BEST PRACTICES FOR NOT-FOR-PROFIT INVESTMENT COMMITTEE GOVERNANCE

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Investment committee governance for long horizon, not-for-profit investment pools is uniquely challenging. Not-for-profit investors typically seek to balance near-term spending needs while maintaining the real purchasing power of distributions into perpetuity. Maintaining this balance is becoming more difficult due to an increasingly complex, global set of investment opportunities with return expectations lower than long-term historic averages. Not-for-Profit Investment Committees (NFPICs) are the guiding hand of stewardship amidst these challenges and must continue setting policies and objectives and maintaining accountability for outcomes. In this executive summary, we discuss our opinions on the four most important elements for successful NFPIC portfolio governance, with supporting evidence from a 2018 proprietary survey of some of the largest and most sophisticated not-for-profit investment pools in the world. We provide additional perspective in the companion whitepaper[1].

1) Governing an investment portfolio is distinct from managing it.

This means a NFPIC should:

- ***Define*** portfolio objectives as they relate to supporting the non-profit organization's goals.
- ***Approve*** an investment policy, including targeted absolute returns, asset allocation targets and ranges, position size parameters, risk tolerances such as targeted volatility, market and drawdown exposures and liquidity requirements.
- ***Assess*** outcomes relative to the policy framework and objectives over time frames consistent with the portfolio's long-term horizon.

Whereas management should be relied upon to:

- ***Implement*** portfolio sub-allocation weightings, manager selection and oversight, detailed portfolio construction, and tactical asset allocation within ranges.

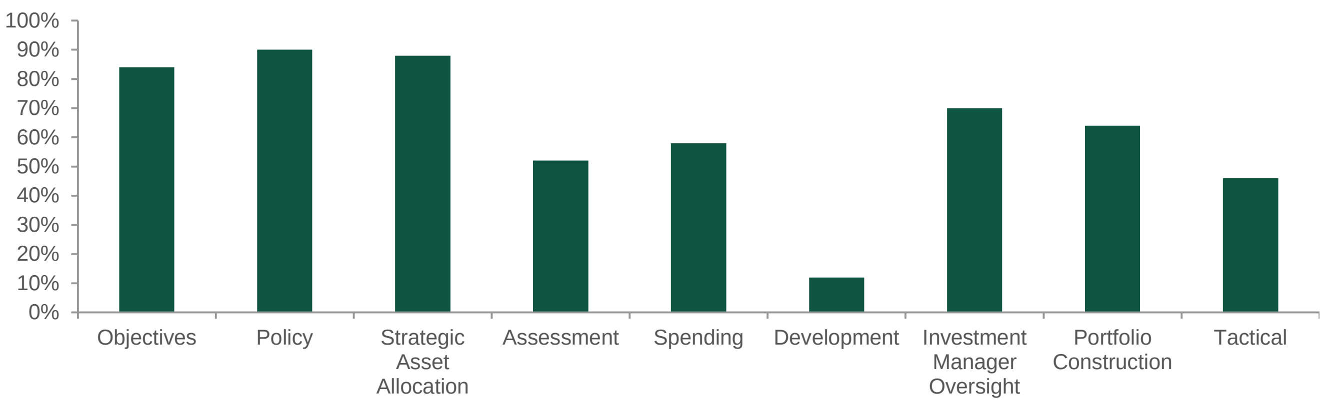
Our survey asked how NFPICs were involved in these governance and management matters (see chart on the following page). The following percentages of respondents approved:

- 89% investment policy
- 85% the definition of objectives
- 85% strategic asset allocation
- 70% investment manager oversight
- 50% assessment of outcomes relative to objectives

- 50% portfolio construction (sub-allocations, manager sizing, and combinations thereof)
- 36% tactical allocation

These results are generally in line with our expectations for NFPICs involvement. Most respondents approve investment policy, objectives, manager oversight and strategic asset allocation. However, it seems that NFPICs are too involved in portfolio construction and tactical allocation, which are tasks that should be performed by management and allow NFPICs to focus on bigger picture issues. Moreover, not enough NFPICs are involved in assessment of outcomes relative to objectives and holding management accountable for those outcomes.

EXHIBIT 1: ROLES AND RESPONSIBILITIES



SOURCE: 2018 Investment Committee Governance Practices Survey, Northern Trust Survey Asset Management

One survey respondent provided a good summary of roles in a well-balanced NFPIC/management structure:

"Management can approve new investment managers and termination of investment managers and has an internal approval/dismissal process. Management can also rebalance the portfolio and implement tactical asset allocation moves within the approved ranges of the normal portfolio. Management can also make decisions on portfolio construction."

2) Time management should be a major concern for committees.

