Diocesan Investment Funds - Governance Guidelines

February, 2009

Executive Summary

The Financial Advisory Group has produced these Guidelines to assist Dioceses establish and maintain best practices in relation to the governance of funds which they manage either on their own behalf or on behalf of parishes or other investors.

Significant experience and research exist showing that organisations with strong governance regimes consistently produce better performance for their investors – and in particular tend to avoid the worst mistakes of investing.

Banking and investing are risky and volatile activities – just ask any global bank or fund manager! Avoiding silly mistakes is possibly the single greatest contributor to better investment outcomes for the majority of investors – and good governance is the best preventative measure available.

This Executive Summary outlines the key requirements, which are more fully set out in the guidelines that follow.

Objectives & strategy formulation

- Articulate in writing the purpose of the funds – "why do we have this fund?"
- The purpose drives the return and risk objectives for the investment portfolio. The major risks depend on the type of fund, but two good questions to ask and answer are:
  - How much can we afford to lose?
  - How often can we afford to make a loss?
- Articulate any constraints which can arise from various sources including liquidity, guarantees and ethical considerations.

Policy making

- A dedicated investment committee should be the primary governance body for a Diocesan fund.
- The investment policy summarises a Diocese's goals on risk and return objectives, the investment principles to be applied for the fund, the range of strategies to be used, the asset allocation principles, appointment of investment managers.
- Defining the investment strategy and asset allocation is critical components of the governance process and should be reviewed at least annually.

Monitoring & supervising

- Generally, Dioceses are able to operate under exemptions from ASIC and/or APRA when raising funds. Compliance is required, however, and should be reviewed annually.
- Service providers include asset consultants, accountants, auditors, administrators, fund managers, stockbrokers and custodians. There should be a service level agreement attached to each provider's contract.
- The overall fund performance relative to its return and risk objectives as well as performance of fund managers should be monitored at least quarterly.
- Investment and deposit funds should be on a par with other Diocesan entities in relation to financial controls and financial reporting, including auditing.
- Assets must be segregated from other Diocesan assets, including bank accounts, and proper custody of the assets is essential.

Investment implementation

Investment Implementation is dealt with in detail in the Discussion Paper "**Towards More Effective Investment Management"** prepared by the General Synod Financial Advisory Group in August 2003 (www.anglican.org.au/governance.cfm?SID=22&SSID=78).

Implementation is a management task. There has to be at least one senior executive who is given responsibility for the day-to-day management of the funds. The Financial Advisory Group strongly recommends that Dioceses share resources across Dioceses when it comes to implementation.

The Finance Managers User Group can be consulted for assistance in this regard, as well as for any other comments or suggestions on the detail of these guidelines. The current Chair is Grant Reubenicht, Finance Manager at the Diocese of Adelaide (greubenicht@adelaide.anglican.com.au).

What is governance?

Structure & constitution

The ASX defines governance as the system by which organisations are directed and managed. It influences how the objectives of the organisation are set and achieved, how risk is assessed and monitored and how performance is optimised.

The starting point for this is to have a clearly documented purpose for the organisation or in our context, the fund. This will usually be described in the constitution of the fund (which might also be called the ordinance, canon, act or deed).

To do the job of overseeing and ensuring that funds invested achieve the purposes for which they have been set aside, the organisation must establish an appropriate structure (corporate entity, board or committee) as the responsible entity for any fiduciary activities involving lending or investment management, and resource it effectively.

The board/committee members must put in place a management structure and system to direct and control - or “govern” - the organisation. In practice this means the entity needs a charter specifically covering the fiduciary duties – see Appendix 3.

In addition, the entity will have to appoint agents, including executives, to give advice as well as to undertake the investment management and lending tasks required to deliver on the entity’s objectives.

Governance activities framework

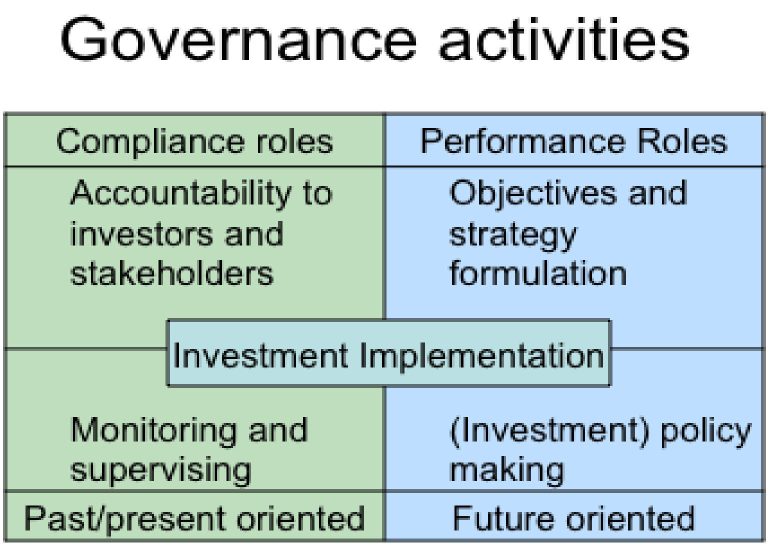
The following model sets out the major activities that a board or committee needs to undertake to achieve proper governance. Each segment is described in more detail below, covering the activities on which the board/committee itself should focus.

