

commonfund



Governance Best Practices & Investment Policy Development

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President and Chief Executive Officer
Commonfund

Pilbara Indigenous Trust
Thursday, October 25, 2012

commonfund
I N S T I T U T E

The History of Commonfund

- Ford Foundation 1969 landmark study “The Law and Lore of Endowment Funds”
- Out of this came a \$2.8 million grant for the founding of “The Common Fund for Nonprofit Organizations” (Commonfund)
- We were officially founded on July 1, 1971
- And today we remain . . .
 - A mission-driven organization
 - A nonprofit, membership corporation with no shareholders
 - Our board represents our investors, not shareholders or management

Intergenerational Equity

The Responsibility of Trustees

“The trustees of endowed institutions are the guardians of the future against the claims of the present. Their task is to preserve equity among generations.”

*- James Tobin
Yale University*

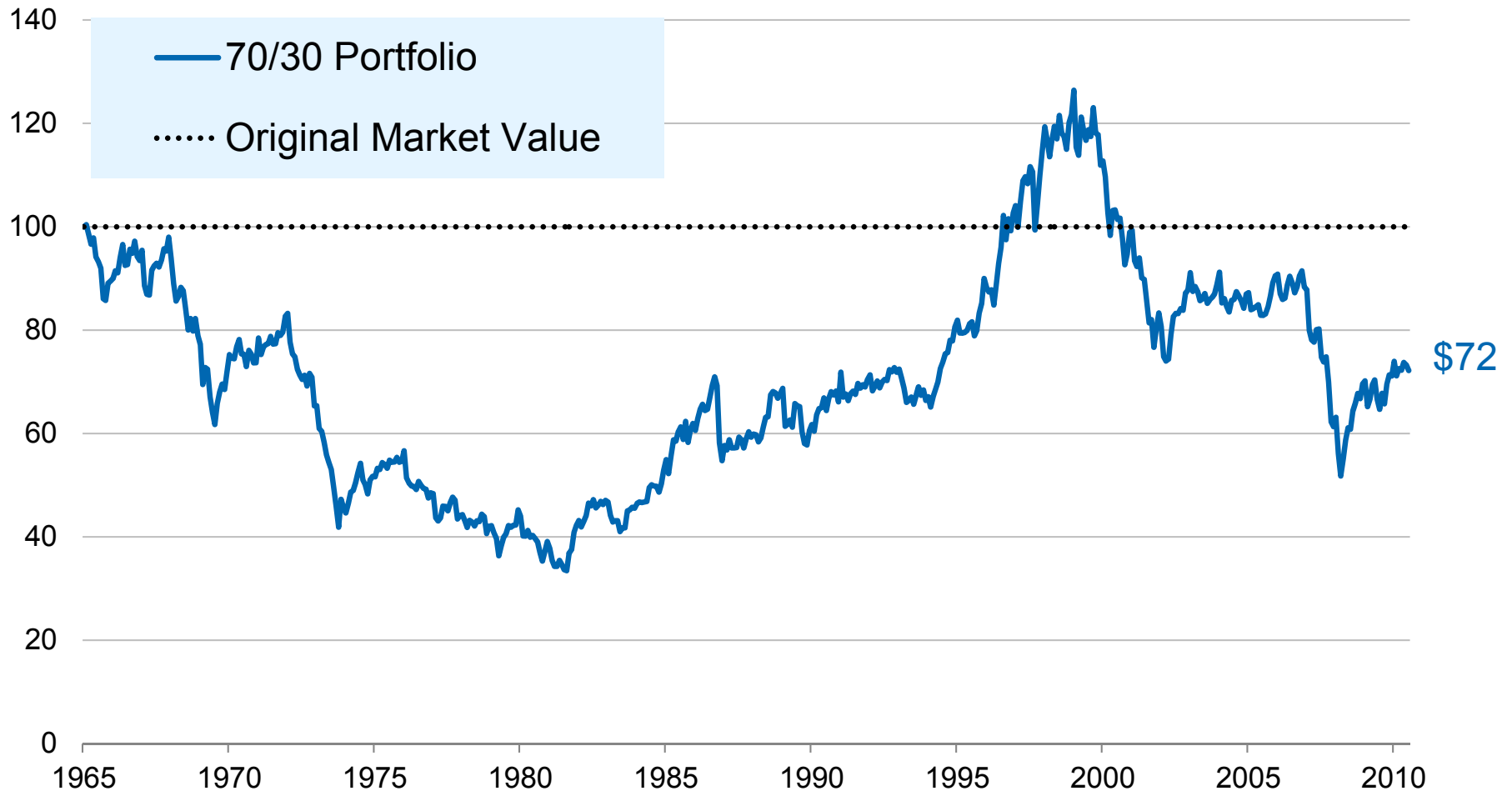
The Challenge of Achieving Intergenerational Equity

January 1966 – June 2012

Cumulative Inflation-Adjusted Performance

70% S&P 500, 30% Barclays U.S. Aggregate and 5% Spend
(Hypothetical Portfolio)

Growth of \$100



Source: Ibbotson, Bloomberg, Commonfund Institute

The equity portion of the hypothetical portfolio is based on monthly returns of the S&P 500 Index (12/65-06/12), and the fixed income portion is based on monthly returns of the Barclays U.S. Aggregate Index (01/73-06/12) and the Ibbotson Associates Long Term Corporate Bond Index (12/65-12/72). HEPI data from 07/06 to 06/12 is estimated using the Commonfund Institute method based on regression analysis. Returns for this hypothetical portfolio assume that it is rebalanced to 70/30 annually on 1/1/yy and 5% is distributed annually on 1/1/yy.

Best Practices in Nonprofit Management and Governance

- The organization must clearly understand and publicly express its mission
- The board must be engaged, informed and independent
- The organization must have policies and practices that ensure the proper use and safeguarding of assets – to include protecting against conflicts of interest and having independent financial reviews
- Decision making should be transparent and well-documented
- A sound strategy is necessary as a bridge between the nonprofit mission and programmatic activities

Source: IRS Tax-Exempt Government Entities Division

How to Gain Strategic Clarity

- Define what the organization is trying to achieve
- Determine what it will hold itself accountable for and the timeframe for doing so
- Define both the benefits the organization seeks to provide and the beneficiaries it seeks to serve
- Define the “cause and effect” by which the organizational and financial resources will be converted into the desired social results

Key Elements of Board Governance

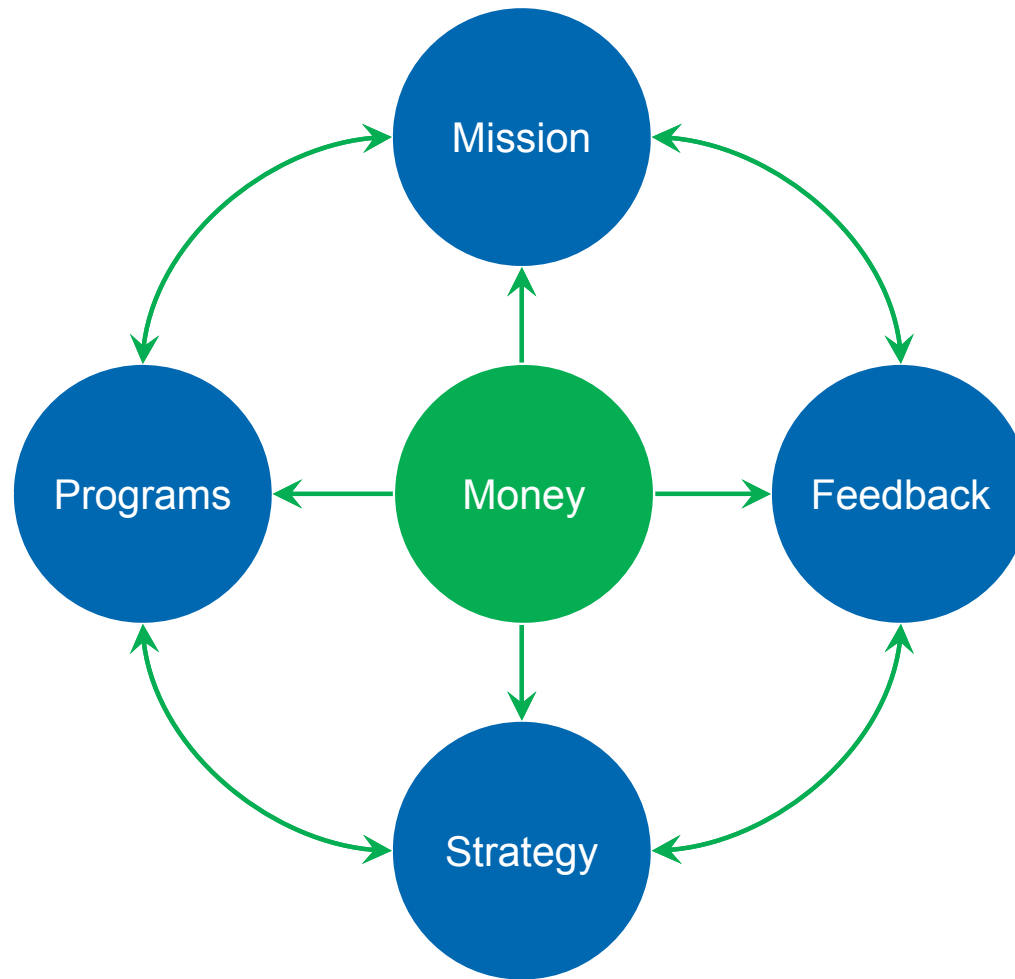
Structure	Process	Behavior
<ul style="list-style-type: none">• Legal structure• Board size• Board make-up• Board recruitment• Board orientation/ continuing education• Number and purposes of committees• Role of chair and committee chairs	<ul style="list-style-type: none">• Strategic plan• Board meeting agendas, goals, plans• Written policies• Board surveys/ evaluations v. goals (internal)• Beneficiary/ stakeholder surveys (external)• Assessments• Knowledge of laws	<ul style="list-style-type: none">• Strategic thinker• Demonstrated integrity• Committed• Inquisitive• Collegial• Learner• Open, candid, listener and communicator• Courageous• Results-driven

