

An Effective Investment Policy Statement

Investing reserves on behalf of a foundation, charity or non-profit organisation is a tremendous privilege, and one that comes with significant responsibility.

It requires a fiduciary mindset, a willingness to thoroughly address all aspects of stewardship, and a robust investment governance framework. It also requires the organisation to understand how its reserve assets serve its mission, and requires sound processes and a carefully considered investment plan. An effective investment policy statement fortifies these requirements by drawing them together into a single cohesive document.

This paper is an extract from Koda's 'The Investment Policy Statement Handbook' and explores the key issues and benefits for non-profit organisations in preparing, implementing, maintaining and complying with an effective investment policy statement.

"To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insight, or inside information. What's needed is a sound intellectual framework for decisions and the ability to keep emotions from corroding that framework"

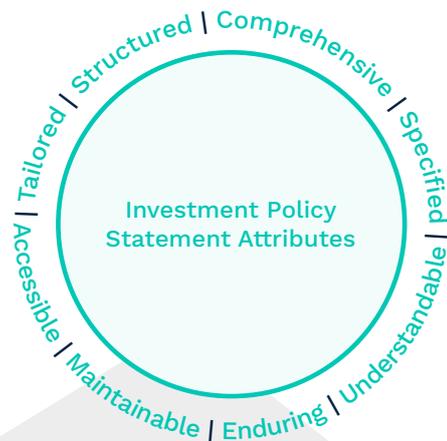
Warren Buffett

1. What is an investment policy statement?

An investment policy statement is a specific document unique to each organisation that provides instructions and guidance on how investments are to be managed in order to best serve the organisation's needs.

An investment policy statement should provide an all-encompassing framework for decision-making and for the design, implementation, monitoring, management, evaluation, communication, and reporting on a prudent investment management program. For an investment policy statement to be effective, it should possess a number of key attributes as illustrated.

Exhibit 1: Key attributes of an effective investment policy statement.



2. Why is an investment policy statement essential?

An investment policy statement is the key investment governance document and provides a blueprint for a tailored investment management program.

It is an important document when determining the organisation's broader financial sustainability and capacity building plans, and provides a tool for engagement with key stakeholders.

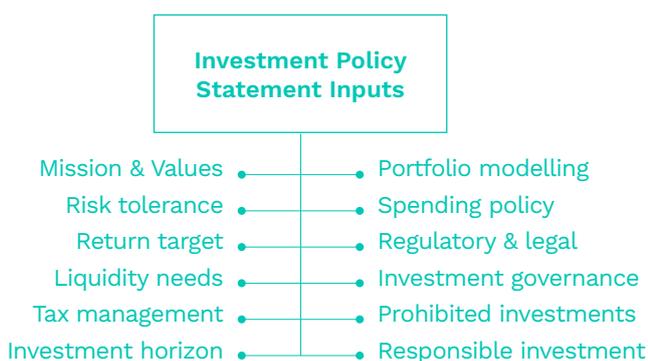
I. A tailored investment management program

The most important role of an investment policy statement is to provide the organisation with a blueprint and scorecard for a tailored investment management program that successfully meets the organisation's requirements and objectives.

“By failing to prepare, you are preparing to fail.”
Benjamin Franklin, US Politician

A deliberate and carefully prepared investment policy statement will help empower the board, trustees and other investment fiduciaries to make superior investment decisions to best serve the mission.

Exhibit 2: Key inputs of an effective investment policy statement



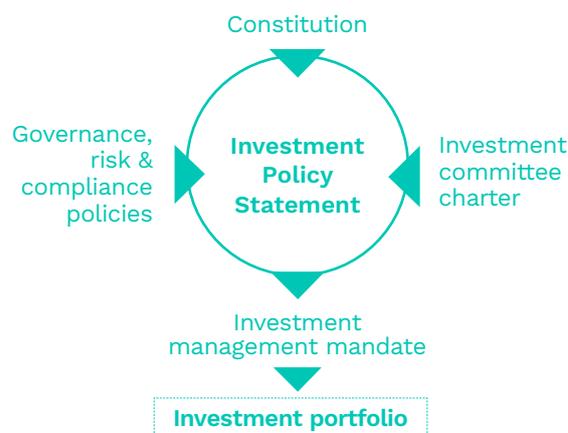
Every non-profit has unique circumstances and mission-based needs, objectives and aspirations. These requirements are best served by a tailored investment solution, rather than a 'one-size-fits-all' solution. Before a tailored solution can be developed, the organisation's requirements and objectives need to be clearly articulated within the investment policy statement