Responsibility for investment implementation is delegated to an executive of the Diocese and the role of the board/committee is to ensure the relevant person has the resources and capabilities to do that job. It does not mean this person does everything, but he/she is the board/committee’s agent to appoint any other resources, including various service providers, to get things done.

Each level of the governance structure will require a work plan each year:

- Board or committee plan
- Executive/management plan
- Plans for relevant service providers

Typically these will break down to annual, quarterly/monthly tasks and daily/weekly operations.



Adapted from the Tricker Model: Tricker, Robert L. International Corporate Governance: Text Readings and Cases, Prentice Hall, 1994

Objectives & strategy formulation

Key points

- *Articulate the purpose of the funds – "why do we have this fund?"*
- *Establish return and risk objectives for the investment portfolio*
  - *Return would usually be some amount above inflation over 5 years*
  - *Risk depends on type of fund – two good questions are:*
    - *What can we afford to lose?*
    - *How often can we afford to make a loss?*
- *Define the investment strategy and asset allocation*
    - *Should be reviewed annually*
    - *Employ an independent asset consultant*
- *Clearly define constraints such as requirements for liquidity, (capital) guarantees and ethical or Christian considerations.*

1. Articulate in writing the purpose of the funds – "why do we have this fund?"

This is one of the most important steps in governance; if it is not possible to agree on why a fund needs to exist, then it probably should not exist and any relevant moneys could be aggregated with general Diocesan funds.

Very often however, there is a requirement to invest surplus funds so as to provide income for the Diocese – referred to as an endowment fund. An example of this type of objective is as follows:

The basic goal underlying the establishment of this fund/endowment is to ensure that the assets of the fund, together with the investment income earned thereon, are invested in a prudent and diversified manner to meet the cash flow disbursements of the Diocese as they come due from year to year. The overall investment objectives of the fund are therefore to:

- *preserve capital in real terms as adjusted for CPI inflation*
- *generate a rate of return sufficient to cover the anticipated disbursements of the Diocese*
- *maintain liquidity*

2. Establishing return and risk objectives for the investment portfolio

Once the purpose of the fund has been agreed, this needs to be translated into quantifiable return and risk objectives. In the endowment example referred to in point 1, the return objective would have to be some amount above inflation – typically it might be described as follows:

The investment return objective is to achieve a return after fees of CPI plus 4.5% per annum over rolling 5 year periods.

The major risks depend on the type of fund. For an endowment fund like that referred to above, the major risk is that over time the fund fails to maintain the real value of its capital, generally due to inadequate diversification of assets or investing in assets which have too great a possibility of losses – for example, many of the products referred to as Collateralised Debt Obligations or Credit Default Swaps – which may have been rated highly, but actually incorporate the possibility to lose all of the invested capital.

Two good questions to ask and answer are:

- What can we afford to lose?
- How often can we afford to make a loss?

For an endowment type fund, a risk objective might be phrased as:

The risk objective is to avoid losses, whether realized or unrealized of more than 20% of the fund's value in any 12 month period.

For a fund with a more conservative risk profile, say if there were capital guarantees in place, the risk objective might be framed as:

The risk objective is to avoid the possibility of a negative return in any reporting period.

3. Defining the investment strategy and asset allocation

These are critical components of the governance process and should be reviewed at least annually. The process is set out in the discussion paper "**Towards More Effective Investment Management"** referenced in the Executive Summary. It is very strongly recommended that Dioceses obtain advice from an independent asset consultant for this part of the process.

4. Articulating constraints

Constraints on investment activity can arise from various sources, but the following are particularly relevant for Dioceses:

Liquidity refers to the ease with which you can turn an investment into cash. Listed shares are highly liquid so they can be sold on the market usually within a few days. Directly held properties, particularly if occupied by the Diocese are highly illiquid. The degree of liquidity for a fund needs to take into account its cash flow requirements and the ability of investors to redeem funds at call.

Guarantees - if the fund provides guarantees of capital values (exists in some Anglican Development Funds and cash management facilities) the investments should be limited to assets which are reasonably well matched in terms of term, volatility and valuation to the fund's liabilities.