Critical Success Factors

- Linking “Mission to Money”
- Aligning roles of boards and staff
- Clarifying what success looks like
- Measuring success

The Fundamental Mission/Money Conflict

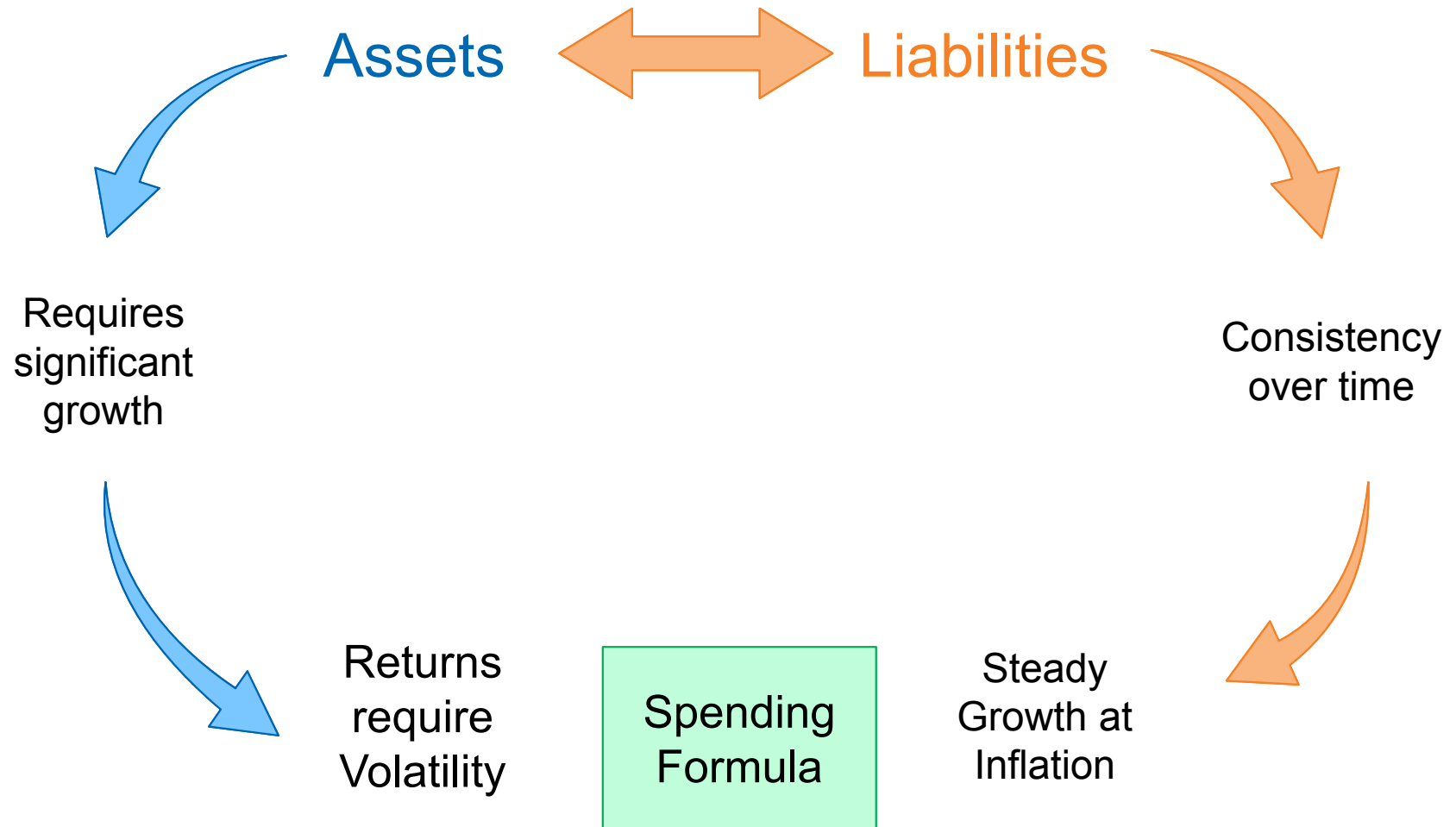
Dynamic Dialog



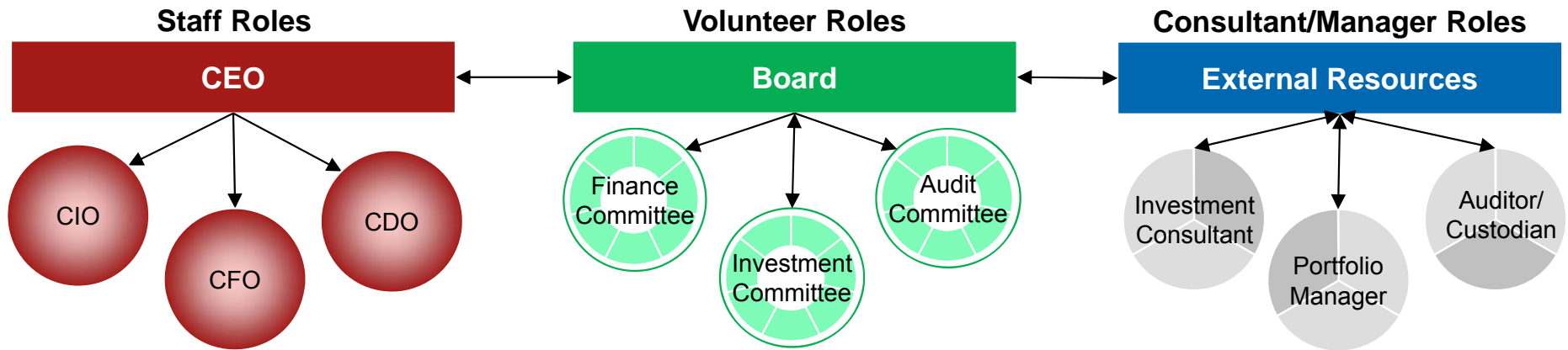
The Fundamental Mission/Money Conflict

- Multiple stakeholders with different needs
- Are actions of board/staff always in Fund beneficiaries' best interests?
- The challenges of maintaining intergenerational equity
- “Angels and Monsters”
- Managing the volatility of spending/distributions
- How much risk are you willing to tolerate to fulfill your mission?

The Asset vs. Liability Challenge



Nonprofit Investment Management Governance Model



Chief Financial Officer (CFO)

- Report to CEO and Finance Committee
- Prepare and manage annual budget
- Recommend and manage debt policy
- Oversee audit of organization, including investment portfolio
- Optimize cash flow

Chief Investment Officer (CIO)

- Report to CEO and Investment Committee
- Execute investment policy
- Maintain asset allocation / policy portfolio
- Oversee and recommend manager / security selection
- Oversee performance reporting and attribution
- Recommend and implement risk management
- Recommend and conduct portfolio rebalancing
- Conduct tactical asset allocation within policy portfolio

Chief Development Officer (CDO)

- Report to CEO and Finance Committee
- Develop and oversee major and annual gift strategy
- Develop and oversee planned gift strategy
- Supervise development staff
- Possess knowledge of endowment management best practices

Finance Committee

- Report to Board
- Develop financial strategy and oversee financial operations
- Review and monitor financial operations
- Maintain financial records
- Present financial information to Board
- Approve capital budgets and debt issuance
- Communicate with and educate Board on financial matters

Investment Committee

- Report to Board
- Develop investment policy
- Develop and oversee asset allocation / Policy portfolio
- Develop and oversee spending policy
- Set risk tolerance and oversee risk management
- Monitor investment performance (manager / portfolio)
- Direct hiring / compensation of managers and consultants

Audit Committee

- Report to Board
- Select and hire independent auditor
- Manage and oversee audit process
- Review audit findings and management letter with auditors
- Present financial statements and auditors' recommendations to Board
- Oversee business office processes
- Oversee conflict-of-interest and whistleblower policy

Investment Consultant

- Report to CIO / Investment Committee
- Educate / inform Investment Committee
- Assist with development and review of investment policy statement and policy portfolio
- Conduct asset allocation studies
- Implement manager search process
- Conduct ongoing manager evaluation and reporting
- Provide Investment Committee with research / analysis

Portfolio Manager

- Report to CIO / Investment Committee
- Conduct investment strategy as contracted
- Provide regular written reports and risk-adjusted performance attribution
- Provide educational materials and economic / market analysis

Auditor/ Custodian

- Auditor reports to CFO / Audit Committee
- Custodian reports to CIO / Investment Committee
- Provide audit / custody services
- Reporting, fund accounting
- Transfer agent
- Compliance
- Legal counsel

Investment Policy Statement

Key Principles

- Objectives
- Payout policy
- Asset allocation
- Manager selection
- Risk management
- Costs
- Responsibilities

Investment Policy Statement | Responsibilities

Key issues that the policy statement should resolve

- Role of the endowment in supporting the institution's mission
- Role of the endowment in maintaining a healthy balance sheet
- How much of the endowment's return should be spent and how much reinvested
- How much of expendable gifts should be channeled to the endowment vs. to current spending
- The extent the operating budget should be supported by the endowment
- Overall investment strategy, particularly asset allocation
- Who should have responsibility for investment decisions
- Which investment decisions, if any, should be allocated to outside advisors or investment managers

Investment Policy Statement | Investment Management Issues

- **Asset allocation** is the key to successful investment management.
- Investments should grow to **offset inflation**.
- Over long periods of time **equities typically produce higher incremental returns** than cash or bonds.
- **Diversification** among asset classes and managers is a key to increase return and reduce volatility.
- **Access quality portfolio managers** and monitor them on a regular basis for compliance with guidelines and performance measurement.
- Conduct periodic asset allocation **review**.
- **Minimize costs**.