A disciplined and systematic investment policy statement preparation process will help guide the board, trustees and other investment fiduciaries to a consensus on these specific requirements; including risk/return, cashflow, liquidity, mission-based performance benchmarks, as well as ethical and responsible investment.

II. Best-practice, governance, risk management & compliance

Investment fiduciaries have a number of duties that they must comply with, such as the Prudent Person Rule for trusts, which emphasise the duties of care, diligence and skill. Prudence is best demonstrated through the process by which an investment strategy is designed, approved, implemented, managed and monitored in regard to the organisation's needs. Importantly, it is demonstrated by the process and the conduct through which investment decisions are made, regardless of the actual investment outcome at a security or portfolio level. An effective investment policy statement provides investment fiduciaries with an investment process framework and acts as an important reference point for new members of the board and investment committee, as well as for external parties who are interested in the investment management program.

Exhibit 3: The investment policy statement as the centre-piece of investment governance



Acting as a lynch pin, an investment policy statement should align and bind the constitution, investment committee charter and investment mandate together. In doing so, it puts investment fiduciaries 'on the same page' and becomes the key document for defining and referencing the investment management program. Every non-profit organisation with reserves should have an effective investment policy statement, regardless of the dollar value. An effective investment policy statement helps preserve organisational memory and reduces the likelihood of the same issues being revisited at each meeting. It supports succession planning, helping new board members, trustees and other investment fiduciaries become familiar with the investment management program and provides investment strategy continuity. Good governance also breeds trust and confidence, and puts the organisation in a better position to attract and retain committed donors and talented staff.

III. Sustainability, self-sufficiency & capacity building

Issues regarding sustainability, self-sufficiency and capacity building are becoming increasingly important for non-profit organisations as they grapple with the requirement to balance the mission needs of today against those of tomorrow.

A recent study showed that 21% of non-profit respondees rated financial stability as very important, with 79% rating it absolutely critical; yet only 13% were totally certain of their financial sustainability, with 66% reasonably certain.¹

These challenges and complexities prompt those charitable and non-profit organisations that are fortunate enough to have an investment corpus to consider how they can make their reserves and social capital work harder. For those without a corpus, these challenges are increasingly prompting them to consider fundraising strategies to help them build their reserves.

“A well-managed investment program can be a highly valuable strategic asset to diversify your organisation’s income stream, to fund innovation and to provide a buffer that can be drawn upon in times of need.” **David Knowles, Koda’s Head of Philanthropy & Social Capital**

The limits of what a well-managed investment management program can achieve for the organisation should also be acknowledged, with realistic growth and income targets set for the program in the investment policy statement.

IV. Strategic marketing asset

An endowment is a strategic asset that can help drive high performance in the organisation and attract more support, while a poorly managed endowment is capable of doing the opposite. With more than 600,000 Australian non-profit organisations competing for funding, the requirement to be able to differentiate the organisation and stand out from the crowd has never been more important.²

“Billions are wasted on ineffective philanthropy. Philanthropy is decades behind business in applying rigorous thinking to the use of money.”
Michael Porter, American Educator

Accountability attracts support, and an increasing number of philanthropists, corporate foundations and government based funders are becoming more targeted in their giving, seeking out organisations that can demonstrate they are well managed and that this extends to their reserves.

