The Non-profit Fiduciaries' Handbook

A step-by-step guide to investment strategy for non-profit investors

Canadian edition

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Preface – A Canadian perspective

World-trade tensions, elections, climate change, along with continued low interest rates have made the world of investing an extremely challenging place. Add in the personal & economic challenges of the COVID-19 pandemic, and the uncertainty that such an event brings, it is clear that investors need to manage more risks than ever, while seeking returns in a an ever-more creative way.

In Canada, the investing landscape for non-profit organizations is being influenced in the following ways:

- More and more non-profit fiduciaries are discussing whether meeting their mission means "existing in perpetuity" or "spending down to meet today's challenges". Which direction they choose will drive the decisions made about spending rates, risk tolerance, liquidity needs, and strategic asset allocation.
- Many foundations spend more than the 3.5% CRA-mandated minimum disbursement for charitable organizations. We see many of our foundation clients spending close to 5% after accounting for both charitable spending and administration. Sustainably supporting a 5% spending rate can be a significant challenge in today's low-return environment.
- The uncertain market environment is making the pursuit of stable returns that much harder to achieve, and many nonprofits are looking for ways to enhance returns without taking on additional risk.
- The continued volatile market environment is making the pursuit of yield and income projection that much harder to achieve, and many non-profits are looking for ways to enhance returns without taking on additional risk.
- Ensuring the sustainability of your investments has also taken on a double meaning – Not only must fiduciaries seek ways to produce returns, often in conjunction with sustainable payout policies, but fiduciaries are now being asked to consider environmental, social and governance (ESG) or "sustainable investing" factors to create value in a manner consistent with your broader organizational mission.

With these challenges in mind, we created this handbook. In this updated version, we hope that it provides fiduciaries with clear guidance on the strategic decisions they are responsible for and how to best work with an outsourced CIO provider to achieve their goals.

We hope that it helps you continue the exceptional work you're doing in your communities around the globe.

See "Important information" for details.

Introduction

The fiduciary responsibility never gets smaller. Yet the circumstances in which to carry that fiduciary burden are ever-more challenging. As we look forward to emerging from the challenges of the COVID-19 pandemic, the economic uncertainties are as high as ever. In other areas, greater pressures are being brought on fiduciaries to ensure that investment returns are achieved in an ethical and sustainable manner. Environmental, social and governance (ESG) considerations are now mainstream considerations, not issues for niche products. Indeed, during the COVID-19 pandemic timeframe, issues of social and racial equality have become headline issues. How is a fiduciary supposed to ensure that the investments not only produce the investment returns needed, but also harvests the returns in an appropriate manner?

As a non-profit fiduciary, you have a difficult job. You need to ensure that your organization has the money, talent, experience, and resources to fund your non-profit's mission. And you need to do this in a never-changing market environment. This means you need to set clear and achievable goals, adapt quickly to rapidly changing circumstances, and continually look for the appropriate balance between investment risk and return. And, you need to find effective ways to implement and manage your chosen strategy.

We know it's a lot to ask, which is why we created this handbook—to help non-profit fiduciaries effectively oversee their investment programs. We believe one of the best ways to manage today's unique challenges is to work with a fiduciary partner – delegating some of your current responsibilities to a trusted co-fiduciary can allow you to re-focus on oversight and strategic decisions.

There are a lot of competing terms used in the marketplace – Fiduciary investment manager, Outsourced chief investment officer (OCIO) or Implemented consultant – all referring to a trusted partner who can take on some of your current duties but also enhance the sophistication and oversight of your investment program at the same time.

Our hope is that you'll be able to use the practical advice provided in this handbook to foster evocative discussions within your organizations that brings about meaningful change and progress.

Sincerely,

Andrew Kitchen

Managing Director, Institutional Canada
Russell Investments Canada Limited

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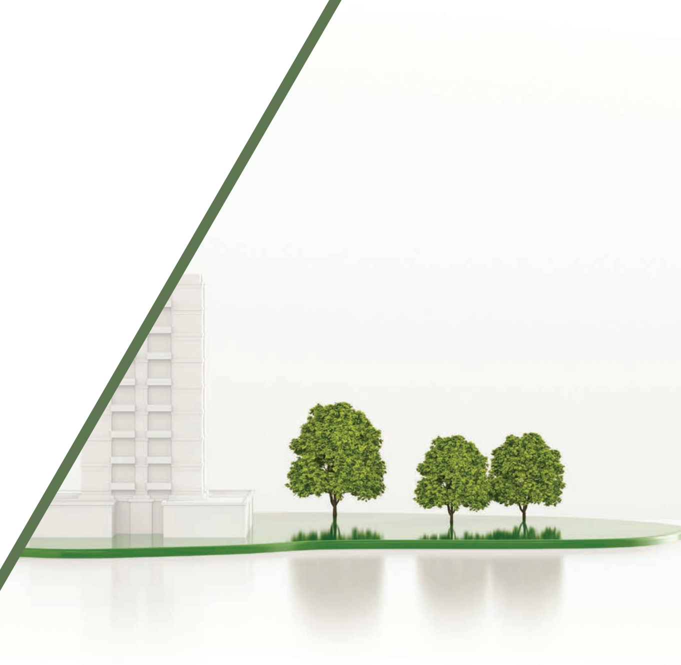
SECTION 1

Being an effective fiduciary



As a fiduciary, you are always in control...

Being a fiduciary for a non-profit organization in today's complex and volatile market environment is an incredibly important, yet very tough, job. Your roles are to establish and monitor an investment policy designed to meet your organization's goals, set an effective spending rate, and ensure that your investment program can support the needs of your community for many generations to come.

An effective fiduciary understands:

- How decisions are made
- Who is most qualified to make decisions
- How decisions are monitored

...but being in control can be challenging

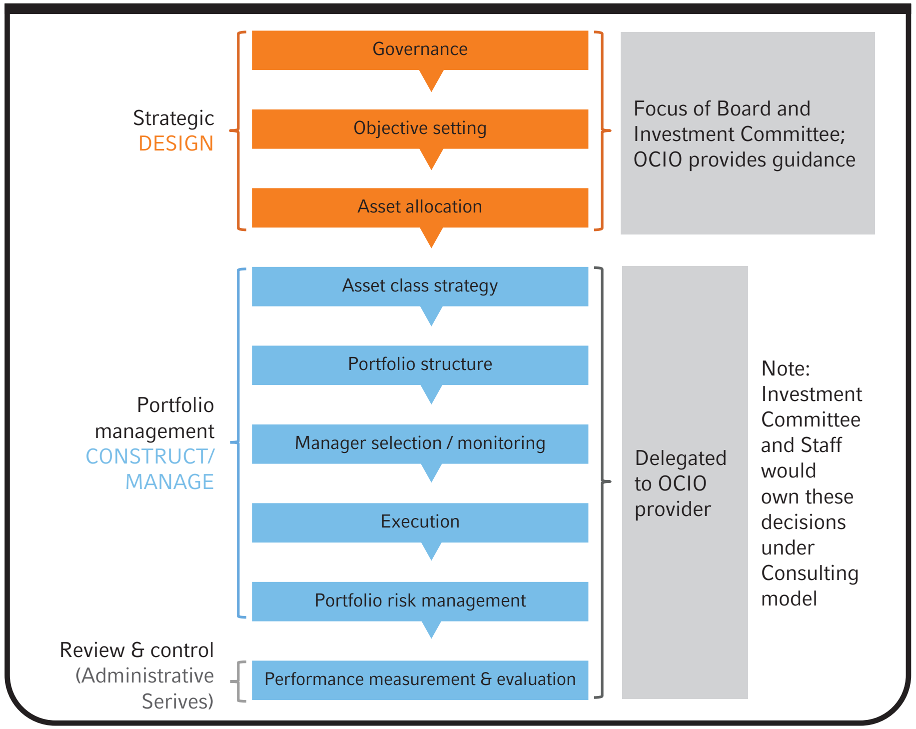
Balancing your desire to spend money on today's beneficiaries with your organization's desire to exist in perpetuity is challenging under the best circumstances; let alone in an investing environment that seems likely to deliver volatile returns for the foreseeable future.

Part of being an effective fiduciary is understanding where to direct your limited time and resources. In a market environment that is fast moving and increasingly complex, investors need to be fleet of foot to capture evolving opportunities and mitigate risks. And organizations that are depending on the cadence of quarterly consultant meetings to manage this volatility will quickly find that this approach is leaving return opportunities on the table.