Roles and Responsibilities

Trustee / Committee Responsibilities

Strategy Development

- Investment Policy
- Spending Policy
- Asset Allocation Policy
- Risk Management Guidelines
- Performance Monitoring
- Corporate Governance/Fiduciary Issues

Investment Office Responsibilities

Strategy Implementation

- Asset Allocation
- Portfolio Construction
- Manager/Security Selection
- Value Added Strategies
- Strategic and Tactical Rebalancing
- Monitoring and Reporting
- Liquidity Analysis

The 4 Levers

Policy Decisions that Affect Financial Outcomes

Informed Decision Making

Policy Drivers

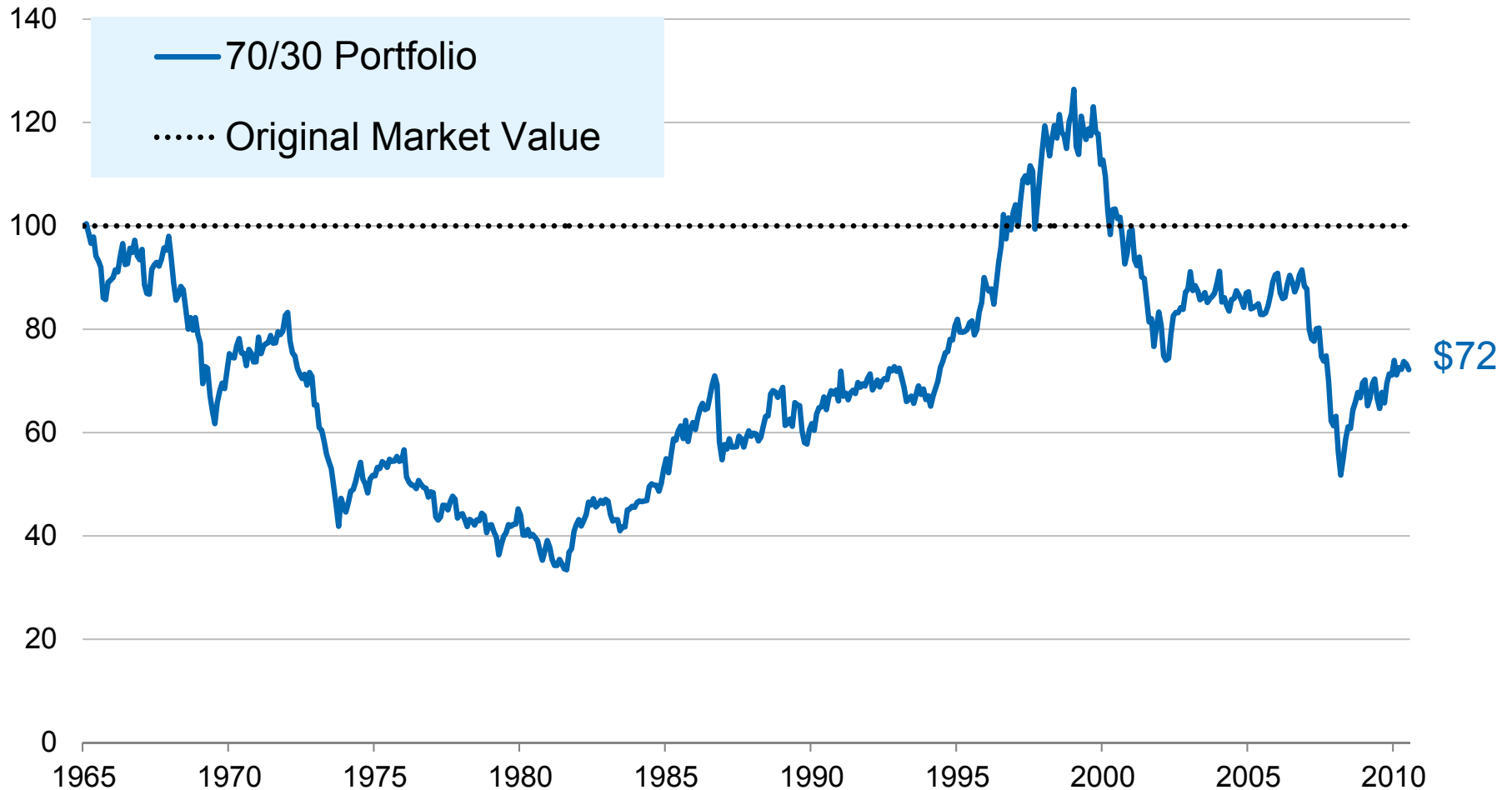
Four Levers ↓	Intergenerational Equity	Median Spend	Volatility of Spending
Asset Allocation (increased diversification)	↑	↑	↓
Contributions (increased)	↑	↑	↓
Spending Rate (lower)	↑	↓	—
Spending Method (smoothing effect)	—	—	↓

The Challenge of Achieving Intergenerational Equity

January 1966 – June 2012

Cumulative Inflation-Adjusted Performance
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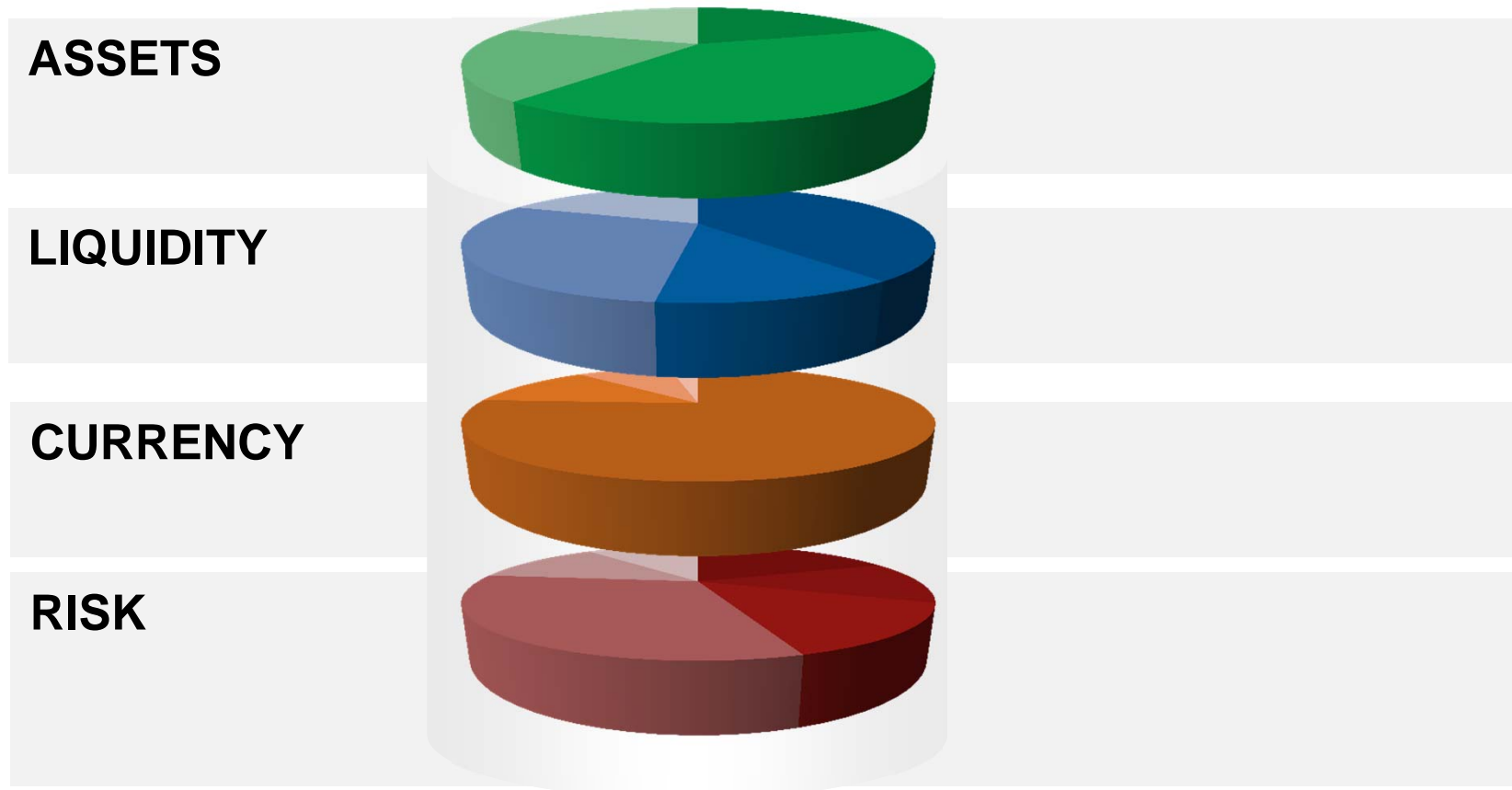
Growth of \$100



Source: Ibbotson, Bloomberg, Commonfund Institute

The equity portion of the hypothetical portfolio is based on monthly returns of the S&P 500 Index (12/65-06/12), and the fixed income portion is based on monthly returns of the Barclays U.S. Aggregate Index (01/73-06/12) and the Ibbotson Associates Long Term Corporate Bond Index (12/65-12/72). HEPI data from 07/06 to 06/12 is estimated using the Commonfund Institute method based on regression analysis. Returns for this hypothetical portfolio assume that it is rebalanced to 70/30 annually on 1/1/yy and 5% is distributed annually on 1/1/yy.

