KODA

Establishing an Investment Portfolio

Large charitable and non-profit groups often come to the conclusion that establishing an investment portfolio is the right thing to do in the context of their mission and purpose.

While some have experience of establishing and managing such a portfolio, many do not. The aim of this paper is to help charitable and non-profit leaders understand the process and what it involves. It describes each step and identifies some of the issues that typically arise at each stage. It is not meant to be an exhaustive summary and we acknowledge that there is plenty of room for other approaches. It is meant to demystify the establishment process, so that charitable and non-profit groups may effectively and efficiently take the first steps to creating a successful investment program that strengthens their organisation and supports their work.

Steps in the process:

#1 Decide to invest

What's involved

The decision to invest cash funds will often be triggered by an event such as the sale of a business or property, or the receipt of a large, untied gift, like a bequest. Before making commitments, it is important to review investment options in the context of the organisation's mission, purpose and strategy. Discussions should involve key stakeholders, such as the executive, the finance team, the relevant Board Sub-Committee(s) and the Board itself. As discussions progress, proposals should be supported by rigorous financial analysis that accounts for cash flow forecasts, appetite and tolerance for risk, plus strategic and operational commitments. When reviewing current and future commitments, it's important to include informal and unwritten obligations to members, funders and other stakeholders. Similarly, any legal, regulatory and constitutional restrictions must be considered.

> "The biggest risk of all is not taking one."
>
> **Mellody Hobson**

What to bear in mind

People involved in the discussion will have different levels of engagement and some will feel they have more to offer than others. Often, the discussion will reveal very different attitudes towards investment. Some people will feel that it is better to spend money now, while others will feel it is more prudent to invest for the future. Likewise, people will probably hold different views in relation to the timing and extent of investment and the risks involved. It is common for people around the table to debate whether the risks of remaining in cash outweigh those associated with investing. It is possible for an organisation to reach a decision to invest cash quickly, but plenty of time should be allowed for review and discussion. At this stage it is not necessary to make binding commitments about how, or how much to invest. The Australian Charities and Not-for-profits Commission provides useful guidance and advice in relation to the management and application of reserves.

#2 Work out what you are trying to achieve

What's involved

As stated above, it is important to ensure any investment decision is designed to support the mission of the organisation and help the organisation achieve its strategic objectives. A key part of the decision process is establishing what purpose the investment portfolio will have. In other words, it should be very clear what the portfolio will finance and how this will serve the organisation's needs. Often, the portfolio will serve more than one purpose, for example, it may be used to fund operational expenses and costs associated with a specific project or program. This stage of the process should involve consulting widely with key stakeholders, in order to fully examine different points of view and different options, before arriving at a consensus that enables the organisation to move forward with the process.

"Clarity affords focus."

Thomas Leonard

What to bear in mind

It may take some time and effort to establish what the nature and purpose of the portfolio should be. It is common for people to have very different views both across and within different levels of the organisation. Discussion is healthy and should lead to better decision making. It is important to reach the point where everyone understands what the portfolio is intended to do for the organisation, as this will influence its design and construction and consequently its value to the organisation. Sometimes, a single portfolio will be split into separate pools, for separate purposes, and each pool will be invested according to its nature.

#3 Assign responsibilities

What's involved

As with other assets, it is essential to confirm and clearly articulate responsibilities and accountabilities in relation to the management of an investment portfolio. The start point should be to ensure all arrangements reflect constitutional, statutory and regulatory requirements, as well as internal policies and protocols, including any delegation of authority framework. While the Board retains ultimate authority and accountability for invested funds, many non-profits delegate responsibility to a Sub-Committee of the Board already charged with overseeing financial matters, for example, a Finance Committee or Risk, Audit & Finance Committee. Increasingly, Boards are establishing dedicated Investment Committees, where membership is extended to individuals who do not serve on the Board, but who possess professional experience of portfolio management and/or financial markets. As always, governance arrangements should be formally documented and the key document at this stage of the process is the Committee Charter, which should set out the nature and extent of the responsibility being delegated by the Board, as well as the specific functions and tasks the Committee is expected to undertake. With roles and responsibilities confirmed at Board and Committee level, non-profits typically delegate additional responsibilities to their Chief Financial Officer (CFO) and the organisation's broader finance team. These responsibilities are often included in the Committee Charter as well, along with any reporting obligations the finance team has to the Committee.

"We cannot be mere consumers of good governance, we must be participants; we must be co-creators."