This realization is driving many non-profit organizations to seek the expertise of a fiduciary investment manager or outsourced chief investment officer (OCIO) provider. In fact, working with such a provider may be the best way to help ensure you are meeting your fiduciary duty in today's environment. That is the perspective we will take throughout this handbook. The pages that follow will illustrate how to best set up your investment program with the help of an external provider.

The fiduciary roadmap

Below is what we call the fiduciary roadmap. It shows a clear hierarchy of decisions fiduciaries must make, and delegate, in running their portfolios.



As a fiduciary, you should always retain control of governance and objective setting. You should also have the final say on the strategic asset allocation (SAA) for your investment portfolio.

After that, you should delegate and oversee the results.

Handing off the remaining responsibilities to a fiduciary partner frees up your board, investment committee, and staff to focus on big-picture governance issues, rather than the time-consuming, day-to-day management of your investment program.

An overview of delegation structures

In the table below, we've identified the decision-making responsibilities required to effectively oversee your investment program, and how those decisions are typically allocated when working with a fiduciary partner such as an OCIO provider.

	RESPONSIBLE PARTY	
	OCIO PROVIDER	NON-PROFIT ORGANIZATION
STRATEGIC DESIGN		
Identify governance structure	ADVISES	RESPONSIBLE
Identify objectives for investment program	ADVISES	RESPONSIBLE
Asset / liquidity / financial analysis	RESPONSIBLE	OVERSEES
Investment policy statement	ADVISES	RESPONSIBLE
Strategic and tactical asset allocation policy	ADVISES	RESPONSIBLE
PORTFOLIO MANAGEMENT		
Investment manager research	RESPONSIBLE	OVERSEES
Investment manager selection, contracting, monitoring, transitions, and terminations	RESPONSIBLE	OVERSEES
Execute rebalancing policy	RESPONSIBLE	OVERSEES
Minimize cash in the portfolio	RESPONSIBLE	OVERSEES
Monitor risk exposures at the portfolio level, identifying sources of risk	RESPONSIBLE	OVERSEES
Adjust exposures to risk sources that exceed tolerance	RESPONSIBLE	OVERSEES
REVIEW AND CONTROL		
Maintain investment policy statement	ADVISES	RESPONSIBLE
Custody and administrative support	RESPONSIBLE	OVERSEES
Daily investment manager performance review / reporting	RESPONSIBLE	OVERSEES
Quarterly manager performance review / reporting	RESPONSIBLE	OVERSEES
Online daily account access	RESPONSIBLE	OVERSEES

Determining your delegation structure

Now, it's your turn. On the following page, spend a few minutes completing the table so that it represents your organization's decision-making structure. Remember, all governance structures should embrace the following:

- Decision-making and oversight should be separated, and you should clearly identify who is responsible for making what decision.
- Decision-making authority should be delegated to the person or entity deemed most competent to make the decisions, and who has the time and resources to make those decisions effectively and quickly.

When you are filling out this chart, watch for areas of disconnect where you either don't have a clear decision-maker identified, or there are two entities responsible for making the same decision. These are areas you should address with your board, investment committee, staff, and external provider.

	RESPONSIBLE PARTY	
	OCIO PROVIDER	NON-PROFIT ORGANIZATION
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Investment policy statement		
Strategic and tactical asset allocation policy		
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REVIEW AND CONTROL		
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Quarterly manager performance review / reporting		
Online daily account access		

SECTION 2

Defining your investment goals and objectives

SECTION 2

Chapter 1: Investment considerations for non-profit organizations

Are you clear on the goals you're trying to achieve?

Before you begin setting up the parameters for your investment program, it's important that all of your fiduciaries are aligned on your organization's mission and goals. A mission statement is critically important; it spells out your organization's reason for being. You need to articulate your mission and goals, and formally review these at regular intervals. If you have not already done so, we encourage you to start now.

Organization ______________________________

Mission ______________________________

We wish to exist: In perpetuity Not in perpetuity

To what extent does your non-profit rely on your investment program (i.e. what percentage of the annual operating budget is supported by the program)? ______________________________

Does your non-profit have any investment restrictions (i.e., does it require screening for certain investments)? ☐ Yes ☐ No

Your goals

Typical goals of a non-profit's investment program include:

- ☐ Support current spending needs
- ☐ Support future spending needs
- ☐ Maintain sustainable spending levels
- ☐ Ensure predictability of spending
- ☐ ______________________________
- ☐ ______________________________
- ☐ ______________________________

Use the extra lines to add goals that are unique to your non-profit, or to replace a "typical" goal

Three fundamental considerations in non-profit investment management

1. Reward ❯ **To earn positive returns**

Grow your portfolio to accommodate ongoing spending over your specified time horizon.

2. Risk ❯ **To manage risk**

Know which risks are worth taking and which risks are not. This is to reduce the likelihood of capital loss and the inability to fund your spending commitments.

3. Inflation ❯ **To maintain purchasing power**

Ensure your ability to fund your mission for as long as desired.

Investment returns matter—a lot

It is critical to a non-profit's long-term survival that its spending be aligned with its overall portfolio target return. In the long run, spending in excess of the real return generated by your portfolio will lead to a decline in purchasing power and limit your capacity to sustain your spending program.

So, what's the minimum return you need to make to maintain your status quo?

That level of return is generally called the **target return**, which can be calculated as follows:

Target return = Spending

\+

Inflation

\+

Expenses

(e.g., investment management and operating)

Taking the right risks is critical

Risk is an essential component of your investment program because you need to assume some level of risk in order to meet your target return. But risk can come in many forms. The risks you want to take are the ones that provide a return—the compensation you hope to receive for taking risk. That expected return is called a *risk premium*.

To determine which risk premium (or premia) you should exploit, you need to:

- Decide on the target return you wish to achieve (e.g., 5% spending + inflation + expenses).
- Evaluate how much risk you may need to take in order to achieve that target return, and if that is in line with your *risk tolerance*—your comfort level for taking risk.
- Only take risks for which you believe you will be compensated.

Credit, equity, currency, and illiquidity are some examples of risk premia, and most investment programs will have some exposure to each.

Inflation can make a big difference

If your goal is to exist in perpetuity, preserving capital and maintaining the purchasing power of your assets over time is important. To do this, your target return must—at a minimum—be equal to the rate of inflation plus spending plus expenses.

When calculating your target return, it's important that you choose a measure of inflation that best reflects your non-profit's sector. This is because not all sectors experience the same rate of inflation. For example, those in the education sector typically face an inflation rate that is materially higher than inflation rates in other parts of the economy.

See common measures of inflation

INFLATION MEASURE	WHAT IS MEASURED
Canadian Consumer Price Index (CPI)	An index that measures the average change over time in the prices paid by urban consumers for a basket of consumer goods and services.
Higher Education Price Index (HEPI)	An index that tracks the main cost drivers in higher education. The index covers most campuses' current operational costs (e.g., salaries of faculty, administrative, clerical, and service employees).
Medical CPI	An index that measures the average change in price for hospital and related services, professional medical services and medical care commodities.

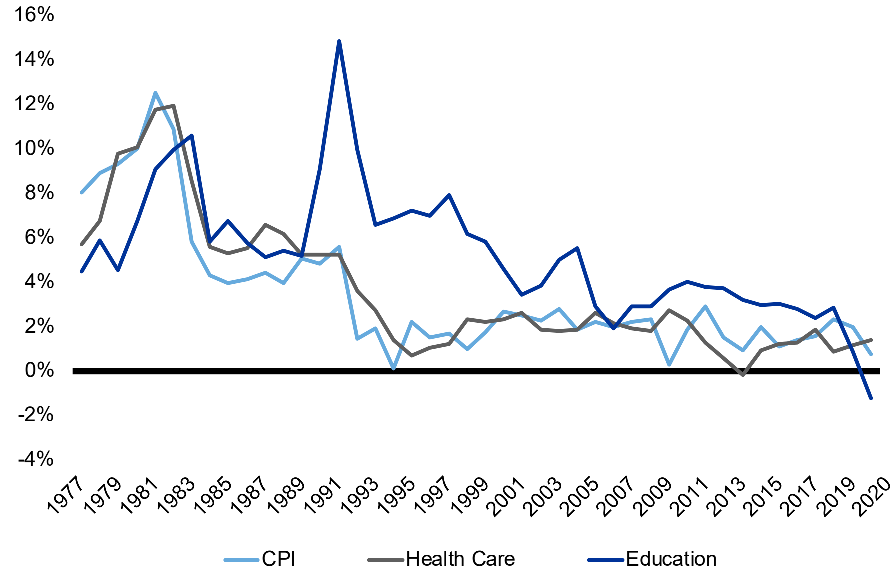
My organization's inflation measure is: ____________________

Because: ____________________

The inflation measure you select is important

To see how various measures of inflation can track quite differently in the same market environment, look at the chart below. You'll see why it's important to ensure that you're appropriately measuring your inflation exposure. Using an inflation measure that most closely mirrors the inflation in your specific sector will allow you to more accurately estimate the target return you need if one of your goals is to preserve the purchasing power of your assets.