Managing Multiple Allocation Layers



NOTE: The above allocations are intended for illustrative purposes only

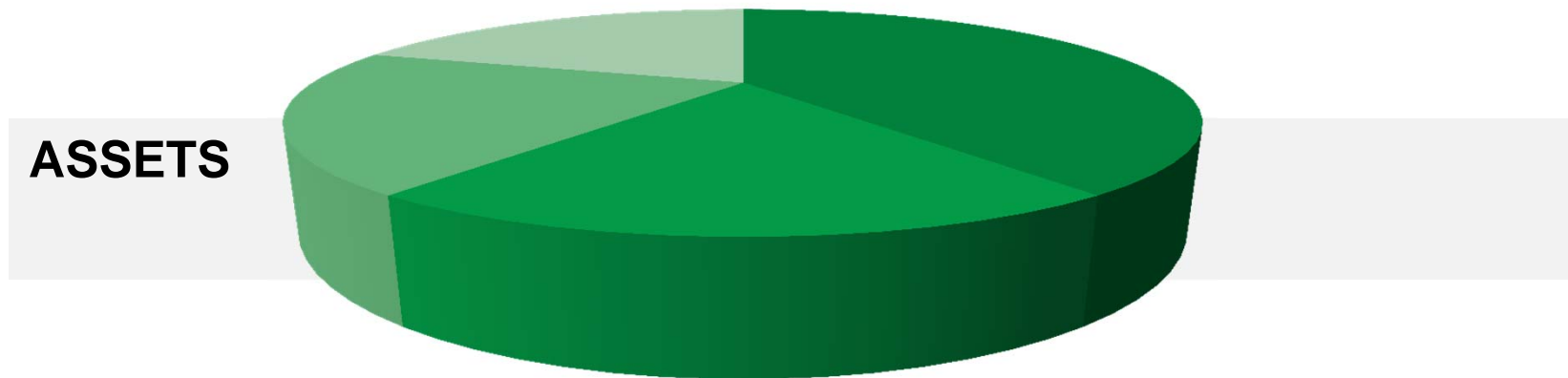
Managing Multiple Allocation Layers | Assets

Real Assets | Inflation hedging

- Commodities
- Natural resources
- Private real estate
- TIPs

Equity | Generate Long-term Growth

- All public equity
- Private equity
- Venture Capital
- Distressed debt



Absolute Return | Skill-based non-correlated

- Long/Short market neutral equity
- CTAs

Fixed Income | Disinflation hedge

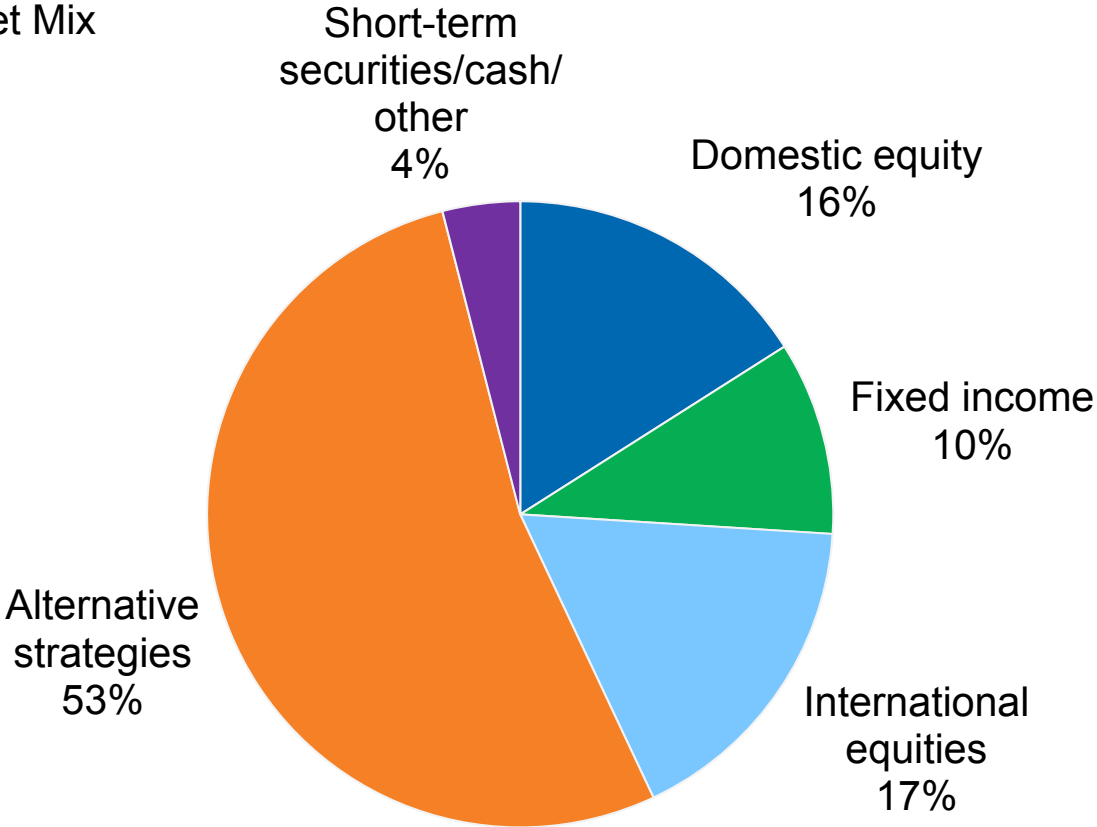
- Sovereign debt
- High grade corporate

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Asset Allocation for Total Institutions

Fiscal Year 2011 ending June 30

Dollar-weighted Asset Mix

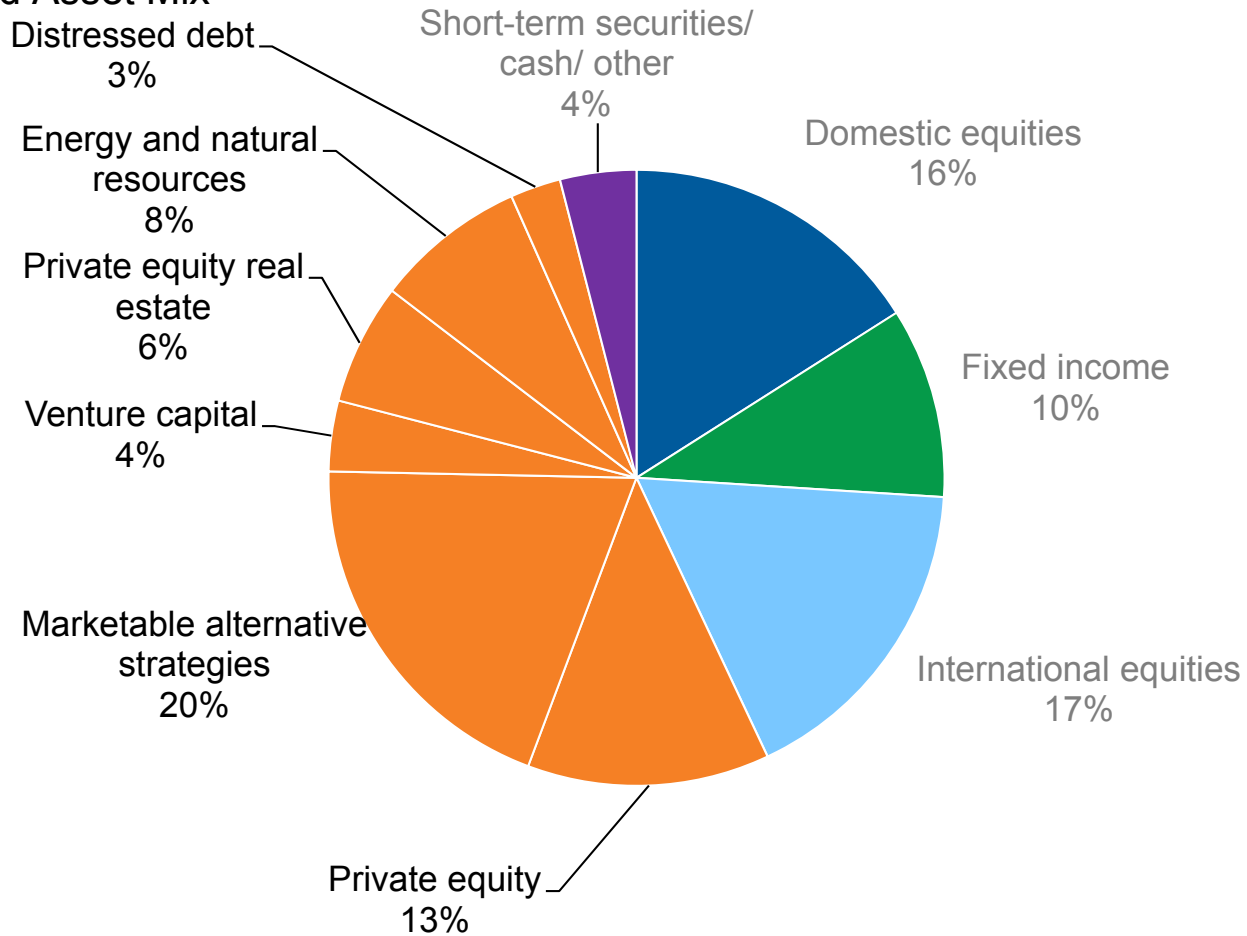


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Asset Allocation for Total Institutions | Alternatives