Rohini Nilekani

What to bear in mind

Other non-profits with their own investment portfolios can provide valuable guidance and assistance during the establishment phase. Some may even be prepared to share their own governance documents, or at least confirm their own governance arrangements. Clarity and comprehensiveness are two of the most important things to aim for at this stage of the process. Clarity removes doubt and equals risk reduction and comprehensiveness is similarly useful. In determining who does what, the RACI framework may be a useful tool, as it classifies all parties to an arrangement into one of four clearly defined categories: Responsible, Accountable, Consulted and Informed. When thinking about the investment adviser's role, consider the extent to which they might be given discretion over investment decisions. The role of an adviser is usually to give advice and make recommendations, but some non-profits prefer to delegate greater responsibility, so that advisers can buy and sell investments at their discretion, pursuant to an approved mandate.

#4 Engage with professional advisers

What's involved

Once an organisation has a good idea about what its plans are, consulting with a professional investment adviser is a good idea, because the adviser can help inform decisions before they are set in stone. Consultation should be obligation-free and non-profits should seek out advisers with experience of and commitment to non-profit advisory work. Likewise, an adviser should have experience of advice and management – that is to say they should be able to discuss investment strategy and not just implementation. Other non-profits may be able to make a referral or recommendation on a peer-to-peer basis. Once in contact with an adviser, the best policy is to be open with them. That way they can help answer unresolved questions, identify issues that need to be managed and outline potential solutions.

> "To profit from good advice requires more wisdom than to give it."
>
> **Wilson Mizner**

What to bear in mind

Many non-profits think about this engagement as the beginning of a partnership, or at least a relationship. Trust is important and being open is the way to get the most out of the engagement. Advisers used to dealing with non-profits should be happy to share their experience and unlike many other professional service providers, this access should be available at no cost. That said, some non-profits do elect to formally engage an adviser to help them build their investment governance framework at this stage. The centrepiece of this work is the creation of an Investment Policy Statement, for which the adviser will typically be paid a one-off fee. As this policy work is often dealt with later in the process, refer to *Step 8, Formalise an investment policy*, below, for more information.

#5 Invite proposals

What's involved

Once a non-profit has a clear view of what it is trying to achieve, or at least the kind of services it needs an investment adviser to supply, it is time to seek proposals from suitably qualified professionals. Some non-profits elect to keep this process very simple and informal. Some may invite only one or two advisers to present a proposal, while others will prepare and issue a formal tender document, often referred to as a Request for Proposal (RFP). Some experienced investment advisers can actually supply an RFP template, as can other non-profits with recent experience of tendering out their investment work. Typically, but not always, proposals are by invitation only, with between three and five investment advisers included in the process. An effective tender document is one that contains the right questions, expressed clearly and unambiguously. This helps advisers to supply the right information and goes a long way to ensuring non-profits get the information they need at the first time of asking. A typical RFP will allow respondents three-to-four weeks to prepare and submit a proposal. Some non-profits issue an Expression of Interest (EOI) document before requesting proposals. An EOI can be an effective way for non-profits to produce a shortlist of potential advisers, without having to wade through a large number of extensive proposal documents. Another way to cut down the time it takes to assess proposals is to include a page limit, which could be anywhere between 10-30 pages, depending on the questions that need to be answered. Regardless of the approach taken, this is not the commitment stage – this is only about gathering information and understanding options.

> "Success is a process."
>
> **Alex Noble**

What to bear in mind

A small minority of non-profits limit what they share about what they want and what they're trying to achieve and it is Koda's view, based on deep experience, that this is counter-productive. A good non-profit investment adviser can be likened to an architect that also builds and manages the property it designs. A clear brief and a willingness to engage fully and openly in the design process is essential if the end result is to give the client what they want and need; and so it is in the context of establishing an investment portfolio. RFP documents allow non-profits to share information about their needs, circumstances and preferences. At a minimum, an RFP should also include contact details for at least one person who may be contacted to discuss matters related to the tender. Better still, at least one person involved in the tender process should be available to meet with and talk openly to respondents throughout the tender process.