Common measures of inflation



Sources: Refinitiv DataStream. Health Care & Education inflation based on respective CPI measure. More information on CPI data can be found at the Statistics Canada website: www.statcan.gc.ca

Data as of December 2020.

Indexes are unmanaged and cannot be invested in directly.

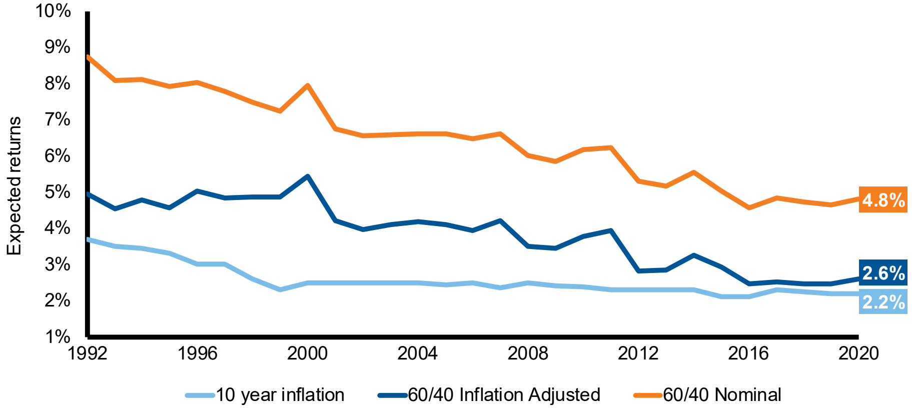
Past performance is not indicative of future results.

The challenge of the low-return environment

The chart below shows the expected long-term growth rate predicted by professional forecasters between 1992 and 2020. It tells a grim story. Over the coming 10 years, forecasters expect the inflation adjusted growth of a passive portfolio of 60% stocks and 40% bonds to fall to 2.6%. **This low-return environment would make supporting a high spending rate unsustainable.**

Non-profit fiduciaries are going to have to think differently about how they go about meeting their return objectives.

Survey of professional forecasters



Source: Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters. Data as of December 2020.

Expected returns on this chart are the expectations that the Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters had during the time period noted on the chart above. These are 10-year forward-looking forecasts. Expected returns based on U.S. market data and used for illustrative purposes only.

Data represent historical forecasts and are not indicative of future results.

60/40 = 60% equity, 40% bond portfolio. Equity returns were calculated using the Survey's forecasts of the S&P 500 Index; bonds were calculated using the Survey's forecasts of the U.S. Treasury 10-year bond.

Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.

Surviving and thriving in a low-return environment

While the outlook for market returns has declined, there are still ways to help improve your ability to meet your objectives.

Here are four strategies to consider going forward.

1 Dynamic portfolio management

In today's low-return environment, investors must incorporate investment strategies that can offer incremental returns, avoid risks for which they don't expect to get paid, and ensure that their portfolios are implemented efficiently.

2 Be mindful of your spending rate

You need to balance your immediate needs with your investment program's time horizon.

3 Manage your liquidity

Illiquid assets can help you achieve your spending goals over time, but they must be managed within the context of your broader organizational goals and objectives.

4 Manage your risks holistically

Focus not just on investment risk, but also on broader organizational risks such as fiduciary or governance risk, operational risk, structural risk, and market risk.

SECTION 2

Chapter 2: Your investment beliefs

Investment beliefs drive your investment program

Your investment beliefs drive all aspects of your investment program—from high-level governance functions, to the actual investment decisions being made, to the reporting and metrics used to evaluate success.

Beliefs can get you ahead by:

- Allowing you to take action in an uncertain world
- Helping you identify inconsistencies in investment portfolios
- Helping you avoid paralysis in a world of information overload
- Enabling efficient decision-making and supporting deeper institutional memory

All beliefs require discussion, periodic review, and documentation in your investment policy statement (IPS) to help ensure your investment solution is aligned with your organization's principles.

Investment beliefs can be grouped by area—for example, the belief that equities should outperform bonds is a beta belief, while the belief that active managers will outperform passive management over the long-term is an alpha belief. However, some beliefs, like sustainable investing, may require deeper review and consideration.

It's your job as a fiduciary to identify and document your beliefs, and it is your fiduciary partner's job to build an investment solution that balances your convictions with your need for investment returns.

Sustainable investing considerations

We use the term "sustainable investing" to encapsulate a broad spectrum of strategies that seek to capture both financial and non-financial returns. In fact, investors can choose from a number of approaches when determining how they want to implement a sustainable investing (SI) program. These include:

- Excluding companies involved in controversial industries
- Supporting the most sustainable companies
- Focusing on environmental, social, and governance (ESG) exposures
- Using ownership to engage with companies

The primary terms and investment approaches used in the industry are:

- **ESG integration:** This is the incorporation of ESG factors into investment decision-making. From a values perspective, ESG integration could be aligned with a moral or ethical belief of the investor. When looked at from a value perspective, investors may choose to evaluate ESG portfolio exposures, opportunities, or risks as a means of generating alpha or reducing risk. There is currently no one way of approaching ESG issues across all investment strategies.
- **Socially responsible investing (SRI):** With this approach, investments are selected to achieve social as well as economic goals. SRI is implemented through the use of positive or negative screens for security holdings.
- **Active ownership:** This can be exercised by shareholder advocacy / engagement or proxy voting to encourage companies to manage non-financial risks and run sustainable businesses, thereby creating long-term shareholder value.
- **Impact investing:** Impact investing involves making targeted investments in companies, organizations, and funds, with the intention of generating measurable social and environmental impact alongside financial return.

So, which is the right approach?

Regardless of the approach chosen, investors must be cautious and diligent about the quality of the investment process. Investors must also carefully evaluate the likely impact of any unintended risks that may have been introduced into the portfolio. Below are further considerations that can help you determine your next course of action:

- Which **asset classes** will be included in your SI implementation?
- What are the **potential implications** of integrating SI considerations in portfolio performance, monitoring, and management?
- Which **investment vehicles** are you going to use?
- What is the **timing of implementation**?

As the field of sustainable investing evolves, solutions and best practices will evolve as well. By asking the right questions, conducting robust governance processes, and performing thorough assessments of risks and opportunities, institutions can narrow their implementation choices. This will help them select practical sustainable investing solutions that align with their specific investment objectives, goals, and mission.

YOUR SUSTAINABLE INVESTING BELIEFS

1 As an organization, we want our investments to support our beliefs by NOT investing in the following types of asset classes, companies, or industries:

____

____

____

2 We believe strongly in supporting the following types of companies, industries, or initiatives, and we want to align our investments with these principles:

____

____

____

3 The following considerations must be taken into account when implementing this change to our investment policy:

____

____

____

SECTION 2

Chapter 3: Designing your strategic asset allocation

Key levers that impact the design of your strategic asset allocation

Identifying your investment beliefs is just the first step toward building your strategic asset allocation (SAA). You will also need to make some decisions regarding four primary, organization-specific inputs (or levers, as we will call them throughout this handbook). These levers will drive the design of your SAA and determine how you and your fiduciary partner manage your investment program.

They are:

1	**Your spending policy**
2	**Your liquidity needs**
3	**Your risk tolerance**
4	**Your desire for perpetuity**

It's important to note that these levers are intertwined, which means that the decisions you make about one will influence the decisions you make about the others. We will go into this in more detail later in the chapter.

LEVER ONE: SPENDING POLICY

How dependent is your spending on your investment program?

