

## Governance

### Governance & Engagement

Managing the investments of a nonprofit organization is a critical responsibility, and many nonprofits grapple with the decision of whether to manage these assets in-house or hire external assistance. Two common forms of external assistance are hiring a consultant or an Outsourced Chief Investment Officer (OCIO).

#### **Investment Consultant:**

An investment consultant typically advises an institution's investment committee on asset allocation, manager selection, performance monitoring, and other investment-related decisions. However, the

ultimate decision-making responsibility and implementation remains with the organization, which can be time consuming, complex and costly. Consultants provide an additional layer of expertise while allowing institutions to retain full control of decision-making and implementation.

#### **Discretionary Management:**

Sometimes referred to as an Outsourced Chief Investment Officer (OCIO), a manager will take responsibility for decision making and implementation of an investment program. In this

structure, it is common that an organization's board, investment committee and / or staff will set broad parameters in the Investment Policy Statement (IPS) within which the OCIO may operate. For example, the target level of risk and allowable investment types may be predefined in the institution's IPS. In this way, the organization retains control of large strategic choices, but outsources the day-to-day management

to a third party. The decision to hire external assistance, be it a consultant or an OCIO, depends on the nonprofit's size, investment complexity, internal resources, and the comfort level of its investment committee. Both models have their merits and drawbacks, and it's crucial to carefully evaluate and choose a structure that aligns with the organization's objectives and resources.

## Investment Policy Statement

A good investment policy statement (IPS) should balance being simple yet comprehensive. Simple, so that it can be easily understood and shared across time and fiduciaries, and comprehensive so that it provides clear direction to those fiduciaries, leaving little to question. The document should not be an overly detailed prescription for "how to invest", but rather a thoughtful overview of the institution's objectives, constraints, and investment process. The IPS should be used as a foundation to orient new committee members and other

portfolio fiduciaries to the investment goals, beliefs, and process of the organization. Key components of the IPS should include:

- **Purpose:** Establishing why this portfolio exists, who it is intended to benefit, and what are the long-term goals of the portfolio. For example, a college or university endowment may represent the collective sum of gifts to the school in support of scholarships, professorships, athletics, etc. The long-term

goal of such a fund might be to provide relatively stable annual support for the underlying activities for which the gifts are designated as well as long-term growth of principal at or above the rate of inflation.

- **Objective:** Establishing the return goal of the portfolio and how it will be appraised. The return goal should be realistically achievable throughout time when measured over long-term periods, and it should be linked to the goals of the underlying assets. For example, a donation provided to a college or university in support of a scholarship should at least seek to provide a return that covers the annual disbursements for the scholarship as well as some measure of inflation given that the cost of tuition will likely rise over time. Targeting a higher return may also be appropriate as

as long it does not lead to an imprudent level of risk taking that could impair the underlying portfolio and the mission of the assets.

- **Investment Principles:** This section should capture any general beliefs or philosophies of the institution that it seeks to incorporate into the investment program. For example, this section may outline the time horizon of the portfolio and recommend that the investment process be structured such that investments are selected with a long-term focus. As many institutional portfolios are related to mission-based organizations, this section may also include a mandate that investments in certain companies that violate the mission of the institution be avoided, such as a community foundation focused on the preservation of a local wetland that may wish to avoid companies that generate revenue from the production and

- **Investment Process:** The investment process section should provide a general roadmap for investing the portfolio that can be consistently applied across time and fiduciaries without being overly detailed or prescriptive. This section should outline the general asset classes expected to be included in the portfolio (e.g., stocks, bonds, real estate, etc.), the general process for selecting individual securities and third-party investment strategies, any approach to rebalancing, and which fiduciaries are responsible for leading the various components of the investment process.
- **Constraints:** Just as important as defining how a portfolio should be invested is defining how it should not be invested. The investment constraints are mostly an expression of the institution's tolerance for investment risk and will provide guardrails against excessive risk-taking. For example, an institution may have

a specific level of losses it seeks to avoid, and fiduciaries should study portfolio risks and invest in a manner that limits the potential intolerable losses that may permanently impair the mission of the organization. This section may also include types of investments that such be limited or excluded such as concentration in individual companies, the portfolio's overall exposure to private investments and outstanding private investment commitments, the use of derivatives, leverage, etc.

- **Governance:** Formulating a clearly defined decision-making structure may be the most important time an institution and investment committee can spend. Nothing can damage the long-term success of an investment program more than unclear governance and accountability. The very



The very nature of investment committees creates challenges as these groups typically have final authority on key decisions but are often comprised of unpaid volunteers who meet infrequently, change composition regularly, and may have varying levels of engagement or expectations for their role. It is imperative that organizations clearly define the role and authority of each member of the investment process and have a transparent system for the accountability of results

- **Spending Policy:** The organization's approach to distributing regular support from the portfolio to the underlying activities for which it was designated. There are many approaches to spending from a portfolio, so each institution should carefully select the policy that best suits its objectives and balances the needs of the

organization against the long-term success of the investment program. An institution's spending policy can be as simple as distributing a specific percentage of portfolio value annually, but they can also increase in complexity as organizations use smoothing rules to fine-tune the volatility of spending for budgetary and portfolio management purposes.