There is also often a desire to reflect **Christian values** in the investment strategy, with the aim to avoid shares or countries or companies that blatantly offend those values. The Church of England provides an excellent starting point for dealing with these considerations:
http://www.cofe.anglican.org/info/ethical

Policy making

Key points

- *A dedicated investment committee should be the primary governance body for any Diocesan fund.*
- *The committee needs to operate in accordance with a written charter/terms of reference setting out its powers, obligations and responsibilities.*
- *The investment policy summarises the goals on risk and return objectives, the investment principles to be applied for the fund, the range of strategies to be used.*
- *The implementation policy deals with the day-to-day operation of the fund.*

1. Investment committee

A dedicated investment committee should be the primary governance body for a Diocesan fund. If this is not a realistic option, then it is desirable to set aside part of the agenda of the Diocesan Finance Committee to focus just on investment matters.

It is important that as far as possible the members of the committee have a relevant finance and/or investment background and are prepared to make the time available to commit to the task.

The committee needs to operate in accordance with a written charter/terms of reference setting out its powers, obligations and responsibilities. It would normally cover the following areas:

- Source of authority
- Membership
- Conduct of meetings
- Investment process
- External relationships
- Consultants, fund managers, custodian
- Risk management
- Review and reporting

2. Investment policy

The investment policy is contained in a document that describes the Diocese's goals for risk and returns, the investment principles to be applied by the fund, the range of strategies to be used, the asset allocation principles, appointment of investment managers and so on.

3. Implementation policy

The implementation policy deals with the day-to-day operation of the fund, covering many aspects (see Documentation summary below). In particular it covers the resourcing for the investment function within the Diocese.

Monitoring & supervising

Key points

- *Generally Dioceses are able to operate under exemptions from ASIC and/or APRA when raising funds.*
- *It is essential that at least annually each Diocese checks that it is fully compliant with the relevant exemptions.*
- *Any service provider should be employed under a written contract, including a service level agreement for regular monitoring of the service provider's performance.*
- *The overall fund performance relative to its return and risk objectives should be monitored at least quarterly.*
- *Performance of any active fund managers employed by the fund should be monitored at least annually.*
- *Investment and deposit funds should be on a par with other Diocesan entities in relation to financial controls and financial reporting, including auditing.*
- *Assets must be segregated from other Diocesan assets, including bank accounts.*
- *Proper custody of the assets is essential.*
- *Only permitted assets should be held.*
- *There should be limits on concentration of assets.*

1. Regulatory obligations

Exemptions from ASIC and/or APRA give significant relief but still impose compliance requirements on the sponsoring Diocese. These can include annual reporting, maintenance of exemption records and inclusion of various disclaimers on public documents and statements.

It is essential that at least annually each Diocese checks that it is fully compliant with the relevant exemptions. These can be obtained from the ASIC and APRA websites:

ASIC Regulatory Guideline 87:
http://www.asic.gov.au/asic/asic.nsf/byheadline/Regulatory+guides?openDocument

APRA Banking Exemption No. 1 of 2006
http://www.apra.gov.au/RFC/Religious-charitable-development-funds.cfm

2. Service providers

Service providers include asset consultants, accountants, auditors, administrators, fund managers, stockbrokers and custodians. Any service provider should be employed under a written contract which clearly describes their powers and responsibilities and obligations to the Diocese.

There should be a service level agreement attached to the contract, which is used as the basis for regular monitoring of the service provider's performance against agreed benchmarks (or KPIs).

3. Investment performance and risk management

This is a particularly important area to monitor at two levels:

- The overall fund performance relative to its return and risk objectives should be monitored at least quarterly, primarily from the risk perspective.
- Performance of any active fund managers employed by the fund should be monitored on at least an annual basis.

The fund's asset consultant would normally be utilised for this function, particularly for assistance with risk management.

4. Financial & investment controls

Investment and deposit funds are no different to any other entity when it comes to financial control requirements. They should be on a par with other Diocesan entities in relation to financial controls and financial reporting, including auditing.

In addition, funds have specific requirements deriving from their constitution and investment policy documents:

- Assets must be segregated from other Diocesan assets, including bank accounts
- Proper custody of the assets is essential to ensure that they cannot be stolen or used for the wrong purpose, including protection from fraud
- Only permitted assets should be held. For example, if a Development Fund is permitted under its charter to hold only loans and fixed income assets, it should not be ever found to be holding shares.
- There are normally limits on concentration of assets, both at the asset class level (known as asset allocation ranges) and in relation to individual securities. A typical example of the latter would be that no single company share or no single loan should represent more than, say, 5% (or maybe 10%) of the fund's portfolio by market value. These limits should be monitored at least monthly and corrective action (known as rebalancing) should be undertaken, preferably before any limit is breached, but immediately if a breach has actually occurred.