A number of factors will help you determine the extent of your organization's reliance on your investment program:

- Organization type
- Ability to fundraise
- Organization's cash flow
- Organization's goals

Before you can determine which spending policy is right for you, you need to understand your specific circumstances. Use the worksheet on the next page to help you do that.

		CIRCLE ONE		
1	We have a CRA*-mandated spending requirement.	Y	N	N/A
2	We have the ability to fundraise	Y	N	N/A
	If 'Yes' to question 2, which of the following apply?			
	We fundraise to offset our spending needs.	Y	N	N/A
	We fundraise to increase our endowed assets.	Y	N	N/A
	The assets we raise are:			
	Restricted	Y	N	N/A
	Unrestricted	Y	N	N/A
	Both restricted and unrestricted	Y	N	N/A
3	We wish to exist for as long as possible.	Y	N	N/A
4	Spending to support our current beneficiaries is more important than ensuring spending for future beneficiaries.	Y	N	N/A
	If 'Yes' to question 4, which of the following apply?			
	Our goal is to spend down our assets over time.	Y	N	N/A
	Our goal is to adjust our spending to prioritize current beneficiaries, while still existing for as long as possible.	Y	N	N/A
	We intend to fund a significant project in the next few years, which will require additional spending over the short term.	Y	N	N/A
5	We rely heavily on our investment returns to meet our annual spending obligations.	Y	N	N/A
6	We are sensitive to the spending trends of our peers.	Y	N	N/A
7	Other: ____________________	Y	N	N/A

*Canada Revenue Agency (CRA)

You should discuss the results of this analysis with your fiduciary partner such as an OCIO provider to ensure that the spending policy you put in place, and the asset allocation strategy you pursue, are aligned with your organization's specific circumstances and spending needs.

LEVER ONE: SPENDING POLICY

Understanding your spending policy options

Spending policy is key to determining the pattern of distributions from your investment program.

Your spending policy has two components:

1	Your spending policy
2	Your liquidity needs

For example

SPENDING POLICY	SPENDING RATE	SPENDING METHODOLOGY
4% of 3-year average assets	4%	3-year averaging
$4 million annually, adjusted for inflation	$4 million	Spending rate adjusted by annual inflation rate

The table below shows some examples of spending methodologies used by non-profit investors.

SPENDING METHODOLOGY	DESCRIPTION
Percentage of moving average assets, e.g., 5% of 3-year average	Typical spend of 1% to 7%, based on 1- to 7-year averaging
Select spending rate each year	Annually determining the percentage of your investments to spend on mission activities
Hybrid rule, e.g., Tobin rule	A blended methodology of a combination of past spending and a portion of current assets
Spend all current income	Spending all income generated from your investment program in any given year
Percentage of beginning-of-year (BoY) market value	Spending a percentage of the BoY market value

Source: Russell Investments.

LEVER ONE: SPENDING POLICY

How well does your spending policy meet your needs?

Different policies can affect your program's ability to maintain stable spending. For example, a beginning of year (BoY) policy may have more volatile spending and the potential to react more quickly to changes in the market value of assets. Compared to a three-year average policy, this may provide more stable spending that is slower to react to changes in the market value of assets. Volatile spending can make forward planning challenging, especially in uncertain markets and funding environments. However, a more reactive spending policy can help protect the asset base after market losses.

Before we move on, take a few minutes to address the following questions regarding your spending policy.

YOUR SPENDING POLICY

Our spending rate is: ______________________________

____

Our spending methodology is: ______________________________

____

We selected this because: ______________________________

____

We were comfortable with our spending policy during periods of continued market volatility or crisis:

☐ Yes ☐ No ☐ N/A

ARE YOU OVERSPENDING?

Remember, spending more than the inflation-adjusted return generated by your portfolio will lead to a decline in the purchasing power of your assets.

Your spending rate	______ %
+ projected rate of inflation	______ %
+ expenses (e.g., investment management and operating)	______ %
= Your target return	______ %

Understanding the impact of liquidity

Even if your organization has a steady hand on its spending policy, if it's not paired with sound liquidity management, the results can be disastrous.

Let's start by defining what we mean by liquidity in the context of your investment program.

Liquidity allows you to:

- Meet your spending requirements
- Deploy your capital opportunistically to take advantage of evolving market conditions
- Rebalance your portfolio as needed or wanted
- Meet pre-existing private capital commitments

During the financial crisis, illiquidity became an issue for many nonprofits. Aside from the known illiquid investments some had in their portfolios, other presumed liquid investments became illiquid during the crisis, which led to a severe liquidity squeeze. As a result, some institutions were unable to fund their missions.

What does a holistic liquidity program look like?

In simple terms, having a holistic liquidity program means aligning the liquidity profile of your investment portfolio with your time horizon and cash-flow demands. By working with your fiduciary partner to create a liquidity program, you should be able to meet your spending obligations as they come due, without incurring unacceptable losses.

Here are some key steps for establishing a holistic liquidity program:

- **Establish your cash flow expectations:**
  Identify the sources, timing, and flexibility of your cash inflow and outflow.
- **Use a variety of approaches to achieve your required liquidity profile:**
  Your provider can coordinate between asset allocation, sensitivity / stress analysis, spending policy, rebalancing, and derivatives.
- **Document and frequently monitor your liquidity profile:**
  Your provider should continuously monitor your liquidity profile, along with other critical risk factors, and provide you with the information necessary to document clear liquidity guidelines in your investment policy statement (IPS).
- **Keep up with regulatory changes:**
  It is important to stay abreast of regulatory changes, as they could impact your liquidity considerations.

LEVER TWO: LIQUIDITY NEEDS

Understanding your liquidity profile

Once you have worked with your provider to identify the sources and uses of cash, it is useful to classify the cash requirements of your investment program based on when you need to access that cash.

This will allow you to match your liquidity requirements with the liquidity profiles of your investments.

A sample liquidity profile classification is shown below:

ACCESS TO CASH	LIQUIDITY LEVEL
Daily	Highly liquid
Quarterly	Liquid
Less than 2 years	Semi-liquid
2 to 5 years	Illiquid
More than 5 years	Highly illiquid

A liquidity profile should consider not only the different types of assets—such as public versus private, equities versus fixed income, and Treasuries versus distressed debt—but also the investment vehicle (i.e., a commingled, daily liquid fund versus a separate account with longer lockups).

The liquidity profile of your portfolio can shift over time in response to unforeseen market movements. Working with your fiduciary partner to model portfolio allocations, and mapping them to your liquidity needs, could help identify such shifts in advance and allow you to adjust accordingly.

LEVER TWO: LIQUIDITY NEEDS

Stress-testing your liquidity profile

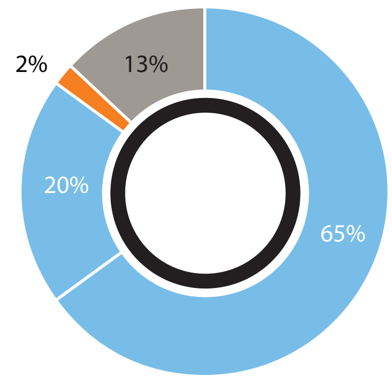
It's important to work with your fiduciary partner to evaluate the liquidity profile of your portfolio in both normal and stresse environments. This means that for each asset class, the liquidity expectations in normal environments need to be identified and then compared against the estimated downside experience in stressed markets.

An example of a liquidity profile for a normal versus a stressed market environment is shown on the following page. The asset allocation was kept constant in both the normal and stressed scenarios. The example doesn't take into account any change in asset valuations or spending from the liquid asset classes.

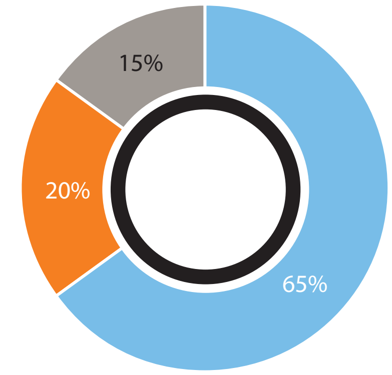
In this example, observe the large increase in the semi-liquid allocation (from 0% to 20%) and the reduction in the liquid and highly liquid allocation (down from a combined 85% of the portfolio to 65%) that takes place in a stressed market.

Do you know the extent to which such a shift could impact your portfolio?

NORMAL MARKET ENVIRONMENT



STRESSED MARKET ENVIRONMENT



Highly liquid / liquid
Semi-liquid / illiquid
Highly illiquid

Source: Russell Investments.