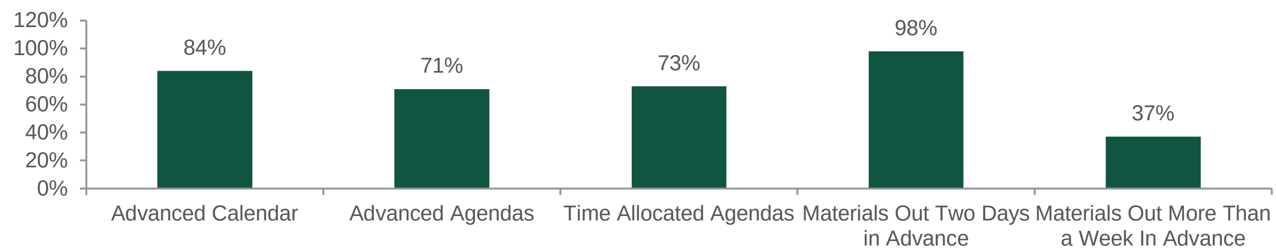
This means a NFPIC should:

- **Set meeting times in advance**, preferably by year. This helps ensure busy committee members can schedule time for meetings.
- **Set agenda items and send materials in advance.** This allows committee members to prepare for discussions and "jump right in" to dialogue and facilitate decisions in a timely manner.
- **Establish discussion time for agenda items.** This helps committees focus on strategic discussions and minimize time spent on less important topics.

Our survey asked how NFPICs handled time management:

- 84% set meeting calendars well in advance
- 71% set agendas more than two weeks in advance
- 73% allocated discussion times on agendas
- 98% send materials more than two days in advance;
  37% send materials a week or more in advance

EXHIBIT 2: TIME STRUCTURE



SOURCE: 2018 Investment Committee Governance Practices Survey, Northern Trust Survey Asset Management

The results of the survey for time structure are in line with our expectations for how committees should manage time, except that only 37% reported they send meeting materials out a week or more in advance. Busy committee members usually require more than a few days to fit reviewing committee materials into their schedules, so there is room for improvement with respect to this time management issue.

3) Regular self-assessment is essential.

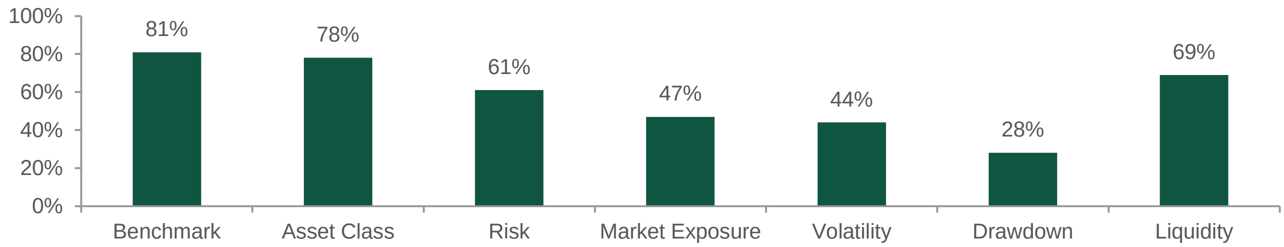
This means NFPICs need to regularly self-assess relative to:

- **Policy goals**
- **Strategic objectives**
- **Appropriate institutional time horizons**

Our survey asked NFPICs which objectives were used in self-assessment:

- 81% cited matching or beating a target benchmark
- 78% cited asset class returns
- 69% cited liquidity
- 61% cited overall risk positioning
- 47% cited market exposure
- 44% cited volatility
- 28% cited drawdown exposure

EXHIBIT 3: ASSESSING SUCCESS



SOURCE: 2018 Investment Committee Governance Practices Survey, Northern Trust Survey Asset Management

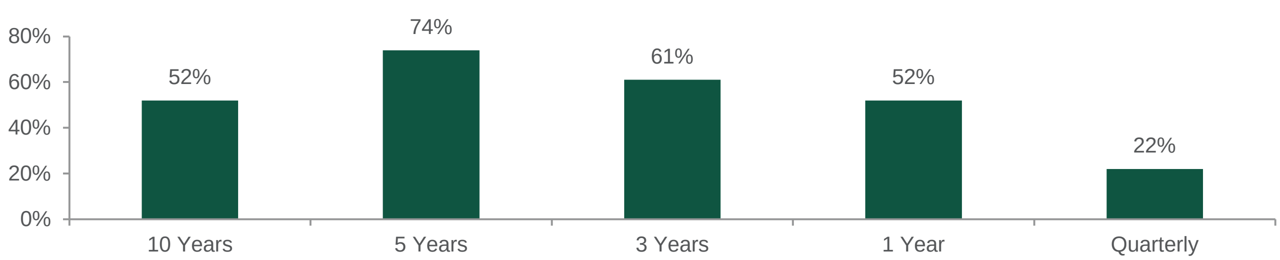
Most NFPICs focus on benchmark relative and absolute asset class returns, which is appropriate given the need to meet their institution's financial objectives. Moreover, because illiquid investments represent an opportunity set to generate higher returns for long horizon portfolios, it is extremely important to maximize exposures in this area. This can take a great deal of time and should be a major focus of self-assessment. However, it seems NFPICs do not commit enough time to assessing risk, market exposures, volatility and drawdowns. We believe NFPICs could benefit from spending more time on these issues to better fulfill their governance requirements.

