investment consulting:** CIO oversight of several independent investment consultants to provide third-party oversight of the programs and investment managers
- **Reduced administrative burden:** Outsourcing of administrative and reporting functions
- **Increased buying power:** Reduction of manager and vendor fees
- **Risk mitigation:** Better understanding and management of risk in underlying investments

With these principles in hand and the risk catalog quantified, Salvato turned to Russell Investments to develop a simplified investment deployment strategy. Schneider explained that, armed with intimate knowledge of TJU's goals and circumstances, her team was able to build a custom, multi-asset solution. "This was designed to provide TJU with the operational support they need, while allowing them to retain authority over key strategic decisions," she said.

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The solution, which leverages Russell Investments' size and scale, greatly simplified the organization's investment program by paring it down from 14 separate pools to four consolidated asset pools that were identified as part of TJU's efforts. Each pool has a target risk-return profile based on its liquidity requirements. The ultimate portfolio structure, illustrated in **Exhibit 2**, combines all the defined benefit plan assets into a single defined benefit plan, and consolidates each of the separate short-term pools, long-term pools, and extended working capital pools into three main pools of capital.

Exhibit 2: New investment program - Umbrella organization

Qualified assets	Non-qualified assets
A single, consolidated defined benefit plan	Short-term pool
	Long-term pool
	Extended working capital pool

Benefits

Creating custom pooled funds significantly condensed the investment program and gave rise to an investment solution that is unique to TJU. This simplified structure allows each pool to have a unique asset allocation, which is composed of Russell Investments' researched "best-in-breed" active and passive strategies that are selected and approved by TJU. The solution saved TJU over 12 basis points in fees, which translates to a reduction of 28%. "

"At TJU, this structure allows us to have multiple individual-manager separate accounts for each asset class, but with the economies of scale and administrative ease of a commingled product. Simply put, this has worked really well for us—it's a very efficient way to deploy assets," Salvato remarked.

We believe this solution blends the best of the consulting model with the best of the OCIO model:

- **Consulting**: Russell Investments advises on portfolio structure and manager selection while TJU retains decision-making authority over hiring and terminating managers[1], based on input from its independent investment advisors. If necessary, TJU has the ability to identify a non-recommended manager, and Russell Investments will negotiate fees on behalf of the client.

- **OCIO**: Russell Investments builds the separate account fund structure for TJU and assume responsibility for implementing their strategic decisions and for performing many of the day-to-day operational aspects of managing a portfolio. Russell Investments also provides detailed, transparent analytics and financial reporting. Additionally, we negotiate and contract with vendors and underlying managers, and TJU benefits from lower manager and vendor fees, thanks to our size and scale.

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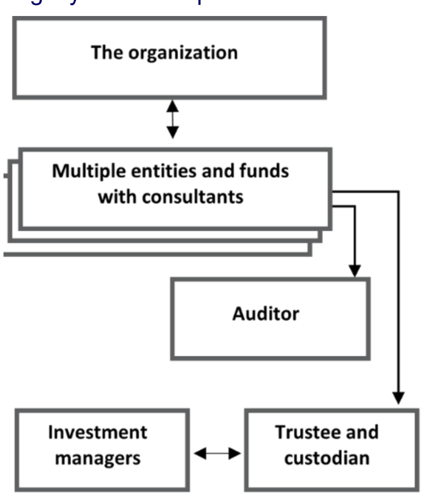
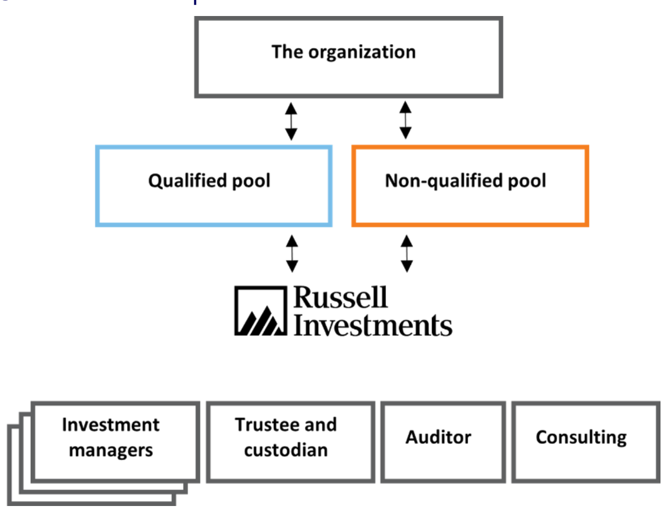
Pooling the administrative structure and vendor relationships also greatly reduced the organization's operational burden. **Exhibit 3** illustrates the simplification of the client's relationship network.

Exhibit 3: Consolidation of vendor relationships

Legacy relationships



Current relationships



Results

By working with Russell Investments, TJU was able to streamline its multiple asset pools, retain control where desired, decrease the complexity of its investment program, and reduce expenses. By grouping TJU's various asset pools into two legal entities and four underlying consolidated asset pools, and leveraging our scale, we were able to increase TJU's buying power with managers and vendors. TJU also benefits greatly from affordable access to our industry-leading manager research[2], portfolio structure insights, and investment manager relationships.

"This solution has reduced TJU's administrative overhead and risk by allowing it to delegate many day-to-day operational and administrative functions such as guideline compliance monitoring, risk analytics, managing frequent cash flows, and operational due diligence," Salvato noted. He added that TJU has benefited from a deepened relationship with Russell Investments as its investment provider.
"By delegating increased levels of administrative discretion to Russell Investments, I now have additional time and resources to focus on higher-level, strategic, and value-creating decisions that will allow the portfolios to better support the organization's overall financial goals. Just as importantly, TJU's investment strategy is now fully aligned with its enterprise-wide financial plan," he concluded.

[1] This is a strategy designed for this specific client. Strategies may differ according to the client.

[2] Over a 28-year period from 1995, an average of 77% of our 'hire' ranked products have outperformed their benchmark over rolling 5-year periods, with an average performance for all 'hire' ranked products of 1.47% above benchmark. Source: Internal Russell Investments analytics data from January 1, 1995 through December 31, 2022.

Where to next?

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About Russell Investments

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