Stressed market environment based on experience in periods of heightened market volatility (such as March 2020), when some investments became less liquid than expected. There is no guarantee that any stated expectations will occur. Some portfolios in stressed market environments may have more drastic impact on liquidity than the scenario depicted above. These examples are for illustrative purposes only.

LEVER THREE: RISK TOLERANCE

Understanding your risk tolerance

Ultimately, your investment approach should be designed to deliver the returns you need within a level of short-term risk you can survive. One of the benefits to come out of periods of financial crisis, such as the volatility experienced in 2020, is that many non-profit boards and investment committees are now better able to articulate how much loss they can tolerate.

After discussing the following three points with your investment committee, take time to clearly document your risk tolerance in your IPS, as this will drive your SAA.

1 What is your *capacity* to tolerate loss?

This hinges on, among other things, the flexibility of your spending program. Access to new assets (e.g., those flowing from fundraising activity) can also affect the capacity of an organization to tolerate risk.

2 What is your *willingness* to tolerate loss?

Meaning, if you take this risk, will you be able to sleep at night?

3 What is your *perception* of risk?

Perception is a subjective judgment of risk, and it's unique to every investment committee and organization. The important takeaway here is to ensure that there is an "agreed upon" perception of risk across your organization. Meaning, does your investment committee believe volatile index-like equities are riskier than hedge funds? Or not? You need to clearly understand how your organization perceives risk.

LEVER THREE: RISK TOLERANCE

Determining your risk tolerance

The answers to the following questions are critical inputs for your SAA process, and will allow your board and investment committee to see the potential impact of different asset allocations. Be sure to share the results with your OCIO provider, as this will guide them in the construction of your portfolio. In the table below, select the characteristics that most closely align with your investment program to determine your risk tolerance levels.

	A	B	C	CIRCLE A, B, OR C
I could tolerate:	**Up to a 20%** loss in any 1 year	**A 20% to 35%** loss in any 1 year	**A 35% to 50%** loss in any 1 year	A B C
My annual spend is:	**Less than 3.5%**, so I don't need a lot of risk to meet my return target	**Between 3.5% and 5%**, so I need to take a moderate amount of risk to meet my return target	**More than 5%**, so I need a considerable amount of risk to meet my return target	A B C
My time horizon is:	**Short** (1 to 3 years)	**Medium** (3 to 5 years)	**Long term** (5 or more years)	A B C
I expect future inflows:	**No**, I am not able to secure future inflows	**Yes**, I am able to secure some additional inflows	**Yes**, I am able to secure significant additional inflows	A B C
There are a number of additional demands on my assets (operating expenses, funding of enterprise activities, etc.):	**Yes**, there are high demands on my assets	**Yes**, there are some demands on my assets	**No**, there are minimal demands on my assets	A B C

Other observations affecting my risk tolerance:

____

____

____

____

____

This exercise is a starting point for discussion with your investment committee.

In general:

- If most of your answers are in column **A**, you tend to have a lower tolerance for risk.
- If most are in column **B**, you have a medium tolerance for risk.
- If most are in column **C**, you have a higher tolerance for risk.

Even if two non-profits answered the worksheet questions identically, they might still ultimately make different risk choices, due to the differing nature of their organizational goals.

LEVER FOUR: DESIRE FOR PERPETUITY

Determining your organization's time horizon

As we mentioned in chapter one of this section, whether or not your organization wants to exist in perpetuity affects how you manage your investment program. Your board, investment committee, and staff should all be aligned around one of the following guiding principles:

1 **We wish to exist for as long as possible.**

If this is the case, then maintaining or building on the assets already in your investment program will be critical. That way, you can help ensure you will have the same, or greater, purchasing power in the future.

2 **We wish to prioritize spending today, and worry about how long we want to exist later.**

This approach is fine for addressing short-term community needs, but it's not sustainable over the long-term. In fact, organizations that stay in this situation for a long period of time are, in essence, choosing to spend down—because eventually your investment portfolio will erode so that your impact tomorrow is less than your impact today. If that's not your intent, we recommend that you re-evaluate your priorities annually to ensure that your investment program remains aligned with your organization's time horizon.

3 **We wish to make a point of spending down our assets over time.**

For organizations that choose this path, maximizing your short-term returns so you can spend more today is key. It's also important to specify how long your spend down horizon is—for example, spending 7% over the next 25 years is easier to plan for than spending as much as you can for as long as possible.

The decision you make regarding your organization's approach to perpetuity will have an impact on how you approach the other levers, as well as your SAA. It will affect:

- How much you want to spend, and over what time frame
- The amount of liquidity you'll need to meet those spending goals
- The types of risks you can take in your investment portfolio
- The investment time horizon you choose when setting your strategic asset allocation

Keep in mind that, as with the other levers, your desire for perpetuity isn't a static decision. It can be adjusted based on your organization's evolving situation and goals. It's important to understand that you can lengthen, or shorten, your time horizon as dictated by your needs. And those changes may impact the decisions you make about the other levers, so you should revisit those as well.

Last, but not least—capital markets expectations

Now that you've made some decisions regarding the four levers, it's time to turn your attention to another piece of information that is vital to building your SAA—capital markets forecasts.

It's highly likely that you'll be using your provider's capital markets forecasts. And you should have a solid understanding of how those are generated. Some questions to ask your provider include:

- Are the forecasts based on short-, medium-, or long-term views?
- Are they historical or forward looking?
- What is your provider's current view on market volatility and how do they anticipate managing that within your portfolio?
- What is the forecast for inflation, and what impact might that have on the assets your provider is recommending for your portfolio?
- What is the forecast for interest rates and how will your provider plan to take that into account in their recommended portfolio?

One important thing to remember about capital markets expectations is that they are just that—expectations. As a fiduciary, you need to feel confident that your provider's expectations are reasonably derived, sound in methodology, and reflective of forward-looking expectations. Sound capital markets expectations will help ensure that you are able to make well-reasoned decisions regarding your SAA going forward.

Making decisions based on asset *roles* instead of asset *classes*

The organizational levers and capital markets expectations we just discussed are all critical to constructing your SAA. However, before moving on, it's time for a shift in thinking. Non-profits have traditionally approached SAA construction in terms of the asset classes they're including in their portfolios. That approach is no longer sufficient. We instead recommend thinking about the roles each asset class will play in your portfolio.

OLD APPROACH All asset pools
Canadian equity
U. S. Equity
International equity developed
Emerging markets equity
Real estate
Commodities
Hedge funds
Private equity
Canadian core fixed income
High yield fixed income
Long duration fixed income
Cash / short duration

In the chart on page 48, you see the "old" approach to asset allocation (defined by asset class) and how that translates to the "new" approach (defined by asset role). We believe a rolesbased approach helps you gain a more accurate picture of how each asset in your SAA may help you achieve your total portfolio outcomes.

NEW APPROACH
Designed to get you to CPI + X%

GROWTH ASSETS 55 - 70 % of *your total portfolio* Dynamically managed return driver of your portfolio	**Global equity** • Global equities • Regional large cap • Regional small cap • Emerging markets equity
	Real assets • Global listed real estate • Global listed infrastructure • Global commodities • Private core real estate
	Return-seeking fixed income • Global high yield • Emerging markets debt • Bank loans
	Directional hedge funds
RETURN ENHANCEMENT 5 - 15 % of *your total portfolio* Longer-term, illiquid allocation to drive additional return.	Private capital • Private debt • Private equity • Private non-core real estate
RISK REDUCING / DIVERSIFYING 20 - 35 % of *your total portoflio* Volatility management and return-smoothing allocations.	• Non-directional hedge funds • Core fixed income • Absolute return fixed income

For illustrative purposes only.