#6 Select an adviser

What's involved

Before inviting proposals, many non-profits form a small group to run the tender process, assess proposals and recommend an appointment. Different people within the group will be responsible for different tasks and the task of selecting and recommending an adviser will usually involve some or all the members of the Committee charged with overseeing the investment portfolio on an ongoing basis. In some cases, where the Board has not delegated responsibility to a Sub-Committee, a subset of the Board will take on this task. Once proposals have been received, the selection Committee will need to review them in detail and often proposals will be rated with reference to predetermined criteria. If the selection Committee feels it needs more information or clarification in relation to a proposal, this should be obtained before proposals are rated. Open dialogue with advisers involved in the process is recommended at this stage. When all proposals have been rated, the selection Committee can make a recommendation in relation to an appointment, however, more commonly two or three advisers will be invited to present their proposals directly to the selection Committee. It is not uncommon for other Committee/Board members and sometimes employees who will be heavily involved in the ongoing arrangement to participate in these presentations. Presentations give decision makers and key stakeholders the opportunity to not only hear from shortlisted advisers, but to ask them any remaining questions. Appointing an investment adviser is an important decision and the time allowed for each presentation should reflect this. Typically, advisers are allocated between half an hour and an hour, to present and answer questions. Advisers are usually given at least two weeks to prepare their presentation and best practice involves confirming in advance who will attend, how the meeting will be run and what the major areas of focus should be. After considering presentations and asking any follow-up questions, the selection Committee will make its formal recommendation, either to a Sub-Committee of the Board, or directly to the Board. In any event, conventional governance dictates that the final decision requires Board approval.

> "Trust is priceless.
> It's all about relationships."
>
> **Ted Rubin**

What to bear in mind

There are a wide range of questions that non-profits might ask in order to select 'the right' adviser. Some of the fundamental questions that come up time and again include: Are they committed to working with groups like us? Do they understand us? Can we work effectively with them? Is their advice unfettered and unconflicted? Can they add any value over and above management of the portfolio? What is more important, price or value?

#7 Establish accounts

What's involved

This step in the process involves establishing accounts that allow an adviser to hold, manage and report on assets held in the portfolio, including cash. This might entail completing paperwork required by the adviser, a Bank and a platform provider. Accounts should be established as early as possible to avoid delays later in the process. In addition to completing paperwork, this is also the time to ensure that cash earmarked for investment will be available when needed.

> "Well begun is half done."
>
> **Aristotle**

What to bear in mind

Establishing accounts may take some time. Account opening documents need to be prepared, reviewed and signed. Signatures need to be organised and that alone can lead to delays, especially given the need for authorised signatories to provide identification documents. Advisers may be appointed for a fixed term – three or four years, most commonly – however good advisers understand circumstances change and clients value flexibility, and there should be no need to sign a fixed term contractual agreement. Often an engagement letter or service level agreement signed by both parties clarifies the nature of the appointment and ongoing services.

#8 Formalise an investment policy

What's involved

An Investment Policy Statement (IPS) is the foundation of successful non-profit investing. It defines and quantifies all major policy positions, including return objectives, risk parameters and liquidity requirements. Creating one is best done with the benefit of professional advice. Ultimately, a non-profit's Board will approve the adoption of an IPS, usually on the recommendation of the Committee charged with overseeing the management of invested assets. The Committee itself may delegate some of the preparatory work to a CFO and senior finance team members. The process of producing an IPS is iterative, and usually involves a series of discussions and drafts. While numerous people will be involved, making a single person responsible for the process creates accountability and helps with communication. Discussions at the executive, Committee and Board levels will almost certainly involve competing views and priorities. A good professional adviser can help by facilitating productive conversations and drafting the document. To avoid delays, it is important to ensure Board and Committee members are engaged and available at this stage of the process.

> "The building is only as tall as the foundation is strong."
>
> **Paula White**

What to bear in mind

While it might be tempting, using an IPS designed for another non-profit might not be the right start point. An IPS needs to be tailor-made and built around an organisation's unique needs, circumstances and values. Doing the work to produce a high-quality, well thought-through policy will pay dividends for years to come. Once in place, an IPS should be seen as a living document, referred to regularly and formally reviewed annually, or in the event of significant change.

#9 Approve implementation

What's involved

Implementation is the stage in the process where a non-profit's cash is first invested, based on recommendations presented by the adviser. Cash must be transferred to the designated account, so that the adviser can fund investment purchases. The investments made and the process by which they are made should be pursuant to the terms of the applicable Board or Committee charter, the approved IPS and recommendations contained in the adviser's implementation plan. In order to approve implementation, a non-profit needs to ensure sufficient authorised signatories are available to sign off on final recommendations in a timely manner. Implementation may occur over a period of weeks or months, due to prevailing market conditions, or if the adviser recommends phased-market entry - a deliberate strategy designed to mitigate risks associated with investing all of an investor's assets at the same time.

> "Time in the market beats timing the market."
>
> **Ken Fisher**

What to bear in mind

This part of the process might be unfamiliar and possibly daunting for the first-time investor, but experienced advisers will have led clients through it many times before. Trust them to do what they are paid to do and take the opportunity to learn about the portfolio and underlying investments, by asking the adviser questions. At this stage, it is easy to obsess over what happens immediately after cash has been invested. It is better to remember that short-term investment performance should be seen in the context of long-term strategy. Generally speaking, investors will be more comfortable the more they understand the investments they are making. Non-profits should follow this rule and attempt to keep all key stakeholders informed and aware, with the help of their adviser. A good adviser should also be able to help them understand how aligned their portfolio is to the organisation's values and any ethical restrictions.