- **Evaluation Process:** The process for appraising the results of the investment program should be quantitative as well as qualitative. Practitioners should seek as much data as possible to understand the impact of past decisions in order to improve future results. From a qualitative perspective, the portfolio's fiduciaries should evaluate the investment process and decision-making structure to ensure that it is as efficient and effective as possible. Balancing prudent oversight with timely decision-making can be a challenge for many institutions.

## Decision-Making Structure

Each institution has unique preferences for their role, responsibilities, engagement-level, and time commitment. Some Boards prefer to maintain the final decision-making authority over individual manager hire/fire decisions and tactical portfolio rebalancing. Other committees may prefer to focus more on policy and less on implementation. In either case, we can offer an investment solution with clearly defined roles and accountability for all parties to balance the efficiency and effectiveness of decision-making.

The investment process can be broken down into three primary responsibility levels: governing fiduciaries, managing fiduciaries, and operating fiduciaries.

**Governing fiduciaries** are responsible for broad oversight of the investment program. Specific tasks that would fall within the roles & responsibilities of governing fiduciaries include setting investment objectives, reviewing and codifying investment policies, setting strategic asset allocation, and monitoring performance of the investment program relative to its objectives. Typically, quarterly meetings of governing fiduciaries should be sufficient, with interim

reporting and engagement on specific special projects as needed.

**Managing fiduciaries** are responsible for the implementation of the investment program. Specific tasks include research on new investment managers and strategies, monitoring of overall portfolio exposures, and tactical rebalancing of the investment portfolio.

**Operating fiduciaries** are responsible for the execution of investment and operating tasks of the investment program. Specific tasks would include monitoring of individual positions, trading of securities, accounting and reporting on positions. The execution of investment functions may be entrusted to specialist investment firms to implement active or passively managed strategies. Operating and accounting functions may be handled within an organization or shared with an external third-party firm.

## Sample Investment Policy Statement

**[Insert] University**

**General Endowment Fund Statement of Investment Policy**

October 2023

### **A. Introduction**

This Statement of Investment Policy, including objectives, spending policy, principles, asset allocation, and general guidelines govern the investment management of University's General Endowment Fund (the Endowment). This Investment Policy is subject to periodic review and revision by the Board of Trustees upon recommendation by the Investment Committee of the Board of Trustees (the Committee).

#### Investment Philosophy

The Endowment has a long-term investment horizon, and allocates capital accordingly. It is recognized that a strategic long-run asset allocation plan implemented in a consistent and disciplined manner will be a major determinant of investment performance. Individual investments, however, may be made with a shorter time horizon.

The assets will be managed on a total return basis. While the Endowment recognizes the importance of preservation of capital, it also adheres to the principle that varying degrees of investment risk are generally rewarded with compensating returns. In order to meet the long-term return goals for the Endowment, the University recognizes that a significant amount of investment risk that may be required. Risk may take the form of investment concentration, volatility, illiquidity, leverage or other dimensions, and monitored thoughtfully. Incremental returns should be appropriate for the incremental risk.

The Endowment will seek to be diversified. The Endowment will balance the benefits of diversification in controlling risk against the advantages of concentrating assets in the most attractive investing opportunities. If an external investment manager employs leverage, directly or indirectly, this should be taken into consideration when sizing an allocation to the manager within the Endowment.

The Endowment will maintain sufficient liquidity to meet the cash flow needs of the spending policy and outstanding commitments to private partnerships. Unfunded partnership commitments plus illiquid assets, defined as greater than one quarter availability of funds, should not make up more than 75% of the Endowment.

## **B. Purpose**

The overall purpose of the Endowment is to provide a stable and growing stream of resources for current use by the University, while preserving its purchasing power for the future. The preservation of purchasing power should be reviewed for individual endowments within the overall Endowment Fund through time in order to confirm that investment performance and spending policies are conducive to maintaining intergenerational equity over the long-term (ten years or greater). Balancing current financial requirements for the academic mission of the University with those needs of future generations demands a thoughtful combination of strong investment performance together with a sustainable spending policy.



### **C. Investment Objectives**

The primary investment objective is to generate a maximum rate of return given a prudent level of risk. The long-term objective of the Endowment is to maintain or grow the purchasing power of the portfolio after spending. This is to be measured over a full business cycle of 7 to 10 years versus the Higher Education Price Index (HEPI).