THE OUTPUT: YOUR STRATEGIC ASSET ALLOCATION

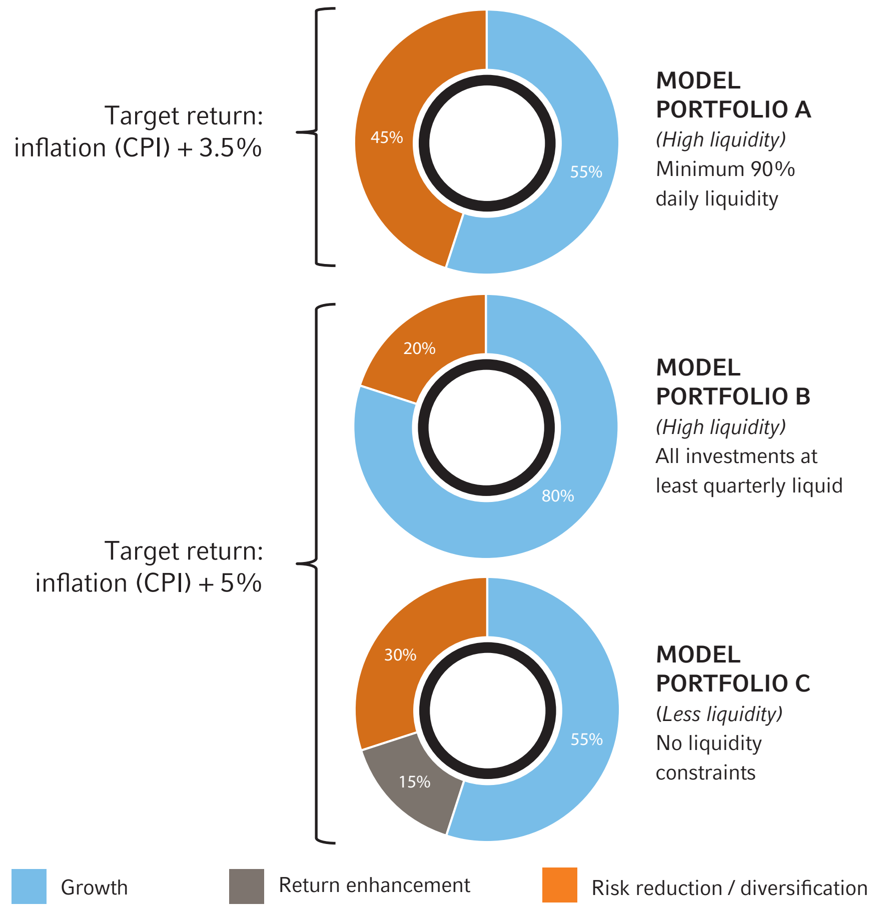
Putting it all together

We just identified the different components that help you create your SAA. We also introduced a new, roles-based approach to asset allocation that helps you see how each strategy may contribute to your total portfolio outcomes. How does all this come together?

Your spending policy, liquidity needs, risk tolerance, and perpetuity levers should be discussed and decided on with the help of your OCIO provider. Then, your provider can marry that information with their capital markets forecasts to provide you with a custom, roles-based SAA for your portfolio. Once you have this information, your job will be to ensure that your portfolio works to meet your organization's goals.

As you go through this process with your provider, it's important that you have a discussion about, and model the impact of, any trade-offs you may need to make in your investment program. For example, will you accept more risk in order to get more return? Are you willing to make trade-offs between your short-term and long-term goals? Having a clear understanding of the impact of these decisions on your investment program is critical to meeting your goals and objectives.

To provide you with a better understanding of how these high-level design considerations come together, we have created three model portfolios. These models have distinctly different allocations across the three asset roles to show you the type of output you can expect from the SAA modeling process.

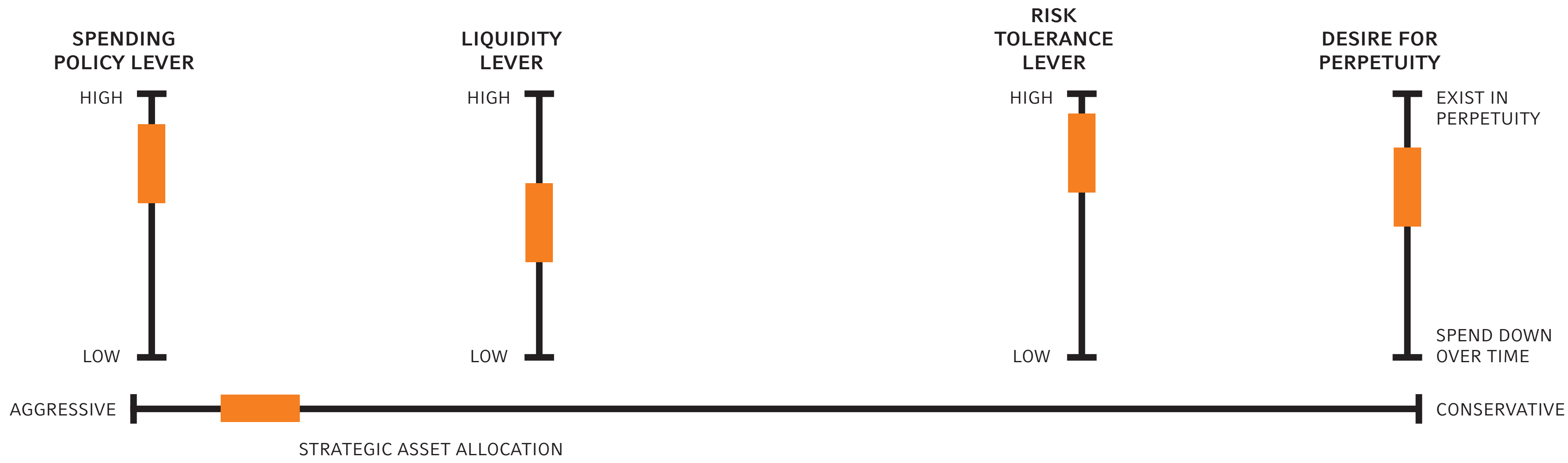


For illustrative purposes only.

Prioritize the levers to align with your desired goals

We've discussed how the various asset roles—growth, return enhancement, and risk reduction / diversification—are interconnected and have an important impact on your investment program. It's also important to understand the interconnectedness of the levers that influence your SAA. Prioritizing one lever will have an impact on the others. You will need to decide which of the four levers is most important and prioritize it, then manage the rest of the levers accordingly.

The chart below shows how the levers might look if you prioritize a higher spending rate. That single decision impacts the other levers, which creates a higher need for risk, providing lower total portfolio liquidity, and resulting in a more aggressive SAA. On the other hand, more flexibility in your spending policy would create more flexibility in the other levers. Keep these interactions in mind as you set the policies for your investment program.



If you find that you aren't willing to trade off one lever for another, then it may be necessary to re-evaluate your priorities. For example, as shown in the chart, if you do not truly have a high risk tolerance, then you may need to rethink your high spending target.

Documenting your decisions and beliefs in your investment policy statement

In addition to modeling the design considerations for your SAA, you will need to record those decisions in your IPS. The IPS is the guiding document for your organization's investment program. It captures your beliefs and expectations and provides long-term, strategic guidance on how to align your non-profit's mission, objectives, and policies. It also outlines the decision-making responsibilities of the various players involved in managing your investment program.

The pillars of your IPS include your:

1	**Spending policy**
2	**Liquidity policy**
3	**Agreed-upon risk tolerance**
4	**Desire for perpetuity**
5	**Strategic asset allocation**

Here is a checklist of the key elements that should be included in an IPS:

GOVERNANCE

- ☐ Mission, purpose, and scope
- ☐ Investment time horizon
- ☐ Statement regarding fiduciary responsibility under applicable trustee acts[1]
- ☐ Definition of roles and responsibilities
- ☐ Expected return goals and objectives
- ☐ Unique circumstances
- ☐ Delegation of authority
- ☐ Beliefs

INVESTMENT STRATEGY

- ☐ Investment philosophy
- ☐ Strategic asset allocation policy
- ☐ Restricted and unrestricted investments
- ☐ Investment structure and guidelines
- ☐ Spending policy
- ☐ Liquidity policy
- ☐ Risk policy and benchmarks for measurement
- ☐ Purchasing power driven decisions
- ☐ Sustainable investment policy, if applicable

ACCOUNTABILITY

- ☐ Monitoring and review process
- ☐ Standards for measuring performance: absolute and relative
- ☐ Rebalancing policy
- ☐ Handling of spending for underwater funds
- ☐ Other operational guidelines

The IPS is also an important tool for educating new fiduciaries on the purpose of the investment program. And it helps sustain your nonprofit's vision over the long-term.

[1] Trustee acts will vary by province and jurisdiction.

SECTION 3

Overseeing your dynamic, outcome-oriented portfolio

SECTION 3

Chapter 1: What's involved in building a dynamic, outcome-oriented portfolio?