Fiscal Year 2011 ending June 30

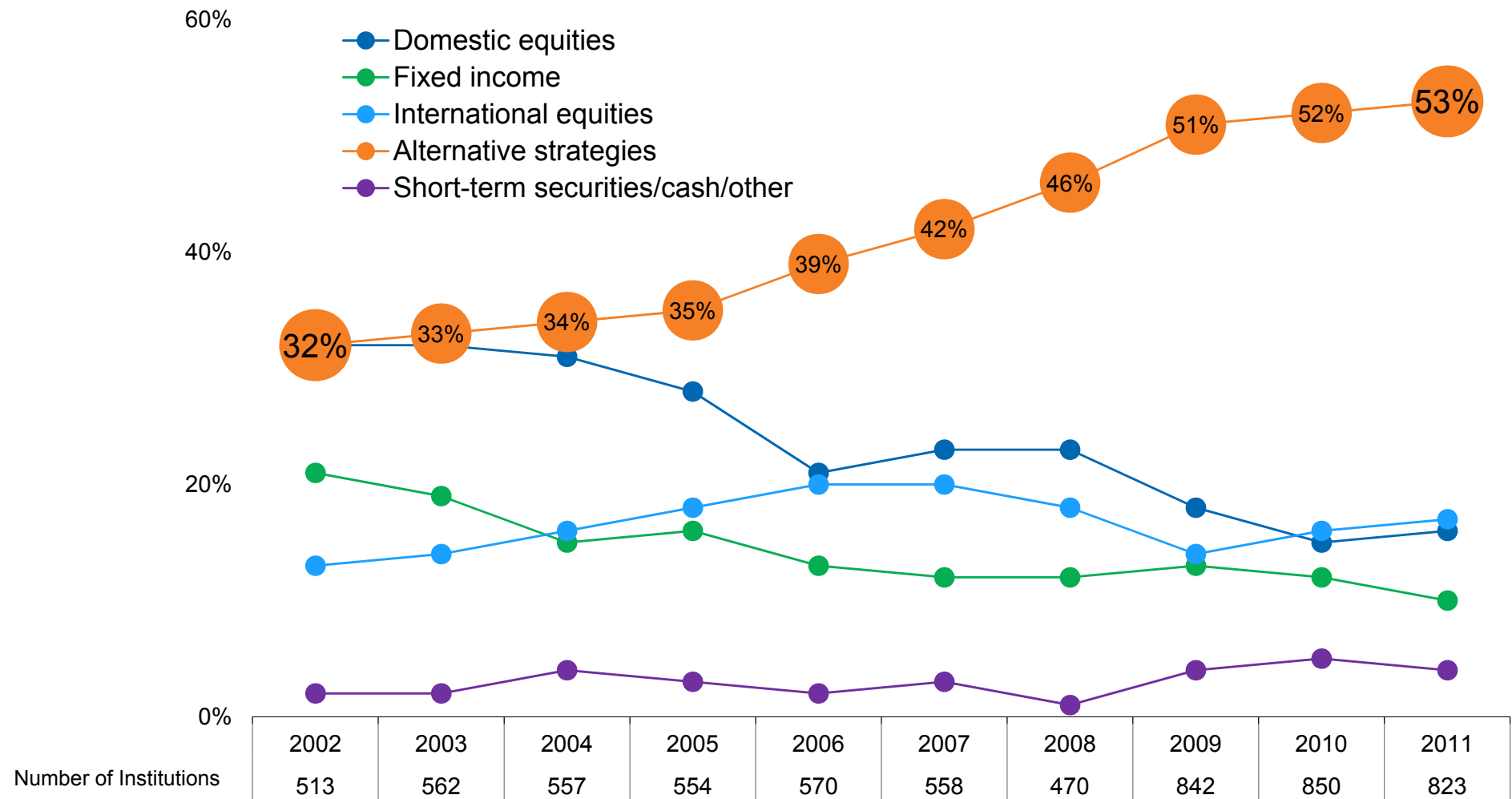
Dollar-weighted Asset Mix



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Asset Allocation* Trend for Total Institutions

Fiscal Years 2001 – 2011 ending June 30



* Dollar-weighted

Source: Fiscal years 2001 – 2007, NACUBO Endowment Study 2008; Fiscal year 2008 – 2011, NACUBO-Commonfund Study of Endowments 2011

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The Role of Alternatives in Institutional Portfolios

Primary Objective ■

Objectives	Return enhancement/ alpha	Diversification	Inflation protection	Current income/ stream of cash flow
Venture Capital	■			
Private Equity	■			
Natural Resources	■	■	■	
Distressed Debt	■			
Commodities	■	■	■	
Private Real Estate	■	■	■	■
Hedge Funds	■	■		

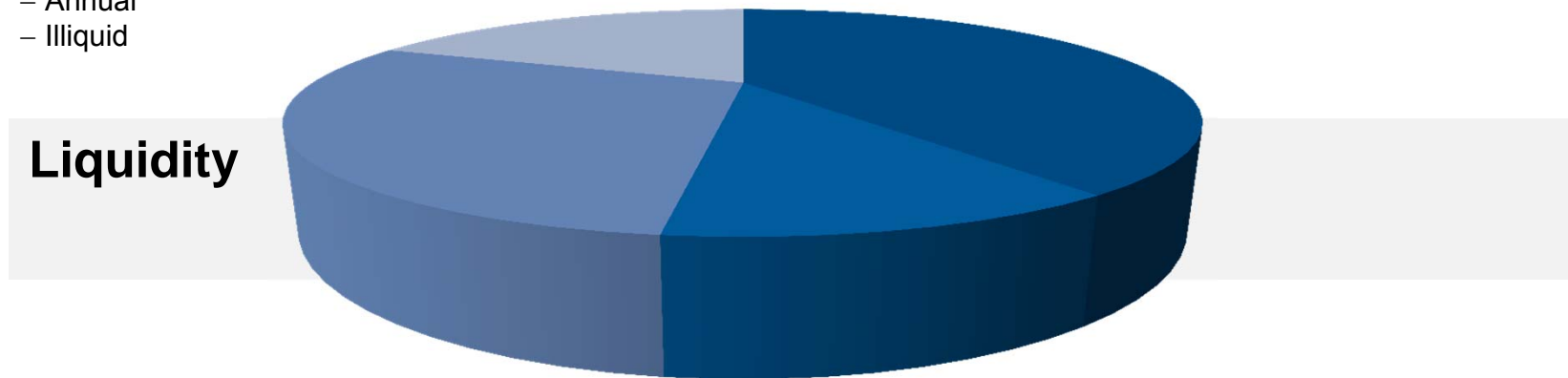
Managing Multiple Allocation Layers | Liquidity

Liquidity Policy Development

- Needs of the organization
- Level of liquidity
 - Daily
 - Monthly
 - Quarterly
 - Annual
 - Illiquid

Liquidity Environment Considerations

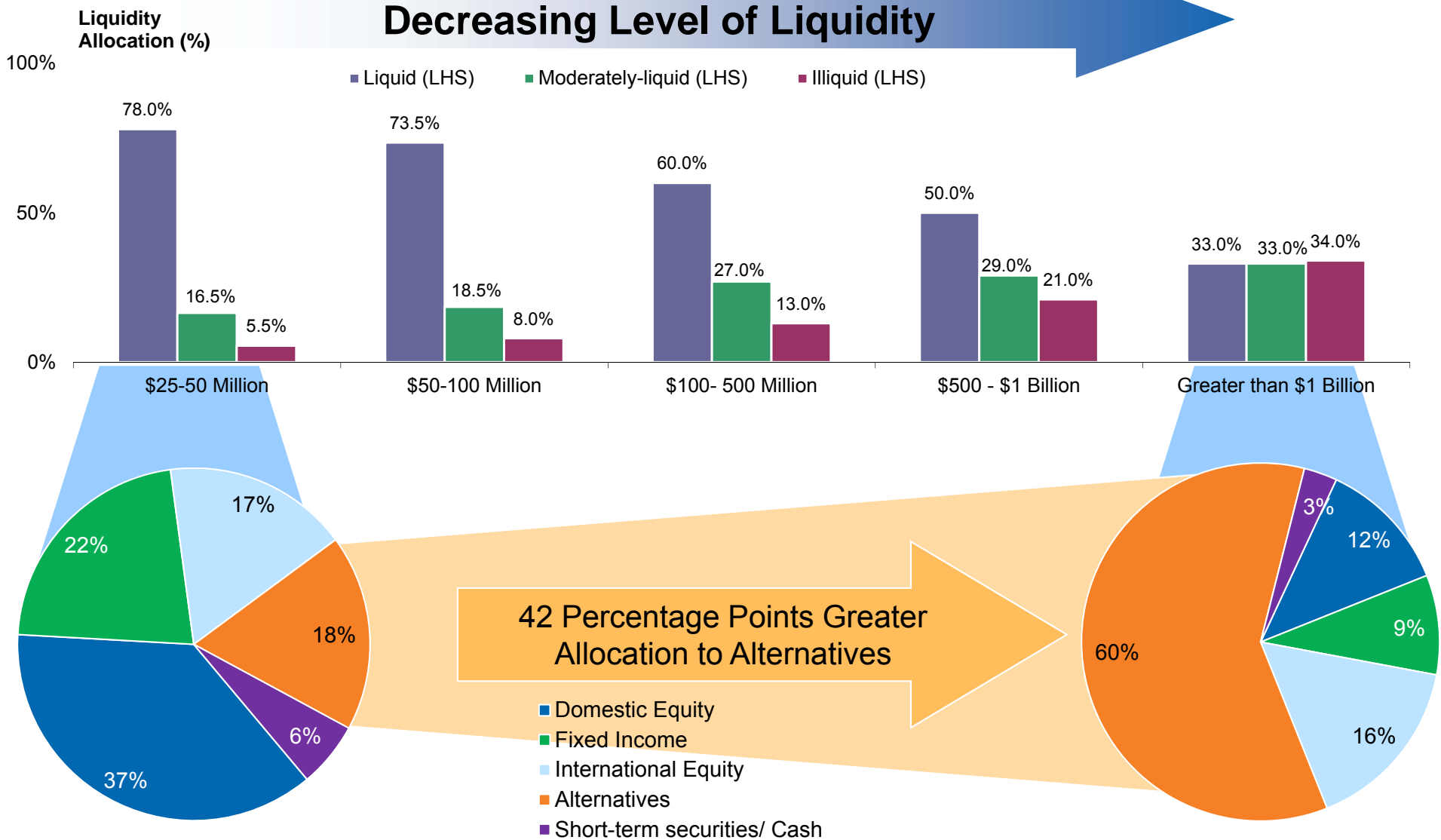
- Normal environment
- Stressed environment
- Liquidity tolerance; approaches to rebalancing
- Need for “dry powder”



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Correlation between Liquidity and Asset Allocation

