

# INVESTMENT POLICY STATEMENT

## ABC Foundation / Endowment

Approved on September 1, 2002

By ABC Foundation Investment Committee

**This investment policy statement should be reviewed and updated at least annually. Any change to this policy should be communicated in writing on a timely basis to all interested parties.**

*This Investment Policy Statement (IPS) has been prepared by invest<sup>mgf</sup>. It is intended to serve as an example of the type of information that would be included in a comprehensive IPS. Clients are advised to have legal counsel review their IPS before it is approved.*

## EXECUTIVE SUMMARY

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<b>Type of Plan:</b>	Tax-exempt, public foundation
<b>Current Assets:</b>	(1) Unrestricted: \$4,500,000 (2) Restricted: \$1,200,000
<b>Time Horizon:</b>	(1) Unrestricted: Greater than 5 years (2) Restricted: Less than 5 years
<b>Modeled Return:</b>	(1) Unrestricted: 7.6% (5.1% over the Consumer Price Index) (2) Restricted: 5.6% (3.1% over the CPI)
<b>Modeled Loss:</b>	(1) Unrestricted: -8.9% (Probability level of 5%) (2) Restricted: -1.9% (Probability level of 5%)

### Asset Allocation – (1) Unrestricted Portfolio:

	Lower Limit	Strategic Allocation	Upper Limit
Domestic Large-Cap Equity			
Blend	5%	10%	15%
Growth	5	10	15
Value	5	10	15
Mid-Cap Equity	5	10	15
Small-Cap Equity	5	10	15
International Equity	5	10	15
Intermediate-term Fixed Income	30	35	40
Cash Equivalent	0	5	10

### Asset Allocation – (1) Restricted Portfolio:

	Lower Limit	Strategic Allocation	Upper Limit
Domestic Large-Cap Equity			
Blend	0%	5%	10%
Growth	0	5	10
Value	0	5	10

International Equity	0	5	10
Intermediate-term Fixed Income	35	40	45
Short-term Fixed Income	25	30	35
Cash Equivalent	5	10	15

**Evaluation Benchmarks:**

**Trustee Counseling Index™ (% Equity Exposure)\***

	<b>LCB</b>	<b>LCG</b>	<b>LCV</b>	<b>MCB</b>	<b>SCB</b>	<b>IE</b>	<b>IB</b>	<b>SB</b>	<b>MM</b>
<b>TCI (20)</b>	5	5	5	0	0	5	40	30	10
<b>TCI (40)</b>	10	10	10	0	5	5	35	20	5
<b>TCI (60)</b>	10	10	10	10	10	10	35	0	5
<b>TCI (80)</b>	15	15	15	10	10	15	15	0	5

\*The TCI™ series of indexes have several unique design features, two of which are:  
 (1) They illustrate a series of prudently diversified portfolios; and  
 (2) They illustrate the performance of a diversified portfolio, calculated using the performance of the median mutual fund manager for each peer group represented in the allocation.

## **PURPOSE**

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The purpose of this Investment Policy Statement (IPS) is to assist the ABC Foundation (Foundation) and Investment Advisor (Advisor) in effectively supervising, monitoring and evaluating the management of the Foundation's assets. The Foundation's investment program is defined in the various sections of the IPS by:

1. Stating in a written document the Foundation's attitudes, expectations, objectives and guidelines for the investment of their assets.
2. Setting forth an investment structure for managing the Foundation's assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce an appropriate level of overall diversification and total investment return over the investment time horizon.
3. Establishing formal criteria to select, monitor, evaluate and compare the performance results achieved by the money managers on a regular basis.

4. Encouraging effective communications between the Foundation, Advisor and interested parties.
5. Complying with all applicable fiduciary, prudence and due diligence requirements experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the Foundation's assets.

## **BACKGROUND**

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### ***Mission Statement***

*The mission of the ABC Foundation is to preserve and foster the traditions of the \_\_\_\_\_ . The Foundation is dedicated to the continuance and enhancement of the professional knowledge and education of its members, and to provide service and promote fellowship among all members of the Foundation.*

This IPS has been prepared for the Foundation, a tax-exempt, public foundation under IRS Code 501(c)(3). There are two portfolios (Portfolios):

- (1) An Unrestricted account with assets of approximately \$4,500,000; and
- (2) A Restricted account with assets of approximately \$1,200,000.