As a secondary measure, the Endowment will be assessed against a blended benchmark, referred to as the policy benchmark, based upon the policy asset allocation as established by the Investment Committee. This benchmark will be defined within the Investment Committee Guidelines. This evaluation is intended to affirm the effectiveness of the Endowment's manager selection and use of investment alternatives within the policy allocation. The Endowment should also be compared with relevant peer institutions and other benchmarks (such as the NACUBO Study of Endowments) as may be pertinent.]

### **D. Structure of Endowment**

The University should pool substantially all of its Endowment assets (which include funds arising from Endowment contributions from donors and board-designated transfers to the Endowment) for portfolio management and stewardship administration purposes. The Endowment will be structured in such a way that each contribution will be used to purchase units (units are similar to mutual fund shares) based on the market value of the assets contributed to the Endowment pool. The market value of the total pooled Endowment fund at the end of each calendar quarter will be used to determine the number of units allocated to new assets contributed or transferred to the Endowment during that quarter. Investment income including net appreciation will be allocated equitably to each donor Endowment and board-designated Endowment based on the number of units assigned. New units purchased at each quarter-end will be eligible to receive spending policy distributions in the following calendar quarter.

## **E. Endowment Spending Policy**

Investment income of the Endowment Fund is distributed to the operating budget of the University at a spending policy rate of 4.5% of the 12-quarter moving average market value of the Endowment for the upcoming fiscal year. The calculation of spending policy will be determined on a per unit basis. Furthermore, the 12-quarter moving average market value shall be determined on a calendar year basis for the subsequent fiscal year (i.e., 12-quarter moving average market value shall be determined on a calendar year basis for the subsequent fiscal year (i.e., 12-quarter moving average at December 31, 2020 will be used for the fiscal year July 2021 to June 30, 2022 spending policy rate).

The annual spending policy per unit will be subject to a 6% cap of the 12-quarter moving average market value.

## **F. Asset Allocation**

As a general guideline, the Endowment will be divided into four components reflecting the purpose of these components to the Endowment:

Growth Assets are intended to produce higher long-term returns. These assets consist of, but are not be limited to U.S., non-U.S. (including emerging and frontier markets) equities, and private equities. Private equity should include, but not be limited to buyout, venture capital, distressed, mezzanine, and secondary funds. Also, equity-like hedge funds may be included.

Real Estate Assets are expected to produce current income and capital appreciation. The total investable universe of real estate tends to be underrepresented by traditional public equity market benchmarks, and thus the real estate investment portfolio will primarily be invested in private real estate assets that are diversified by geography and property type.

Low Volatility Assets should produce modest returns in most environments and provide stability for the endowment. Most investment grade fixed income securities would be in this category.

Hybrid Assets should produce returns that are less correlated with growth assets. Typically these investments should include, but not be limited to hedge funds, absolute return strategies, high yield and other credit investments, short duration illiquid investments, direct investments, and structured products.

The approved ranges for these assets groups are:

Growth Assets	40% – 75%
Real Estate Assets	0% – 20%
Low Volatility Assets	5% – 20%
Hybrid Assets	10% – 50%

### **G. Charge to the Investment Committee of the Board of Trustees of the University**

The Committee shall consist of members of the Board of Trustees as appointed annually by the Chairperson of the Board. The Committee may also include selected alumni or friends of the University as determined by the Chairperson of the Board and the Chair of the Committee.

The Board of Trustees may establish a nominating committee tasked with identifying and formally nominating future Investment Committee members. Incoming Investment Committee members shall undergo training as established by the Board of Trustees and the Investment Committee.

The responsibilities of the Committee shall include, but are not limited to, the following:

- Annually evaluate the Investment Policy for the Endowment and recommend changes, as appropriate, to the Board of Trustees for their formal adoption;
- Annually evaluate and approve the Committee's Investment Guidelines, asset allocation, benchmarks and other policies and revise as necessary;
- Annually evaluate investment advisers in the execution of their assigned responsibilities;
- Evaluate the process regarding selection, retention, and asset allocation among external investment managers;

- Engage, as needed, investment advisers, for assistance with endowment management, asset manager sourcing and evaluation, asset allocation, and other needs;
- Review and evaluate performance and risk characteristics of the Endowment;
- Present annually to the Board of Trustees a report on the performance of the Endowment.

The Committee will establish target ranges for asset sub-classes, and the Investment Advisor will have discretion to rebalance the portfolio within those ranges. Such activity may include, but not be limited to, transactions involving:

- Redemptions from or additions to assets invested by existing external managers;
- Individual securities held by the University (including, but not limited to, exchange traded funds, mutual funds, and index funds);
- Portfolio hedging activities.

## **H. Conflicts of Interest**

Members of the Investment Committee and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. These parties shall reveal, in writing, all relationships that could create, or appear to create, a conflict of interest in their unbiased involvement in the investment process.

No investments will be made with investment management firms from which a Committee member, a staff member, or any employee of the Consultant receives remuneration of any kind unless specifically authorized by the Investment Committee and the Chair of the Board of Trustees.



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