Accessing the right managers

Once you have set up your strategic asset allocation (SAA), it's time to work with your OCIO provider to populate your strategy with the right managers to help you meet your strategic outcomes. It's a bit like putting together a puzzle. Individual managers bring unique strengths and biases to the table, and it's up to you to ensure that your provider has taken these into account when putting together your overall investment program.

Your provider should:

- Have the right processes and resources available to source, hire, and manage the best managers for your investment program in every asset class
- Seek to limit uncompensated portfolio risk. Ideally, you want your portfolio to deliver excess returns relative to the outcomes it was designed to meet, without introducing unnecessary risks
- Ensure you have adequate diversification by including managers / strategies that have diverse and complementary investment styles and processes
- Help you understand the drivers of excess return for different strategies. For example, is security selection the driver of excess returns, or is it sector allocation?

Evaluating your implementation options

Another decision you and your provider should make together is the balance of implementation approaches you need to incorporate into your portfolio, such as active and passive strategies, as well as factor exposures. This will determine the types of managers your provider hires on your behalf.

Most exposures can be accessed via one or more of the following approaches:

- **Active strategies:** Active managers aim to deliver better risk-adjusted returns than those associated with passive approaches. The active approach can provide the flexibility to respond more quickly to shifting market and economic circumstances.
- **Passive strategies:** A passive approach simply aims to track the behavior of an index that represents the asset class or market to which you want to have exposure, or a composite index that represents your strategy.
- **Factor exposures:** These are synthetic instruments or security-level portfolio exposures used to pursue shortterm market opportunities or help mitigate specific risks.

Determining what strategies are ultimately included in your investment portfolio is a process you should undertake with your provider.

When making your decisions, you should remember to:

- Take only those risks for which you believe you will be rewarded
- Keep fee constraints in mind as they may drive the decision about where to incorporate which type of manager
- Consider passive or factor exposures as a means of providing certain exposures in a more cost-effective way than active management
- Understand your liquidity needs, as they will be a driving factor in your decision-making

Manager research: What does a robust process look like?

Regardless of the style of manager you're selecting, you need to ensure that your OCIO provider has the right resources and processes available to source, hire, and manage the best managers for your investment program. In the following worksheet, we list some of the things that we believe will ensure a robust manager research process. Take a moment to mark whether your provider has these resources and processes.

	YES	NO
RESOURCES		
Specialists in each asset class, including alternatives		
Research analysts located around the globe		
Proprietary database (i.e., not purchased from someone else)		
Analytical tools to analyze manager portfolios to make sure they are doing what they say they are doing		
Ability to meet with managers in person as well as via video conference and phone		

	YES	NO
RESOURCES		
Unbiased manager selection process (i.e., no ownership interest in or pay-to-play relationship with recommended managers)		
Qualitative and quantitative research processes		
Operational due diligence process		
Consistent documentation process		
Explicit manager ranking criteria		
Ongoing research for buy ranked managers		
Crisis response process		
Ability to evaluate a manager's understanding of ESG issues and incorporate that into the investment process		

If more of your answers are in the "No" column than in the "Yes" column, you should have an in-depth conversation with your provider regarding their capabilities and consider working with a provider with a more robust research platform.

Managing your portfolio dynamically

Once your OCIO provider has found the right strategies and managers to populate your portfolio, you're all done, right? Not quite. One of the ways to thrive in a volatile market environment is to incorporate a dynamic portfolio management approach. However, your job isn't done when your provider has found the right strategies and managers to populate your portfolio. There are additional steps that you, as a fiduciary, need to take, as well as capabilities your provider must have to ensure success.

You will need to:

- Set trading bands around the target SAA for each asset class and / or role in your portfolio
- Give discretion to your provider so they can implement your decisions in real time

Your provider will need some specific skills and capabilities to be able to manage your portfolio dynamically. They need to be able to do the following on your behalf:

- Hire or fire an existing manager
- Adjust manager weights within the portfolio
- Create targeted exposures within the portfolio using either physical or synthetic instruments to capture short-term opportunities or mitigate risk

Capabilities like these can help make the difference between a truly dynamic portfolio and one that merely pays lip service to being dynamic.

Ensuring you have the right provider

In this chapter, we have focused on how to ensure that your provider has selected the right managers and strategies for your investment program, and on the importance of managing those portfolio exposures dynamically. But as your fiduciary partner, an OCIO provider does much more than just combine the right managers and meet once a quarter to talk about performance against your goals.

You should also expect your provider to deliver:

- Advice on your investment program and the ability to execute against your IPS
- Daily, real-time portfolio management Reporting tailored to the outcomes that matter most to your organization
- Implementation strategies that are cost efficient and easy to execute
- A solution customized to your unique governance structure, organizational goals, and needs

Some of the best OCIO providers in the market serve as co-fiduciaries for their clients' assets. This ensures that their interests remain aligned with yours.

SECTION 3

Chapter 2: Building a robust enterprise risk management system

Enterprise risk management is critical to the success of your investment program

Thus far, our discussion of risk and its management has focused on investment risk. But risks exist at multiple levels in a non-profit organization, which is why a broader definition of risk—enterprise risk—is so important.

Some risks are unique to a particular category of non-profit, such as charitable organizations or hospital foundations. Some are unique to the entity itself, such as a small liberal arts college, which faces risks of a different character than those of a large state university, even though both are educational institutions.

Enterprise risk management (ERM) is the process of identifying organizational risks that may have an impact on your investment program, as well as investment risks that may have an outsized impact on your organization. There is increased recognition among non-profit fiduciaries that managing your investment portfolio in a silo, without an understanding of how key risks can impact the broader organization, can be less than optimal and has the potential to give rise to unintended consequences.

Developing an enterprise risk management framework

A key step in developing an ERM framework is to identify the risks that have the potential to derail your non-profit's mission. Below is an example of a framework to help you identify and categorize enterprise-level risks. We've grouped them into two broad categories—organizational and investment risks—each of which is composed of two sub-categories.

- **Fiduciary risks** are those that arise from the governance structure of your organization.
- **Operational risks** are those that stem from the day-to-day operational policies and procedures of your organization.
- **Structural risks** are those that come from how you've chosen to build your investment portfolio.
- **Market risks** are those that arise from the capital markets, economy, and geopolitical environment.

Areas of enterprise risk

ORGANIZATIONAL RISKS	
FIDUCIARY	**OPERATIONAL**
Policy outcomes	Staffing and volunteer resources
Regulatory requirements	Fundraising capacity
Defining success	Cash flow
Decision-making oversight	Compliance
Tolerance monitoring	Liquidity
Reputation	Systems / technology

INVESTMENT RISKS	
STRUCTURAL	**MARKET**
Policies / procedures	Political
Active / passive	Inflation
Style	Demographics
Benchmark(s)	Interest rates
Holdings concentration	Currency
Rebalancing	Systems / technology

Identifying your organization's risks

Now, it's your turn. Using the below chart as a framework, talk with your board, investment committee, and staff to identify the risks your non-profit might be facing.

Areas of enterprise risk

ORGANIZATIONAL RISKS	
FIDUCIARY	OPERATIONAL

INVESTMENT RISKS	
STRUCTURAL	MARKET

Prioritizing and ranking your non-profit's risks

Once you have identified the risks impacting your organization, you'll need to prioritize and rank them based on which risks you feel may have the greatest potential to derail your organizational goals. Below we've provided a sample, which we've pre-populated to portray how it might look once you're done filling in the risks you identified on the previous page.

On the left are the broad risk categories, and samples of specific risks. At the bottom is the ranking system for each of the assessment factors (e.g., likelihood, speed to impact, reputational severity, financial severity). Those then correlate with the overall assessment weighting you assign to each category at the top. The right-hand column is the overall weighted average for each individual risk, and the place where you can assign an overall rank to each risk. You should review this risk analysis with your provider as the outcomes of this work may have an impact on your investment program going forward.

