GOVERNANCE: THE CORNERSTONE OF SUCCESSFUL INVESTMENT PROGRAMS

Endowment and Foundation Practice Team

Introduction

Sound governance is the foundation of any effective investment program. It ensures an efficient and prudent decision-making process to better support the goals and objectives of the organization. To this end, we frequently field questions from members of investment committees and staff on best practices for governance for the oversight of assets of an endowment or foundation. These queries run the gamut, ranging from the optimal size of an investment committee to succession plans and the most efficient ways to conduct committee meetings. Through this paper, we seek to summarize our thoughts, experiences and opinions on key governance criteria for consideration in the management of your investment program.

In addition, we share the key findings on your peers' thoughts and views around governance practices from NEPC's *2015 Survey of Endowments and Foundations on Governance*.

GOVERNANCE HELPS SET A CLEAR PATH FOR A BOARD, INVESTMENT COMMITTEE OR STAFF TO HELP STEWARD AN INSTITUTION OR INVESTMENT PROGRAM

We conducted a survey of a diversified group of endowments and foundations. The respondents represented a broad swath of institutions, from university endowments to private foundations whose assets ranged from $50 million to over $1 billion.

We hope our comments will provide additional perspectives on how to enhance governance practices within your organization. As always, please don't hesitate to reach out to your NEPC consultant if you have any additional questions.

What is governance?

Simply put, governance is part of the fiduciary duty of the board, investment committee or staff to prudently manage the investment program in support of its mission. There are many paths to sound governance; however, common themes exist around clear objectives, strong leadership, open communication and diversity of ideas and people.

Why is governance important?

Governance helps set a clear path for a board, investment committee or staff to help steward an institution or investment program. Many board or committee decisions have enormous impact on an institution. A well-conceived and efficiently executed process best ensures consistent and effective decision-making amid a multitude of operating environments and challenges.

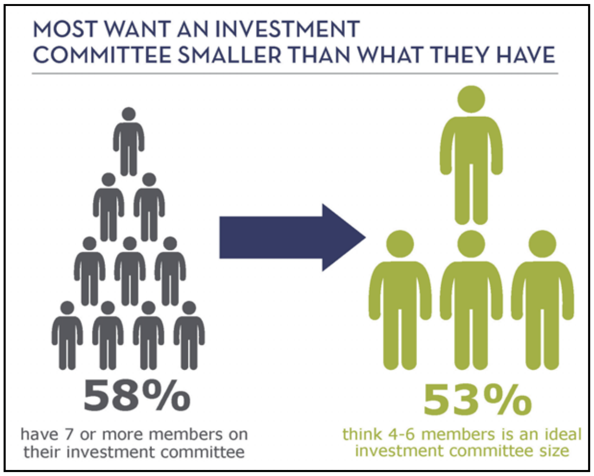
What Makes an Effective and Efficient Investment Committee?

Smaller is Better

A smaller investment committee tends to be more productive and efficient with decision making. We have worked with large committees of over 20 members with the drawback that too much time is spent recapping and revisiting prior meetings since many members do not regularly attend. These committees often run out of time to address all important agenda items!

Our survey showed that over 50% of endowments and foundations favor smaller investment committees with four to six members as the optimal size. However, in reality, 58% of survey respondents have seven or more members (Exhibit 1). A smaller investment committee is a "wish list" item for many organizations.

Exhibit 1: Investment Committee Size



Diversity and Different Backgrounds are a Plus

Committees work better and avoid "group think" when members have different life experiences and investment perspectives. For instance, we frequently see committee members lean more heavily on the "hedge fund expert" when making a decision on hedge funds or on the energy company executive for their opinion on energy investments.

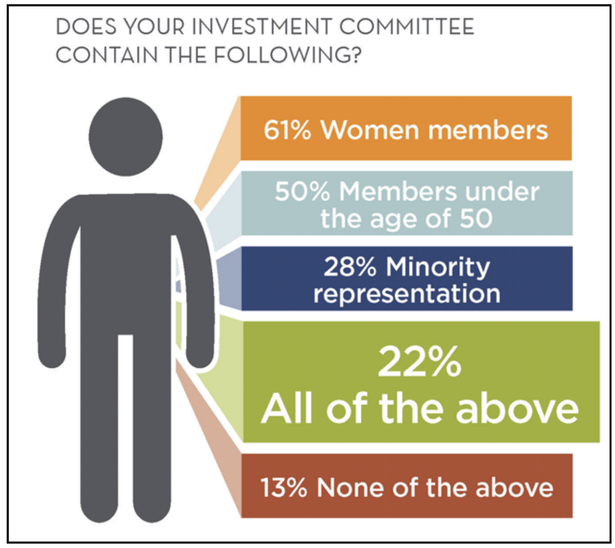
Our survey respondents ranked investment knowledge and business experience as the most important criteria when selecting new committee members (Exhibit 2).