As of June 30, 2011

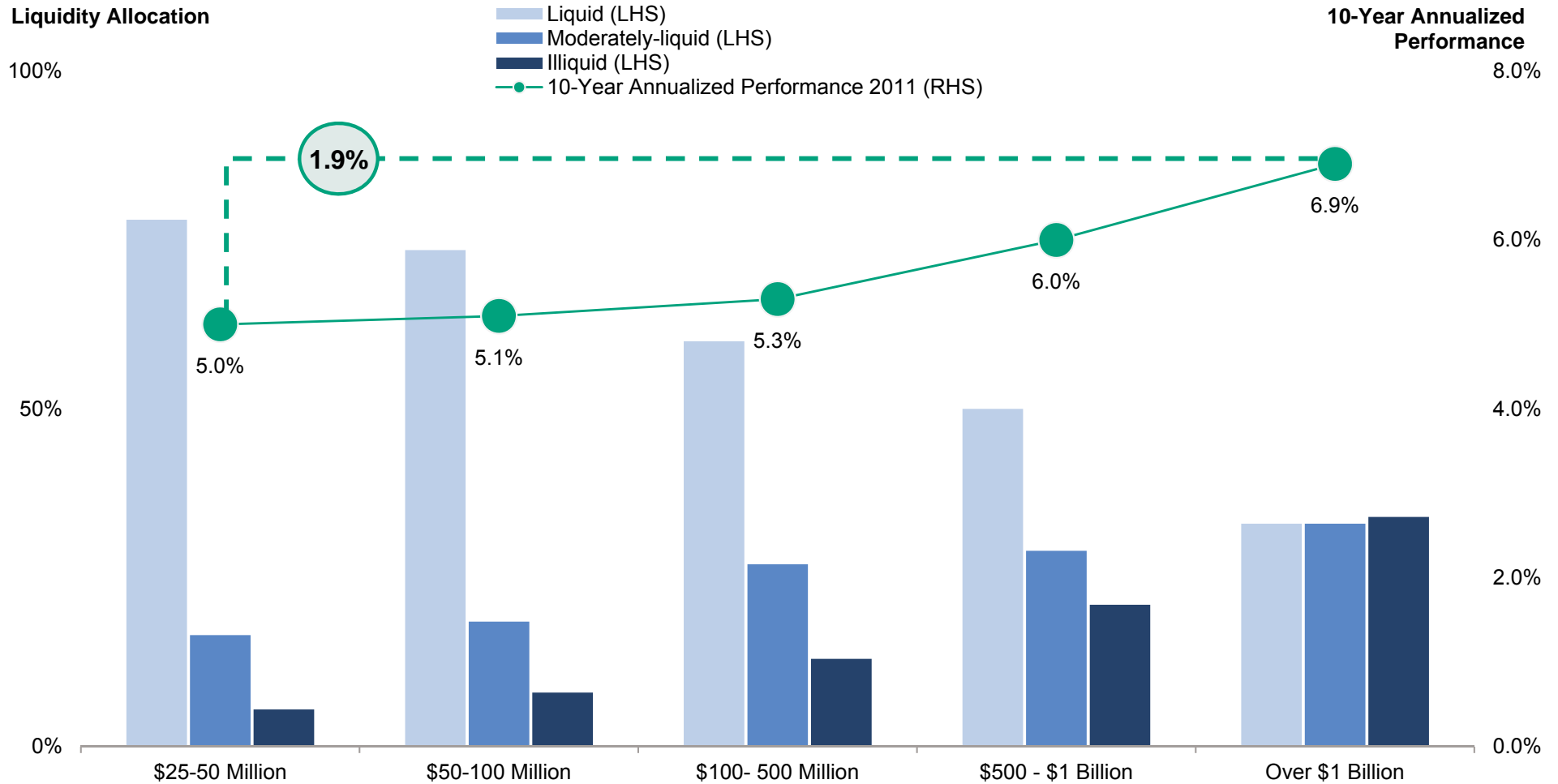


Survey of 850 educational institutions

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Liquidity Performance Correlation

June 30, 2011



NOTE: Liquid = approximately 1 day to liquidate, Moderately-liquid = Monthly or quarterly liquidity and Illiquid = assets with liquidity characteristics that are greater than quarterly or are considered long term (unable to prematurely liquidate without significant cost).

Source: 2011 NACUBO-Commonfund Study of Endowments. Report, Based on 823 institutions that provided asset allocation data.

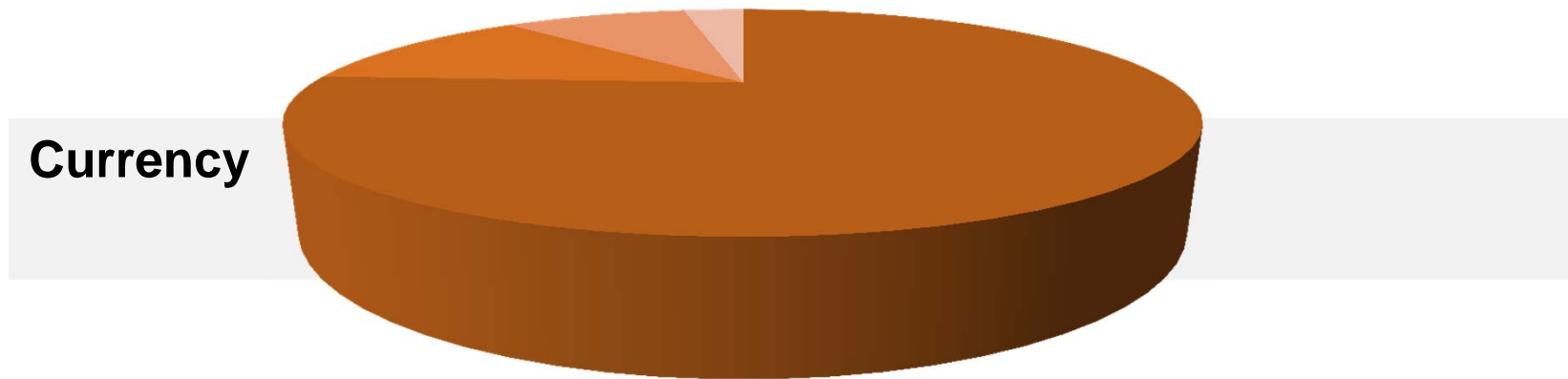
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Managing Multiple Allocation Layers | Currency

Currency Policy Development

- Why currency matters
- How much currency exposure do you have?
- How much currency exposure should you have in your investment policy?
- Currency outlook and strategy: secular and cyclical themes