		Assessment Factor	Weight	Assessment Factor	Weight	Assessment Factor	Weight	Assessment Factor	Weight	Impact	
		LIKELIHOOD	0.2	SPEED TO IMPACT	0.2	REPUTATIONAL SEVERITY	0.3	FINANCIAL SEVERITY	0.3	WEIGHTED SCORE	RANK
ORGANIZATIONAL RISKS	**Fiduciary**										
	Regulatory: increasing	Occasionally	3	Short term	5	Significant	5	Significant	5	4.6	1
	Reputational	Rarely	1	Intermediate	3	Significant	5	Significant	5	3.8	6
	Operational										
	Staffing: not enough	Occasionally	3	Intermediate	3	Significant	5	Weak	1	3	9
	Audit / accounting: failed audit / weak accounting	Rarely	1	Intermediate	3	Significant	5	Moderate	3	3.2	8
	Systems / technology: must upgrade	Rarely	1	Short term	5	Significant	5	Significant	5	4.2	4
INVESTMENTS RISKS	**Structural**										
	Systems / technology: risk systems	Regularly	5	Intermediate	3	Significant	5	Significant	5	4.6	1
	Transparency: understanding what you own	Regularly	5	Intermediate	3	Significant	5	Significant	5	4.6	1
	Liquidity: needs change	Occasionally	3	Short term	5	Low	1	Moderate	3	2.8	10
	Market										
	Demographic changes: older, immigration	Regularly	5	Intermediate	3	Low	1	Significant	5	3.4	7
	Inflation: increasing	Occasionally	3	Short term	5	Significant	5	Moderate	3	4	5
	Interest rates: increasing	Occasionally	3	Intermediate	3	Low	1	Moderate	3	2.4	11
	Volatility: increasing	Occasionally	3	Intermediate	3	Moderate	3	Weak	1	2.4	12
	Currency: volatile	Occasionally	3	Intermediate	3	Moderate	3	Weak	1	2.4	12

Scale		Scale	Scale		Scale		
LIKELIHOOD		SPEED TO IMPACT		REPUTATIONAL SEVERITY		FINANCIAL SEVERITY	
Rarely	1	Long term (+10 years)	1	Low	1	Weak	1
Occasionally	3	Intermediate (5-10yrs)	3	Moderate	3	Moderate	3
Regularly	5	Short term (1-5 yrs)	5	Significant	5	Significant	5

How does your enterprise risk management program stack up?

Once you have implemented an ERM program, you need to ensure that you have a clear understanding of whether it's working. Take a few minutes to respond to the statements below:

		YES	NO
1	We have developed an ERM process that includes consideration of the investment program.		
2	We have a committee dedicated to considering investment issues.		
3	There is a mechanism in place to allow the investment committee to share key issues with the board and staff. *(For instance, there is overlap in membership between the board and the investment committee.)*		
4	We have developed a process to identify, understand, and respond to key enterprise-level risks that may impact the investment program.		
5	We consider the potential impact of how the investment program is managed on the overall organization.		
6	We stress test our portfolio under different key scenarios to understand the potential impact on the organization.		
7	We have experts helping to measure, assess, and manage the risk.		

If you have fewer than six check boxes in the "Yes" column, you should re-evaluate your enterprise risk management process to ensure that you have the full picture of the risks that can impact your investment program as well as your organization as a whole.

If you had more check boxes in the "No" column than in the "Yes" column, the worksheet below may help you identify some of the weakest links in your program:

		YES	NO
1	We have sufficient financial resources to implement a best-in-class ERM program.		
2	ERM is an important priority.		
3	There is enough time in investment committee meetings to identify (or monitor) risks that are of the greatest concern.		
4	The investment committee and fiduciaries agree on which risks are most critical to manage.		
5	We have limited transparency into the investment program, making it very difficult to assess investment risk.		
6	There are too many silos within the organization. (Fiefdoms limit conversations across groups.)		
7	Other:		

The potential for your investment portfolio to impact your mission is ever present, so it is essential that you do everything within your power to make your ERM program as strong as it can be. If it's not currently where you believe it needs to be, work with your provider to help you get there.

One of the challenges of developing an ERM process is to identify the big risks that really matter and avoid getting too bogged down in the risks that most likely won't have a significant impact on the total organization.

Closing thoughts

Congratulations, you're all done! Now the hard work begins.

As we've expressed throughout this handbook, effectively managing your investment program is a complex, ongoing process. So, we want to leave you with a few big ideas:

- **Know who is responsible for what decision.**
  You don't have to do it all, but you do need to make sure it's all being done. Being an effective fiduciary is about your ability to steer, give guidance, and intervene when you see a potential gap—and then to decide who is best equipped, internally or externally, to fill that gap.
- **Create alignment.**
  Your beliefs, combined with the decisions you make about the four levers, as well as insight regarding the capital markets, must all align in order to construct an SAA that will help you meet your non-profit's mission. As the markets move and your organization's situation changes, don't be afraid to revisit these decisions to ensure they still align with the goals you're trying to achieve.
- **Pay attention to enterprise risk.**
  Risk can make or break your ability to meet your organization's goals. And it can come from any number of sources. Make sure your provider is dynamically managing your investment program to help capture short-term opportunities and mitigate risks. And, ensure you have a robust enterprise risk management process that you evaluate and adjust as situations change.
- **Stand tall.**
  Serving as a fiduciary for a non-profit organization is an important job. You've committed to this for the long haul, and we honor you for it. Your dedication to your organization fills a vital role in our society, and we hope this handbook helps you build and manage an investment program that will help your organization thrive for many years to come.

Glossary

Alpha: Risk-adjusted outperformance over the return of a relevant market benchmark.

Beta: A generic term for market risk, systematic risk, or non-diversifiable risk.

Currency risk: The risk associated with the fluctuation of foreign exchange rates; also called foreign exchange risk.

Derivatives: Contracts (agreements to do something in the future) that derive their value from the performance of an underlying asset, event or outcome.

Diversification: The practice of combining assets and types of assets with less than perfect correlation in a portfolio for the purpose of reducing risk.

Fiduciary: The word fiduciary comes from the Latin words *fides*, meaning faith, and *fiducia*, meaning trust. A fiduciary is someone who has undertaken to act for, and on behalf of, another in a particular matter in circumstances that give rise to a relationship of trust and confidence. In investments, a fiduciary's task is to invest the pool of assets that one oversees for the best possible return for level of risk.

Index: A theoretical portfolio of securities (such as stocks or bonds) that represents the market or a portion of it in those securities.

Inflation: The percentage increase in the general price level from one period to the next; a sustained rise in the overall level of prices for goods and services.

Inflation risk: The risk associated with the rise or fall of inflation levels and the impact on purchasing power and value of assets after accounting for inflation.

Interest rate risk: The risk associated with interest rate changes and their impact on bond prices and other financial instruments.

Perpetuity: An infinite time horizon, often used in the context of a non-profit organization that has the time horizon of existing forever.

Rebalancing: The process of adjusting the weights of the constituent securities in an index, or adjusting the weights of assets in a portfolio.

Restricted endowments or investments: Assets, or income, that are restricted as to their use, the types of organizations that may receive grants from them, or the procedures that may be used to make grants from such funds.

Strategic asset allocation (SAA): The long-term mix of assets that is expected to achieve an investor's long-term objectives, given the investor's investment constraints.

Time horizon: The length of time over which an investment is made or held before it is liquidated; time horizons can range from seconds, in the case of a day trader, all the way up to decades for a buy-and hold investor.

Tobin rule: The Tobin spending rule sets annual spending to a percentage of the prior year's spending, adjusted for inflation, plus the long-term spending rate times the market value of assets. The formula for the Tobin spending rule is: [X% * prior year's spending * (1 + inflation)] + [(1-X%) * Spending Rate * Market Value of Assets]; also known as the hybrid rule.

Unrestricted endowment or investments: An unrestricted fund is one that is not restricted by the donor to specific uses, or for which restrictions have expired or been removed.

Volatility: A statistical measure of the dispersion of returns for a given security or market index that can be measured using the standard deviation or variance between returns from that same security or market index. Commonly, the higher the volatility, the riskier the security.

Your mission is important. We can help you achieve it.

There's more than money at stake. Your investment program is the lifeblood of your organization, and in today's fast moving, complex, and challenging market environment, you may need more than simply investment advice. As is often the case when managing complexity, we find that delegation and oversight are key.

For over 35 years, Russell Investments has customized solutions for organizations like yours – solutions that let you delegate many of the day to day operations of your program while retaining the level of oversight and control that suits your needs.

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Toronto 1 First Canadian Place
100 King Street West, Suite 4510
Toronto, ON M5X 1E4
416-362-8411

Call **866-737-2228** | visit **russellinvestments.com/ca/institutional**
russelltorontoinstitutional@russellinvestments.com