The Foundation has established a unique asset allocation strategy for each Portfolio taking into account contemplated grants, operating expenses and future contributions.

### ***Key Information***

**Name of Foundation:** ABC Foundation

**IRS Tax ID:** 56-1234567

Additional key information, which is subject to change from time-to-time, is contained in Appendix \_\_\_\_ (the appropriate appendix).

## **STATEMENT OF OBJECTIVES**

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The objectives of the Foundation have been established in conjunction with a comprehensive review of current and projected financial requirements. The objectives are:

1. Maintain the purchasing power of the current assets and all future contributions. The objective is to maintain the level of services and programs in relation to the average cost increases. This requires establishing an equilibrium-spending-rate of 4%.
2. Maintain a constant funding-support-ratio. The desire of the Foundation is to maintain the level of programs and services currently provided. This can only be accomplished if sufficient total return is reinvested and new funds added to keep pace with cost increases and program expansions.
3. Apply a smoothing rule to mitigate the effects of short-term market volatility on spending. One of the following rules will be applied:

*Moving average.* The equilibrium-spending-rate will be applied to an average of the past three years of the portfolio's market values.

*Preset increment over last year.* The level of spending will be increased by \_\_\_% over that of the previous year.

*Judging the need for spending.* The Foundation will determine the amount to be spent based on the needs of the recipient organizations.

4. Maximize return within reasonable and prudent levels of risk.
5. Maintain an appropriate asset allocation based on a total return policy that is compatible with a flexible spending policy, while still having the potential to produce positive real returns.

### ***Time Horizon***

The investment guidelines for the Unrestricted Portfolio are based upon an investment horizon of greater than five years. Therefore, interim fluctuations should be viewed with appropriate perspective. Short-term liquidity requirements are anticipated to be met with the Restricted Portfolio.

### ***Risk Tolerances***

The Foundation recognizes and acknowledges some risk must be assumed in order to achieve the long-term investment objectives of the Unrestricted Portfolio,

and there are uncertainties and complexities associated with contemporary investment markets.

In establishing the risk tolerances for this IPS, the Foundation's ability to withstand short- and intermediate-term variability (through the Restricted Portfolio) were considered. The Foundation's prospects for the future, current financial condition, and level of funding in the Restricted Portfolio suggest collectively some interim fluctuations in market value and rates of return may be tolerated with the Unrestricted Portfolio in order to achieve longer-term objectives.

### ***Performance Expectations***

In general, the Foundation would like the Unrestricted Portfolio to earn at least a targeted return of 7.6%. It is understood an average return of 7.6% will require superior manager performance to: (1) retain principal value; and, (2) purchasing power. Furthermore, the objective is to earn a long-term rate of return that is at least 5.1% greater than the rate of inflation as measured by the CPI.

In general, the Foundation would like the Restricted Portfolio to earn at least a targeted return of 5.6%. The objective is to earn a long-term rate of return that is at least 3.1% greater than the rate of inflation as measured by the CPI.

## **ASSET CLASS GUIDELINES**

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The Foundation believes that long-term investment performance, in large part, is primarily a function of asset class mix. The Foundation has reviewed the long-term performance characteristics of the broad asset classes, focusing on balancing the risks and rewards.

History shows that while interest-generating investments, such as bond portfolios, have the advantage of relative stability of principal value, they provide little opportunity for real long-term capital growth due to their susceptibility to inflation. On the other hand, equity investments, such as common stocks, clearly have a significantly higher expected return but have the disadvantage of much greater year-by-year variability of return. From an investment decision-making point of view, this year-by-year variability may be worth accepting, provided the time horizon for the equity portion of the portfolio is sufficiently long (five years or greater).

The performance expectations (both risk and return) of each asset class are contained in Appendix A. The following nine asset classes were selected and ranked in ascending order of "risk" (least to most).