Exhibit 2: Investment Committee Qualities

Although diversity only ranked six out of the seven listed attributes in importance when selecting new committee members (Exhibit 2), we find diversity is vital to promoting open discussion and differing points of view. 92% of survey respondents think a diversified committee drives a successful investment program, yet only 22% of respondents stated that their committees include women, younger members and minority representation (Exhibit 3).

Have a Succession Plan

Exhibit 3: Investment Committee Diversity



Investment committees seek stability in the form of continuity of members while also bringing in "fresh faces" and new ideas. Continuity is relevant as it is important to know the history of why decisions were made, especially during difficult market times or when an investment manager is struggling with performance. Without adequate continuity, committee members may not know the historic reasons behind decisions. On the other hand, it is also vital to bring in new members with different ideas and backgrounds. There are trade-offs between having term limits and open-ended positions.

A succession plan is necessary to ensure continuity and leadership. For instance, an effective succession plan should identify the next chair of the investment committee or potential new committee members. An example of good succession planning is an endowment that has rolling six-year terms for its investment committee with one new person being added and one person leaving each year.

In our survey, 45% of respondents stated they did not utilize term limits. Furthermore, of those who use term limits, 20% had limits of seven years or greater. We believe that term limits allow for fresh ideas and thinking among members along with the ability to increase diversity. Being open to different ways of looking at a problem or new approaches to an issue are critical to the overall success of an investment program, especially in a world that is constantly changing; complacency and resistance to change can be detrimental.

Avoid Conflicts of Interest

Sound governance documents should also address conflicts of interest. For example, the documents should state whether a committee member's firm can be used within the investment program and, if yes, whether the committee member should recuse him/ herself if there is any discussion or vote. Finally, there should be a periodic sign-off, for instance, annually, by members on any potential conflict of interest.

DECISION-MAKING AUTHORITY NEEDS TO BE UNDERSTOOD BY ALL FIDUCIARIES

How to have Effective Investment Committee Meetings

Attendance and Preparation

Consistent attendance makes for more productive and efficient meetings. Unfortunately, the reality is that most investment committee members are volunteers who are busy with their "day jobs" and other volunteer engagements. Decisions can drag out when attendance isn't consistent or there isn't the required quorum at a meeting. In one instance, we saw an endowment exert subtle pressure on their committee members to attend meetings by putting their attendance record—for example, five out of eight meetings—after their names in the meeting minutes. Now, this investment committee has great attendance!

The meeting materials also need to be concise, decision-oriented, and available in advance so members can be prepared. As a consultant, we have to continually tell ourselves that brevity is better! Have an executive summary that highlights the agenda and actionable items. Provide a supplementary book with details for those members who want to get into the weeds. Make sure the agenda isn't overcrowded with too many topics to cover. We have seen a shift away from having investment managers at meetings, which leaves more time for higher-level discussion on areas of greater impact, such as asset allocation or impact investing. We have seen investment committees set up separate monthly calls to conduct due diligence meetings with investment managers.

Getting the Most Out of Investment Committee Meetings

The investment committee chair should work with staff and the investment consultant to determine the agenda and actionable items for the meeting and review the materials ahead of the meeting. In addition, opinions and/or questions should be solicited from members prior to the meeting on any sensitive items to help drive consensus and discussion for decision making. A strong investment committee chair works to get consensus, steers the committee back to the agenda topics and makes sure everyone's input has gone into the decision-making process. Lastly, committee members should work collectively, leaving personal biases aside, to focus on what is best for the institution's investment pool.

How to Delegate Responsibility

An effective governance policy ensures the responsibilities of the fiduciaries are not only clearly defined, but also delegated to the board, investment committee, staff, investment managers and/or the investment consultant. Investment policy and asset allocation are the most important decisions and they are usually approved by either the investment committee or the board. Endowments and foundations with large investment staffs may have the staff take on greater responsibilities for conducting due diligence on investment managers, hiring/firing managers or rebalancing the fund than programs with a small staff or a Chief Financial Officer who has many other responsibilities. The organization needs to know:

- Who has responsibility to vote/approve (i.e., issues on asset allocation or a manager hiring)?
- Who provides advice or a formal recommendation?
- Who reviews and provides oversight on the decision?
- Who implements the decisions?
- Who is notified as an interested party?