Australia, like most parts of the western world, is poised to experience the largest intergenerational wealth transfer in the country’s history. This is estimated to be some \$A1-2 trillion as baby boomers bequest their wealth over the next 15-20 years. A large portion of this wealth is being transferred to younger generations who are generally more interested in philanthropy, and viewing business through a social lens, for-purpose enterprises and impact investment.

“An investment policy statement can help showcase your investment management program, providing insight into the organisation’s vision, ambition, determination, financial health and sound management.” **Chris Wilson, Koda Philanthropy & Social Capital team member**

An investment policy statement demonstrates how the endowment is prudently managed and can be utilised as a strategic asset to engage with key supporters. The need to articulate how the endowment contributes to the mission is particularly critical when asking these funders for a gift of significant capital to help overcome the fallacy that an organisation with reserves needs less support. The key is being able to differentiate the organisation from the crowd by demonstrating the organisation is well managed and manages its finances prudently.

¹ Australian Institute of Company Directors, Discussion Paper, ‘Investment governance – increasingly critical for not-for-profit directors’, 2015

² The Productivity Commission, ‘Contribution of the Not-for-Profit Sector’, January 2010

3. What are the key components of an effective investment policy statement?

The key components of an investment policy statement should help provide a disciplined and systematic framework for decision making, management, monitoring and reporting on the investment program. Whilst every non-profit is different, there are ten components relevant for every organisation.

I. Introduction

The introduction should provide a brief overview of the document's purpose, objectives, scope, and structure, as well as how it was designed and prepared. This enables key stakeholders to quickly familiarise themselves with the document.

II. Organisation summary

Non-profits are defined by their mission and the investment management program should be aligned to the mission. External investment advisers and investment managers should be able to quickly familiarise themselves with mission requirements and investment objectives to tailor their advice.

III. Governance, risk management & compliance

As the key investment governance document, the investment policy statement should contain information on delegation of roles and responsibilities, prudential obligations, appointing external advisers, ethics and conflicts of interest.

IV. Investment management strategy

The investment strategy must be well specified, defined and quantified so investment fiduciaries are clear on the requirements and objectives. Well defined reference points should include the purpose and objectives of funds, liquidity requirements, risk, return, tax management and responsible investment values to help formulate the strategy. Asset allocation, portfolio construction and investment selection parameters are essential, with the parameters being derived from extensive portfolio modelling.

V. Performance benchmarks

To act as a scorecard and track progress, appropriate benchmarks are required to monitor, measure and evaluate the performance of the investment management program.

VI. Monitoring & rebalancing

Monitoring and rebalancing policies will help ensure the investment management program remains compliant with the investment policy statement and on track relative to stated objectives, milestones and expected outcomes.

VII. Contributions & withdrawals

Policies and procedures for investing contributions (e.g. surpluses, grants, fundraising and bequests) and funding withdrawals (e.g. deficits, capital expenditure and spending policy distributions) are necessary for liquidity management.

VIII. Communications & reporting

Proactive communication and reporting keep investment fiduciaries informed and engaged with the organisation's investments, assisting them fulfill their fiduciary obligations.

IX. Acknowledgement & approval

The board should provide approval and acceptance before the investment policy statement is formally distributed to investment fiduciaries.

X. Appendices

Appendices should contain important information relevant to the purpose and effective use of the document (e.g. portfolio modelling and stress testing data).

4. What is the best way to implement, maintain & comply with an investment policy statement?

The best way of implementing, maintaining and complying with an investment policy statement is in a manner that delivers the organisation the highest probability of meeting stated investment requirements and objectives to assist the organisation fulfill its mission.

“Finding good partners is the key to success in anything: in business, in marriage and, especially, in investing.” **Robert Kiyosaki, American Author**

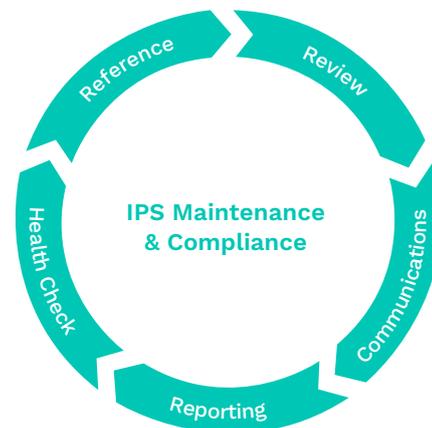
Most non-profit organisations choose to employ an investment adviser to assist with their investment management program, while others manage it with internal resources in a ‘do-it-yourself’ manner.