Accountability to investors and stakeholders

Key points

- *Stakeholders include the Bishop, Bishop in Council (Diocesan Council or equivalent), the Diocese (including executive management), parishes and other Diocesan organisations, parish members, regulators and sometimes the general public.*
- *Recognise that in every case, the responsible entity for the fund is acting in a fiduciary capacity and so are its directors/councillors/committee members.*
- *The standard approach to demonstrating accountability is regular good quality reporting.*
- *Good communication includes early disclosure of any unexpected problems that emerge.*

The important accountability issue is to recognise that for all stakeholders, the responsible entity for the fund is acting in a fiduciary capacity and so are its directors/councillors/committee members. The High Court of Australia defines a "fiduciary duty" as the "duty to act with fidelity and trust" to another. This obliges one to act honestly, in good faith and to the best of his/her ability in the fund's interests.

The fact that ASIC and APRA have given certain reliefs to Diocesan funds provided, inter alia, that they include associated disclaimers on all public documents, places added emphasis on the fiduciary responsibilities of the responsible entities of the funds relative to a standard commercial offering.

The standard approach to demonstrating accountability is regular good quality reporting. This can include an annual report on the progress of the funds, annual (or more regular) investor statements for public offer funds, regular publication of unit prices, and production of audited accounts in accordance with the Financial Advisory Group's recommendations.

In addition, good communication includes early disclosure to relevant stakeholders of any unexpected problems that emerge, as they do from time to time.

Investment implementation

Key points

- *Implementation is a management task. There should be at least one senior executive with responsibility for the day-to-day management of the funds.*
- *Significant parts of the process will be outsourced to external suppliers including custodians, asset consultants, fund managers, accountants, administrator and auditors.*
- *The Financial Advisory Group strongly recommends that Dioceses share and/or leverage available resources across Dioceses when it comes to implementation.*
- *Significant cost benefits can accrue to Dioceses from sharing implementation functions.*

Investment Implementation is dealt with in detail in the Discussion Paper "**Towards More Effective Investment Management"** prepared by the General Synod Financial Advisory Group in August 2003. (www.anglican.org.au/governance.cfm?SID=22&SSID=78)

Generally, there will need to be at least one senior executive who is given responsibility for the day-to-day management of the funds. This may be only a part of the person's job, but it need to be clearly described and included in the person's agreed duties and key performance indicators.

The extent of internal resourcing will depend on the size of the funds and of the Diocese. It is likely that a significant part of the process will be outsourced to external suppliers including custodians, asset consultants, fund managers, accountants, administrator and auditors. These all need to be appointed with clear contracts and service level agreements.

The Financial Advisory Group strongly recommends that, where possible, Dioceses share and/or leverage the available resources across Dioceses when it comes to implementation as this is a scale driven activity which is quite labour intensive. The Finance Managers User Group can be consulted for assistance in this regard. The current Chair is Grant Reubenicht, Finance Manager at the Diocese of Adelaide (greubenicht@adelaide.anglican.com.au).

Significant cost benefits could accrue to Dioceses from sharing implementation, particularly for functions like asset consulting, custody, fund managers, unit pricing, accounting and administration.

Documentation summary

There are up to five types of documentation required for each fund. **All the documents listed below can be accessed under the Financial Advisory Group on the General Synod website**:

http://www.anglican.org.au/governance.cfm?SID=22&SSID=78

1. Constituent documents

All formally established funds need to have some form of constituent document - deed, constitution, ordinance, act, canon etc. This will need to comply with any regulatory requirements under the ASIC or APRA exemptions if the instrument is being offered to the public. The document normally describes why the fund has been established, what it is expected to achieve and how it will go about this, as well as rights of investors and other stakeholders and any guarantees, etc which may be provided. **An example is the Perth Anglican Community Fund.**

2. Offer documents

Offer documents – referred to as a product disclosure statement or information memorandum – are required for Anglican Development funds and Investment Funds which are open to the general public, even if only to church members.

Significant relief is granted to funds which have an APRA and/or ASIC exemption from the corporations law requirements for fund raising, provided the appropriate ASIC or APRA disclaimer is included. **An example is the Melbourne Growth Fund.**

3. Charters

The Investment Committee (or board equivalent) requires a charter as discussed above. **An example is the draft Investment Policy Statement of the Brisbane Diocese**

4. Reports

- Annual accounts should comply with the General Synod Financial Advisory Group standards for Diocesan accounts

- Investor statements – for public offer funds – need to comply with regulatory disclaimers and be timely. They should include relevant tax information and include enough information to enable the investor to develop an informed opinion as to the progress of his/her investment.

5. Policy & procedures manual

The policy and procedures manual covers all the day to day operations of the fund and is the key guiding document for executive management. **A very comprehensive example is the Melbourne Growth Fund.**

General Synod Financial Advisory Group

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