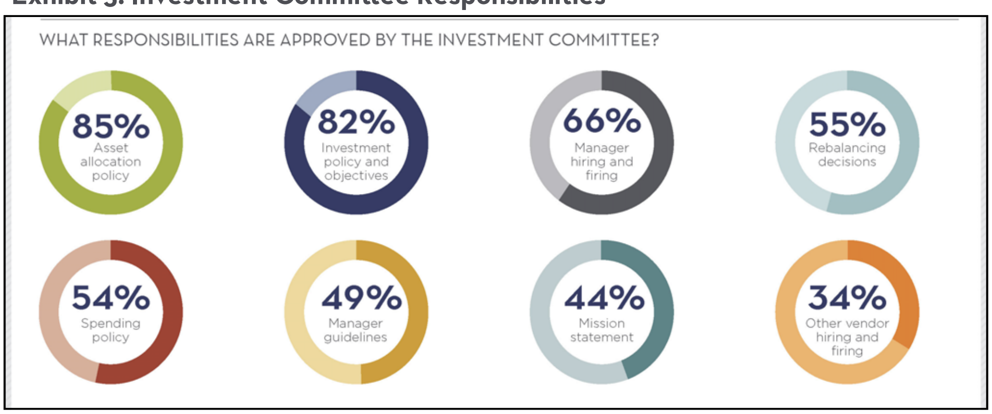
Exhibit 4 lists some of the key responsibilities where the decision-making authority needs to be fully understood by all fiduciaries. We have indicated the typical decision maker; however, this may vary from one organization to another based on the size of the investment pool and the staff. Additionally, the decision-making authority may have evolved with some programs migrating to an outsourced Chief Investment Officer provider and delegating a part of these responsibilities to that provider.

Exhibit 4: Delegation of Responsibility

Responsibility	Typical Decision Maker
Set Strategy:	
Mission Statement	Board
Investment Policy Statement	Board /Investment Committee
Spending Policy	Board/Investment Committee
Code of Ethics	Board
Long-Term Asset Allocation	Investment Committee
Rebalancing Policy/Ranges	Investment Committee
Implement Strategy:	
Tactical Deviations from Policy Target	Investment Committee
Rebalancing within Ranges	Staff
Manager Evaluation and Structure	Investment Committee
Manager Approval/ Termination	Investment Committee
Investment Manager Guidelines	Investment Committee
Monitor Strategy:	
Manager Due Diligence	Staff and Investment Consultant
Guideline Compliance	Staff and Investment Consultant

From our survey, over 80% of investment committees approve the asset allocation policy and investment policy statement (Exhibit 5).

Exhibit 5: Investment Committee Responsibilities



Investment Committee Self-Assessment

Investment committees periodically evaluate staff, the investment consultant, and investment managers; however, we rarely see investment committees conduct a self-evaluation to see how they can improve the effectiveness of meetings and decisions. In our survey, only 21% of committees conducted an annual self-assessment. One of our clients recently implemented a quarterly survey with quick "check the box" type of questions to garner feedback on the meetings. While quarterly check-ins may be too frequent, we believe an annual self-evaluation can help identify areas of strength and those for improvement to make the investment committee more effective.

Exhibit 6 identifies some potential sample questions to ask in a self-assessment evaluation.

Exhibit 6: Self-Assessment Questions

Investment Committee Self-Assessment Survey
Do you understand your responsibilities as a committee member?
Do you think you are doing a good job as a committee member? How can you improve? How can the committee improve?
Do you have the opportunity to provide input and opinions?
Do you understand how the organization's goals are integrated into the investment approach?
Are decisions made on a timely basis or do they linger over several meetings? How can decisions be made quicker?
Are you provided the meeting materials on a timely basis to review before the meeting?
Are the meeting materials concise and do the materials provide the action items and rationale needed to make decisions?
Do you have enough education on investment topics to make decisions?
Are meetings too long and/ or are additional meetings needed?
Do you understand your fiduciary responsibility?

Concluding Thoughts

Hopefully, some of these suggestions and potential best practices on governance will assist with the challenges that investment committees and staff face frequently in the day-to-day oversight of an investment program. Not surprisingly, our survey respondents listed many of the concerns we have addressed here. Respondents felt that timeliness of decision-making (24%) and external time commitments of the committee (22%) were the biggest challenges (Exhibit 7).

Exhibit 7: Investment Committee Challenges

We strongly believe that sound governance practices and their communication to all fiduciaries better aligns investment practices with the organizational mission.

Disclaimers and Disclosures

- The information in this report has been obtained from sources NEPC believes to be reliable. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.

- The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.