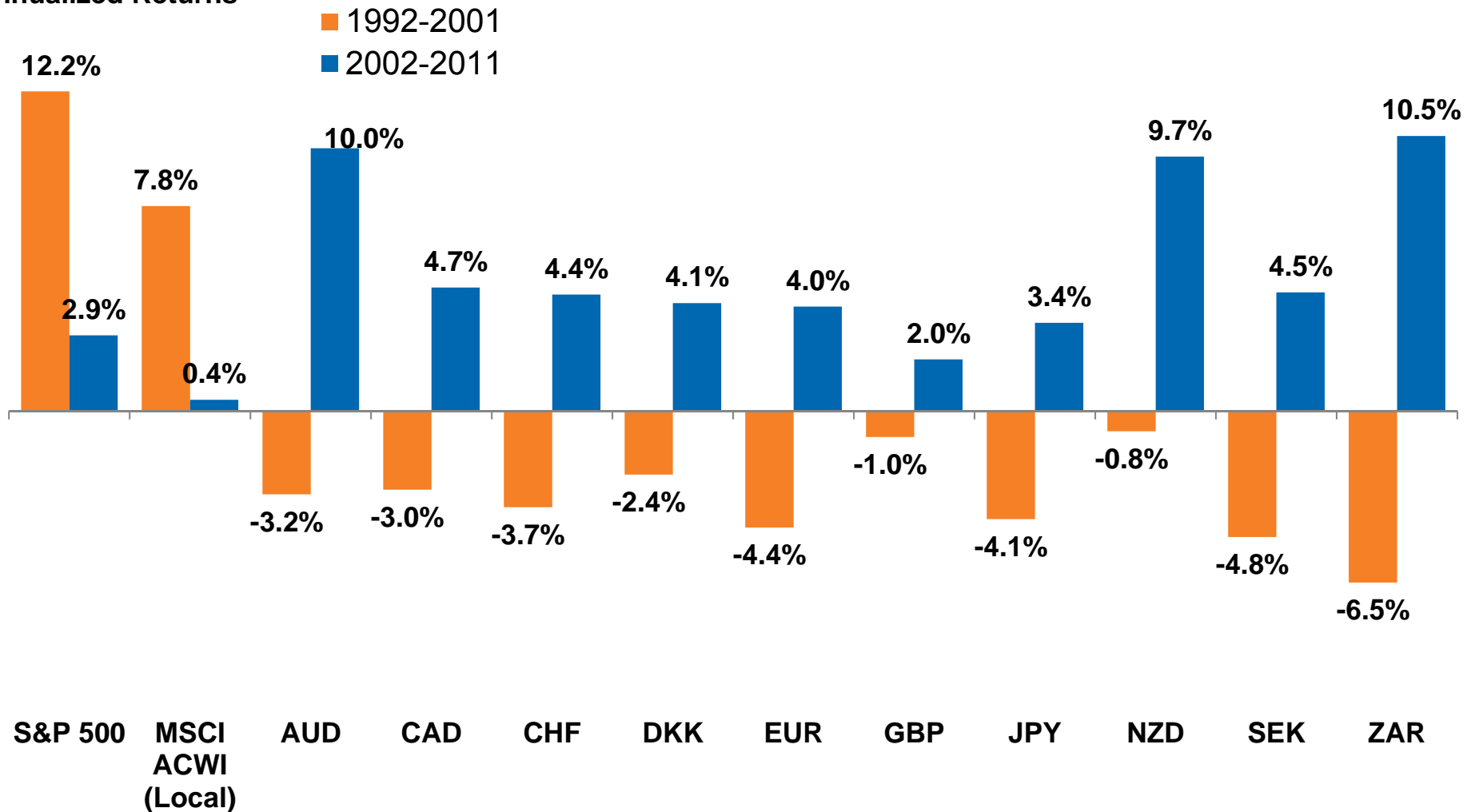


NOTE: The above allocations are intended for illustrative purposes only

Currency Returns

While volatile, can be a significant contributor to total portfolio returns

Annualized Returns

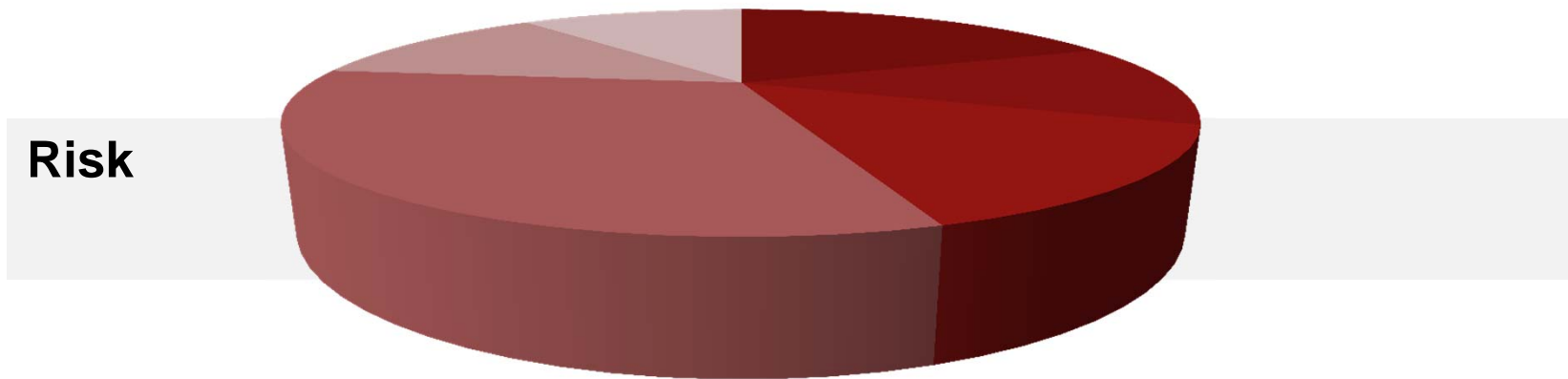


Source: Bloomberg

Managing Multiple Allocation Layers | Risk

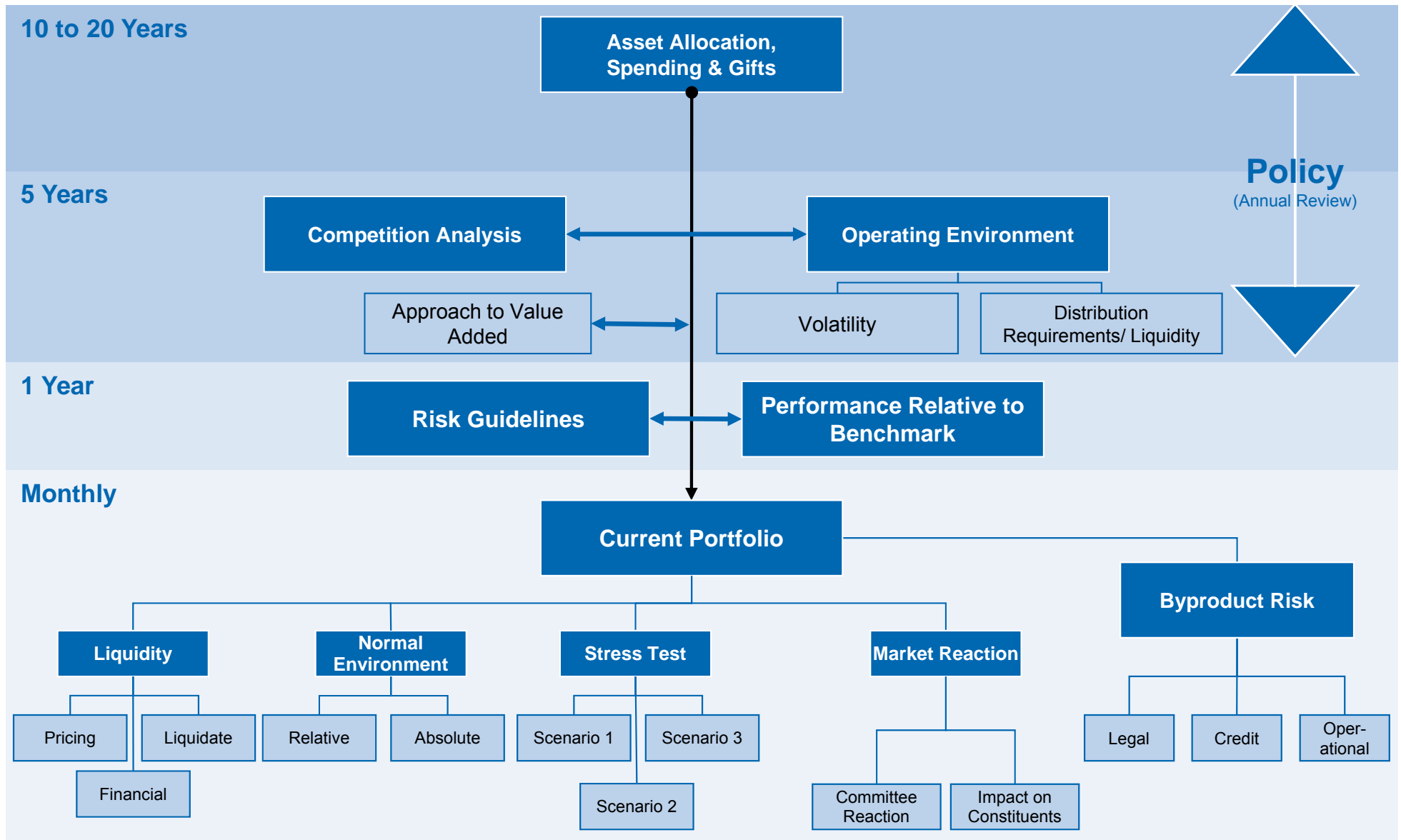
Risk Policy Development

- Develop a risk framework for policy development
- Identify risk considerations
- Consider the time dimension of risk