Our survey also asked the top three time frames used in self-assessment (see chart on the following page):

- 52% cited using a ten-year horizon
- 74% cited using a five-year horizon
- 61% cited using a three-year horizon
- 52% cited using a one-year horizon
- 22% cited using a quarterly horizon

These results are generally appropriate for long-term portfolios, especially those that employ illiquid strategies that can take three to seven years to show meaningful results. However, it would be better for more NFPICs to focus on ten-year performance given most institutional funds are perpetual in nature. Also, we would prefer that NFPICs did not focus on quarterly horizons, which are too short for perpetual funds.

EXHIBIT 4: TIME FRAMES



SOURCE: 2018 Investment Committee Governance Practices Survey, Northern Trust Survey Asset Management

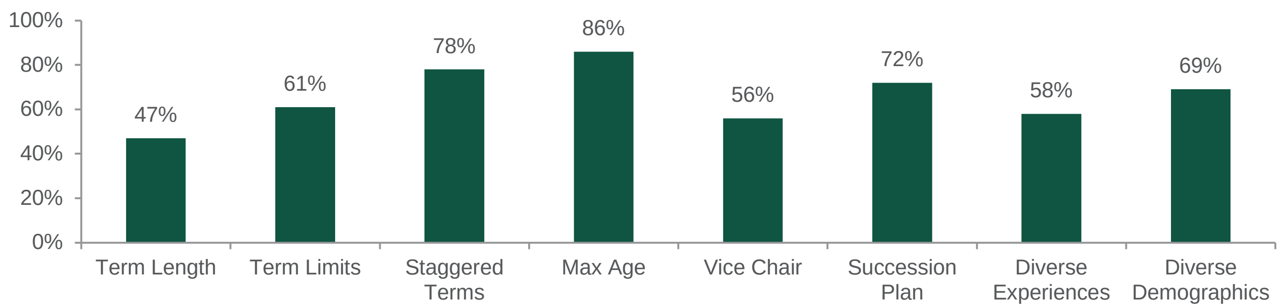
4) **Committee member continuity and diversity of thought is essential.**

This means NFPICS should have **formalized measures** to ensure continuity and diversity**.**

Or survey of NFPICs determined that:

- 64% had no term limits for the chair
- 56% had no prescribed term lengths for the chair
- 56% did not have a vice chair role or chairperson elect
- 72% lacked a formal succession plan
- 47% had no prescribed term lengths for members
- 61% had no consecutive term limits for members
- 78% lacked staggered committee member terms
- 86% did not have a maximum age limit for members

EXHIBIT 5: LIMITED FORMAL CONTINUITY MEASURES



SOURCE: 2018 Investment Committee Governance Practices Survey, Northern Trust Survey Asset Management

Providing consistent direction and oversight for a long horizon investment program, governance continuity and incorporating new and different perspectives is important, and achieving these goals is associated with better key governance results. Moreover, a deliberate approach to continuity helps extend success over the long term, which is the essence of stewardship.

Based on the survey results, it seems NFPICs can benefit from material improvement in their continuity and diversity practices. Consistent with our sample charter[2], more NFPICs should define term lengths, set consecutive term limits, set maximum age limits, stagger committee member terms and implement a formal chairperson succession plan, including the structured use of a vice chair role.

SUMMARY

We believe there are four key considerations that NFPICs should take into account when serving their institutions long term needs. They should realize that portfolio governance differs from portfolio management, time management is a major concern, self-assessment is essential as is member continuity and diversity. Through our proprietary survey, we have found that many NFPICs use recommended best practices with respect to these considerations. On the other hand, we have found there is substantial room for improvement in governance practices. More specifically, we believe that more NFPICs should:

- Rely on management so committees can focus on big picture issues.
- Commit time to assessing risk, market exposures, volatility and drawdowns.
- Send out meeting materials further in advance of meetings and focus more on longer-term rather than shorter-term time horizons in assessing success.
- Define term lengths, set consecutive term limits, set maximum age limits, stagger committee member terms and implement a formal chairperson succession plan, including the structured use of a vice chair role.

We recommend these best practices based on our decades of industry experience working with large and sophisticated institutional investors and believe that any NFPIC can benefit from examining their governance practices through the prism laid out in this summary and expanded on in the companion whitepaper[1].

Note: We are fortunate to interact with many of the largest and most sophisticated not-for-profit investment pools in the world. In the first quarter of 2018, we distributed a survey to 222 not-for-profit entities and received responses from 50.

[1]*Review of Best Practices in Not-For-Profit Investment Committee Governance: Roles, Time, Success and Continuity*, Northern Trust Asset Management

[2]Northern Trust Asset Management has a sample Investment Committee Charter and a sample Investment Policy that we make available to clients to help guide their development of these important documents.

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