To be successful with the ‘do-it-yourself’ approach, a significant amount of technology, infrastructure, time, effort, investment expertise and experience is required from the board, trustees and executives.

The benefit of employing a suitably qualified investment adviser is that they will have the technology, infrastructure, tools, resources and investment processes to implement, manage, monitor and comply with an investment policy statement efficiently.

When considering the appointment of a suitable investment adviser, it is essential that they demonstrate an understanding of the significant nuances and intricacies of investing for non-profit organisations that distinguishes them from other types of investors. It is also important that the investment adviser can demonstrate how they will advise and assist the organisation to review, maintain and comply with the investment policy statement.

Exhibit 4: The investment policy statement maintenance & compliance cycle



5. How does Koda advise & assist non-profit organisations with an investment policy statement?

Preparing an effective investment policy statement can be a complex and time consuming process. However, investing the time and effort upfront in a systematic and disciplined manner will be rewarded with superior investment outcomes for many years to come.

“Successful investment professionals are disciplined and consistent, and they think a great deal about what they do and how they do it.” **Benjamin Graham, American Economist**

A well credentialed investment adviser to non-profits, such as Koda, will be able to help the organisation with the formulation of an investment policy statement, although the organisation must ultimately take ownership of the final document. It is essential that the investment adviser is able to clearly explain their process and demonstrate the disciplined and systematic nature of their formulation framework.

Exhibit 5: Example of a multi-phased investment policy statement preparation process



About the Author



Simon Duckett,
Adviser & Partner, Koda Capital

Simon joined Koda with a financial markets career spanning more than 20 years, including 13 years at Macquarie.

He provides investment advice, governance, policy, strategy and portfolio management services to high net-worth individuals, families, charities, foundations, and non-profit organisations.

These clients have similar needs including, bespoke investment strategies for unique risk/return requirements, a preference for low volatility investment across asset classes to preserve and grow capital in real terms, generation of strong cash flows and investment income to support mission delivery and intergenerational wealth objectives, maximising after-tax benefits of franking credits, as well as operating within specified liquidity guidelines and investment time frames.

Working with boards, investment committees and specialist advisors on asset allocation strategies, portfolio construction, investment selection, after-tax management, ethical preferences, philanthropic support, as well as governance, risk management and compliance are important services Simon provides to clients.

Simon has a Master of Applied Finance, Bachelor of Economics, Graduate Diploma in Applied Finance & Investment, and has completed the AICD Duties, Responsibilities & Finance for the Not-for-Profit Director.

He serves on the St Vincent's Health Network Sydney (SVHNS) Audit & Risk Committee, is a Financial Standard's Power50 ranked adviser, as well as a Barron's Top 50 and Top 100 Adviser.

Simon works alongside Jordan Ryan and Michelle Lam in a team to provide clients with suitably successful investment outcomes in a transparent, prudent, ethical and cost effective manner.

Further Reading

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

- Essential Questions for Board and Investment Committee Members
<https://kodacapital.com/insights/investing-for-non-profits-essential-questions-for-board-and-investment-committee-members/>
- Preparing for the Future - Do or Die for Non-Profit Boards
<https://kodacapital.com/insights/preparing-for-the-future-do-or-die-for-non-profit-boards/>
- 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/>
- 10 Investment Lessons for NFPs from the GFC
<https://kodacapital.com/insights/investing-for-non-profits-10-investment-lessons-for-nfps-from-the-gfc/>
- Courage & Care: Preparing for the Next Market Crisis
<https://kodacapital.com/insights/courage-care-preparing-for-the-next-market-crisis/>

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