NOTE: The above allocations are intended for illustrative purposes only

Risk Management Framework

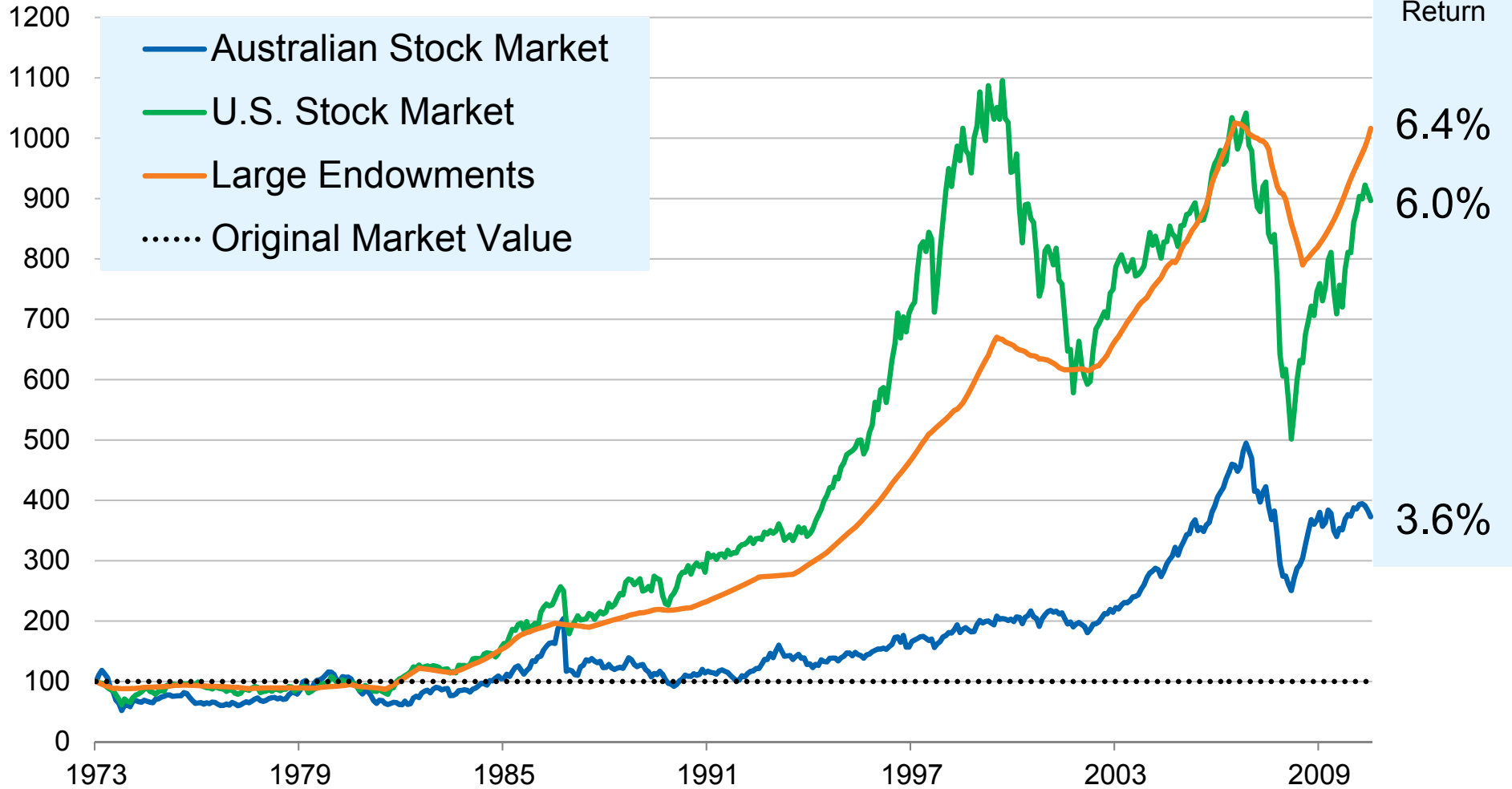


Timeframe Matters | Equity Market and Endowment Returns

Inflation Adjusted Australian Equities, U.S. Equities and Large U.S. Endowments

December 1973 to June 2011

Growth of \$100



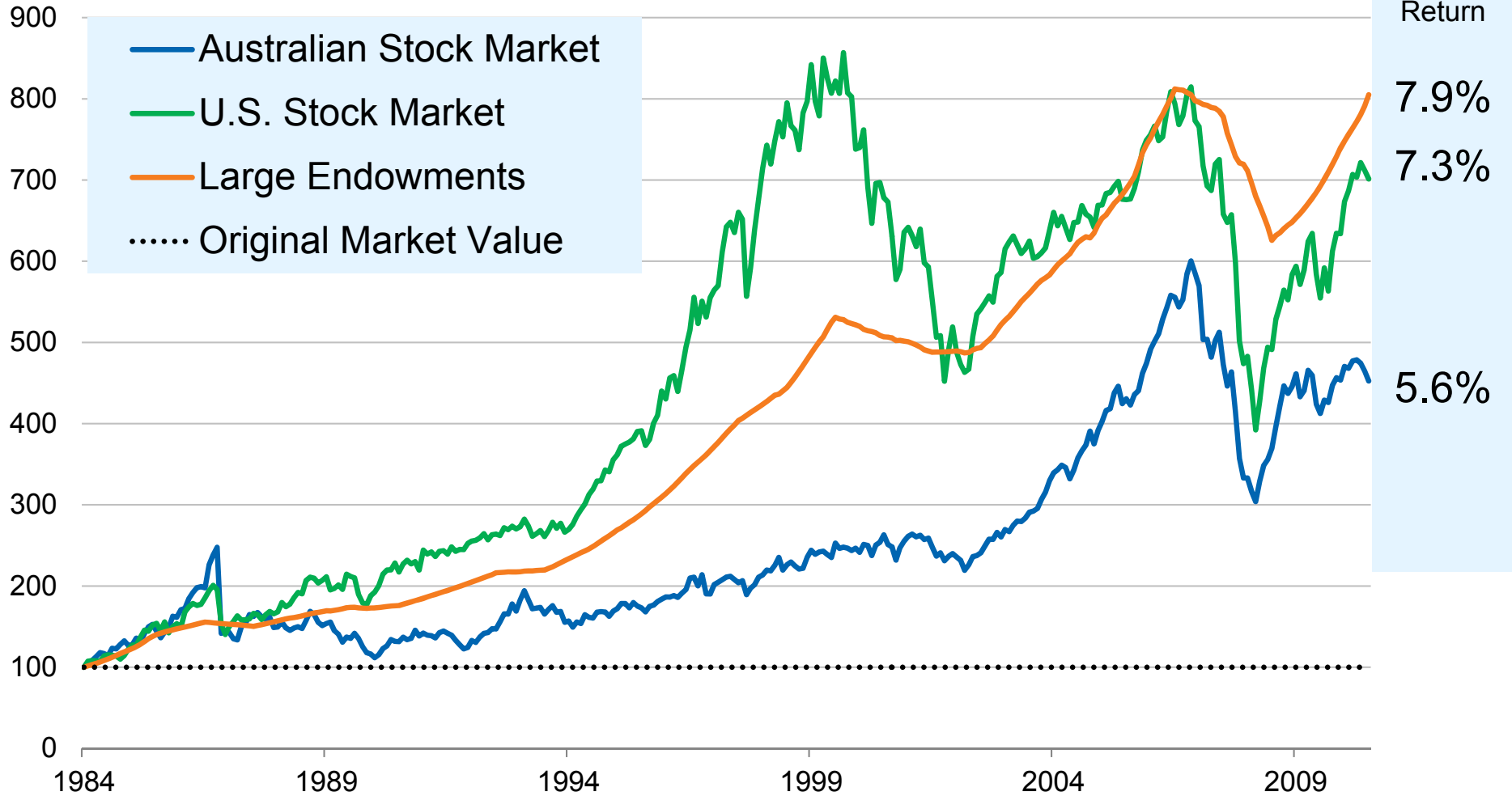
Source: Bloomberg, Australian Equities (ASX – All Ordinaries), U.S. Equities (S&P 500 Index) Large Endowment returns NACUBO and Commonfund Institute. For detailed information regarding Large Endowments see Large Endowments | Size and Historical Returns in appendix.

Timeframe Matters | Equity Market and Endowment Returns

Inflation Adjusted Australian Equities, U.S. Equities and Large U.S. Endowments

December 1984 to June 2011

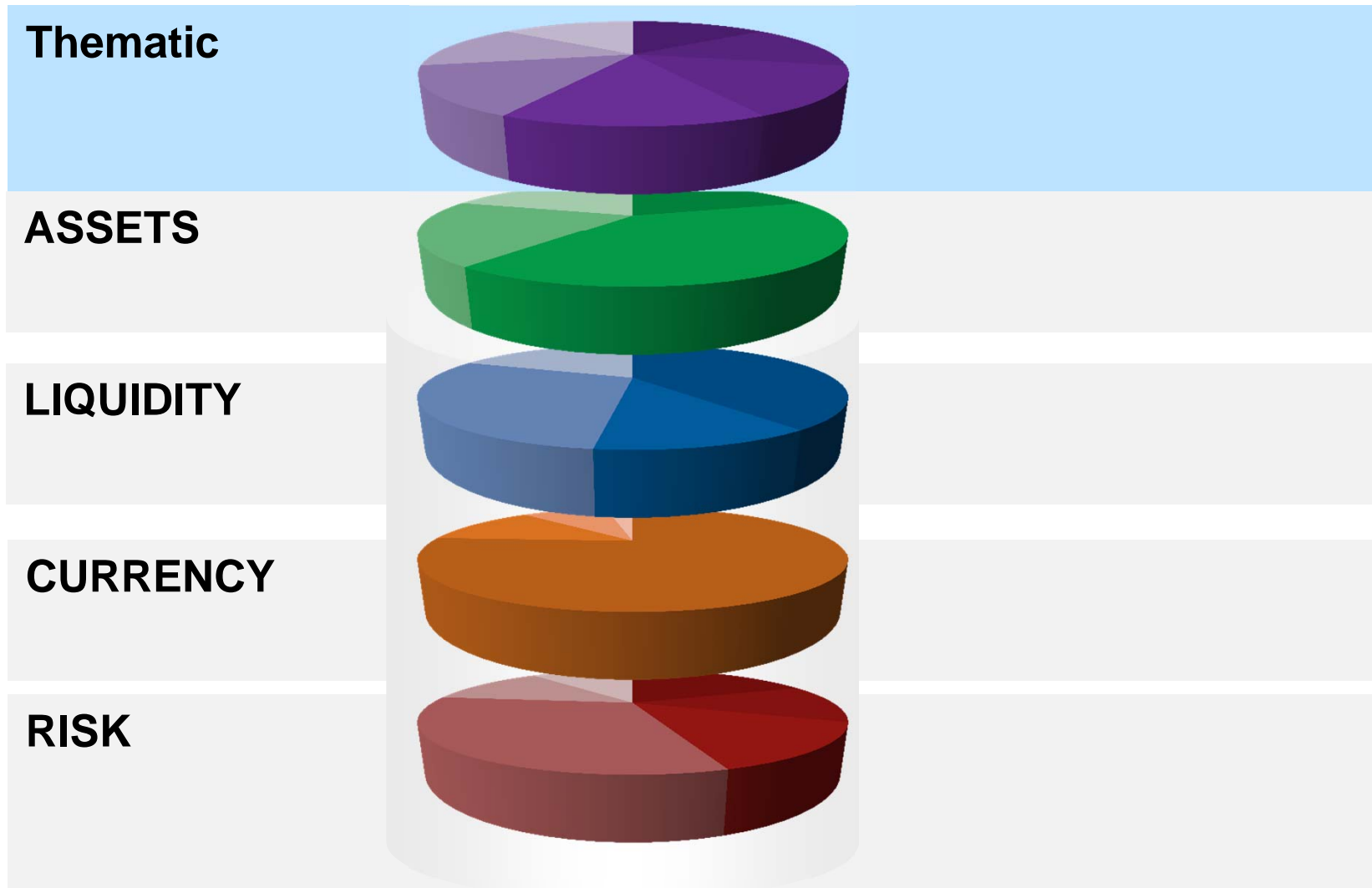
Growth of \$100



Source: Bloomberg, Australian Equities (ASX – All Ordinaries), U.S. Equities (S&P 500 Index) Large Endowment returns NACUBO and Commonfund Institute. For detailed information regarding Large Endowments see Large Endowments | Size and Historical Returns in appendix.

Managing Multiple Allocation Layers | Thematic Investing

The next layer of policy allocation



NOTE: The above allocations are intended for illustrative purposes only

APPENDIX

Large Endowments | Size and Historical Returns

Fiscal Year	Annual Return	Large Institutions Asset Size	Source
1974	-12.48%	Over \$50 Million	NACUBO
1975	11.75%	Over \$50 Million	NACUBO
1976	10.35%	Over \$50 Million	NACUBO
1977	4.17%	Over \$50 Million	NACUBO
1978	3.11%	Over \$50 Million	NACUBO
1979	12.18%	Over \$50 Million	NACUBO
1980	14.27%	Over \$50 Million	NACUBO
1981	16.61%	Over \$50 Million	NACUBO
1982	-1.63%	Over \$50 Million	NACUBO
1983	43.95%	Over \$100 Million	NACUBO
1984	-2.26%	Over \$100 Million	NACUBO
1985	25.92%	Over \$100 Million	NACUBO
1986	29.72%	Over \$100 Million	NACUBO
1987	14.99%	Over \$100 Million	NACUBO
1988	0.50%	Over \$400 Million	NACUBO
1989	14.30%	Over \$400 Million	NACUBO
1990	11.30%	Over \$400 Million	NACUBO
1991	6.00%	Over \$400 Million	NACUBO
1992	13.90%	Over \$400 Million	NACUBO
1993	14.50%	Over \$400 Million	NACUBO
1994	4.10%	Over \$400 Million	NACUBO
1995	16.60%	Over \$400 Million	NACUBO
1996	19.50%	Over \$400 Million	NACUBO
1997	21.60%	Over \$400 Million	NACUBO
1998	19.40%	Over \$1 Billion	NACUBO
1999	12.30%	Over \$1 Billion	NACUBO
2000	23.90%	Over \$1 Billion	Commonfund Institute
2001	-1.50%	Over \$1 Billion	Commonfund Institute
2002	-2.70%	Over \$1 Billion	Commonfund Institute
2003	3.10%	Over \$1 Billion	Commonfund Institute
2004	17.20%	Over \$1 Billion	Commonfund Institute
2005	13.90%	Over \$1 Billion	Commonfund Institute
2006	15.20%	Over \$1 Billion	Commonfund Institute
2007	21.00%	Over \$1 Billion	Commonfund Institute
2008	0.40%	Over \$1 Billion	Commonfund Institute
2009	-20.50%	Over \$1 Billion	NCSE
2010	12.20%	Over \$1 Billion	NCSE
2011	20.10%	Over \$1 Billion	NCSE

NOTE: Fiscal year end June 30

Source: NACUBO and Commonfund Institute, NACUBO-Commonfund Study of Endowments (NCSE)

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