#10 Monitor, review and report on the portfolio

What's involved

The final step in establishing an investment portfolio is to put in place arrangements that ensure the portfolio will be effectively monitored and reviewed on an ongoing basis. An adviser will monitor and manage the portfolio on a daily basis. That is one of the benefits of employing a professional. The adviser should also provide regular reports and access to information. Many advisers will offer clients online, 24/7 access to their portfolio via a secure login. Good advisers will aim to supply information that makes it easy for the finance team to report to the Committee and for the Committee to report to the Board. Monthly, quarterly and annual reports can all be timed to coincide with scheduled Committee and Board meetings. Typically, an annual report will also involve a more detailed review of performance, policy and strategy. Good advisers will ensure reports are tailored to individual needs and circumstances.

> "Leadership is stewardship."
>
> **Andy Stanley**

What to bear in mind

In the months following implementation, it is important to keep focused on the long-term strategy, for reasons already explained. The first year is a year of change, of bedding down new and possibly unfamiliar arrangements and of developing an adviser-client relationship. Clear, agreed lines of communication and regular, open dialogue between client and adviser will help and should be a priority. Likewise, strong and timely internal reporting and communication right up to Board level is an essential ingredient in any successfully managed investment program.

Conclusion

Once a decision has been made to invest cash on behalf of a charitable or non-profit group, a number of critical decisions must be made. Better decisions lead to better outcomes and better outcomes can be achieved by following a logical process that is clear to all involved. Bringing people along on the journey is key to the effectiveness of this process and therefore open and effective communication should be considered integral at every stage. Investing time and effort into the process will more than likely produce better results.

> "If you can't describe what you are doing as a process, you don't know what you're doing."
>
> **W. Edwards Deming**

About the Author

David Knowles,
Head of Philanthropy & Social Capital, Koda Capital

David is responsible for Koda's non-profit and philanthropic client business and for the firm's impact investing service.

He chairs Koda's Non-Profit & Responsible Investment Group and sits on Koda's Partnership Committee.

David has worked in the industry since the late 1980s, including 10 years overseas with Coutts & Co. and Merrill Lynch. He has led philanthropic & non-profit advice businesses at Perpetual and JBWere, where, as a member of the Executive Leadership team, he was a Managing Director and head of product and marketing.

David currently serves on several charity boards and advisory councils and is a co-founder and Chair of Plus One, which provides free professional development opportunities to charity leaders. He has significant experience of chairing and serving on endowment and investment committees, overseeing charitable funds in a fiduciary capacity. David has studied Non-Profit governance at the AICD and the Harvard Business School. He is a professionally qualified trustee with significant experience of establishing, managing, investing and distributing trusts and foundations.

This paper was produced with the benefit of contributions made by Chris Wilson.

Contact Koda Capital's Philanthropy & Social Capital team:

David Knowles
M 0429 726 277 | E david.knowles@kodacapital.com

Chris Wilson
M 0428 866 607 | E chris.wilson@kodacapital.com

Further Reading

For more information on non-profit investment governance, policy and strategy please visit the following links:

- Investing for Non-Profits: Essential Questions for Board and Investment Committee Members https://kodacapital.com/insights/investing-for-non-profits-essential-questions-for-board-and-investment-committee-members/
- Top 10 Mistakes of the Australian Non-Profit Investor... And How To Avoid Them https://kodacapital.com/insights/top-10-mistakes-of-the-australian-non-profit-investor-and-how-to-avoid-them/
- Investing for Non-Profits: An Effective Investment Policy Statement https://kodacapital.com/insights/an-effective-investment-policy-statement/
- Responsible Investment: Using Your Capital for Profit and Purpose https://kodacapital.com/insights/responsible-investment-using-your-capital-for-profit-and-purpose/
- COVID-19 Investment Lessons for Non-Profit Committees https://kodacapital.com/insights/kodas-covid-19-investment-lessons-for-non-profit-committees/
- Principles of Endowment-Style Investing https://kodacapital.com/insights/the-principles-of-endowment-style-investing/

Sydney

Level 8, 20 Bond Street

PO Box R216
Royal Exchange NSW 1225

Melbourne

Level 15, 385 Bourke Street

GPO Box 5356
Melbourne VIC 3001

Brisbane

Level 27, 1 Eagle Street

PO Box 15519
City East QLD 4002

Perth

Level 3, 66 Kings Park Rd

PO Box 277
West Perth WA 6872

kodacapital.com **+61 2 8651 3400**

KODA