Money Market (MM)  
Short Bond (SB)  
Intermediate Bond (IB)  
Large-Cap Value (LCV)  
Large-Cap Blend (LCB)  
Large-Cap Growth (LCG)  
Mid-Cap Blend (MCB)  
Small-Cap Blend (SCB)  
International Equity (IE)

The Foundation has considered the following asset classes for inclusion in the asset mix, but has decided to exclude these asset classes at the present time:

Global Fixed Income  
Real Estate

### ***Rebalancing of Strategic Allocation***

The percentage allocation to each asset class may vary as much as plus or minus 5% depending upon market conditions. When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation of the Portfolio. If there are no cash flows, the allocation of the Portfolio will be reviewed quarterly.

If the Foundation judges cash flows to be insufficient to bring the Portfolio within the strategic allocation ranges, the Foundation shall decide whether to effect transactions to bring the strategic allocation within the threshold ranges (Strategic Allocation).

## **DUTIES AND RESPONSIBILITIES**

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### ***Foundation Investment Committee***

As a fiduciary, the primary responsibilities of the Foundation are:

1. Prepare and maintain this investment policy statement.
2. Prudently diversify the Portfolio's assets to meet an agreed upon risk/return profile.
3. Prudently select investment options.

4. Control and account for all investment, record keeping and administrative expenses associated with the Portfolio.
5. Monitor and supervise all service vendors and investment options.
6. Avoid prohibited transactions and conflicts of interest.

### ***Investment Advisor***

The Foundation will retain an objective, third-party Advisor to assist the Foundation in managing the overall investment process. The Advisor will be responsible for guiding the Foundation through a disciplined and rigorous investment process to enable the Foundation to meet the fiduciary responsibilities outlined above.

### ***Investment Managers***

As distinguished from the Foundation and Advisor, who are responsible for managing the investment process, investment managers are responsible for making investment decisions (security selection and price decisions). The specific duties and responsibilities of each investment manager are:

1. Manage the assets under their supervision in accordance with the guidelines and objectives outlined in their respective Service Agreements, Prospectus or Trust Agreement.
2. Exercise full investment discretion with regards to buying, managing, and selling assets held in the Portfolios.
3. If managing a separate account (as opposed to a mutual fund or a commingled account), seek approval from the Foundation prior to purchasing and/or implementing the following securities and transactions:
  - Letter stock and other unregistered securities; commodities or other commodity contracts; and short sales or margin transactions.
  - Securities lending; pledging or hypothecating securities.
  - Investments in the equity securities of any company with a record of less than three years continuous operation, including the operation of any predecessor.
  - Investments for the purpose of exercising control of management.



4. Vote promptly all proxies and related actions in a manner consistent with the long-term interest and objectives of the Portfolios as described in this IPS. Each investment manager shall keep detailed records of the voting of proxies and related actions and will comply with all applicable regulatory obligations.
5. Communicate to the Foundation all significant changes pertaining to the fund it manages or the firm itself. Changes in ownership, organizational structure, financial condition, and professional staff are examples of changes to the firm in which the Foundation is interested.
6. Effect all transactions for the Portfolio subject "to best price and execution." If a manager utilizes brokerage from the Portfolio assets to effect "soft dollar" transactions, detailed records will be kept and communicated to the Foundation.
7. Use the same care, skill, prudence, and due diligence under the circumstances then prevailing that experienced investment professionals acting in a like capacity and fully familiar with such matters would use in like activities for like portfolios with like aims in accordance and compliance with the Uniform Prudent Investor Act and all applicable laws, rules, and regulations.
8. If managing a separate account (as opposed to a mutual fund or a commingled account), acknowledge co-fiduciary responsibility by signing and returning a copy of this IPS.

### ***Custodian***

Custodians are responsible for the safekeeping of the Portfolio's assets. The specific duties and responsibilities of the custodian are:

1. Maintain separate accounts by legal registration.
2. Value the holdings.
3. Collect all income and dividends owed to the Portfolio.
4. Settle all transactions (buy-sell orders) initiated by the Investment Manager.
5. Provide monthly reports that detail transactions, cash flows, securities held and their current value, and change in value of each security and the overall Portfolio since the previous report.

## **INVESTMENT MANAGER SELECTION**

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The Foundation will apply the following due diligence criteria in selecting each money manager or mutual fund.

1. *Regulatory oversight:* Each investment manager should be a regulated bank, an insurance company, a mutual fund organization, or a registered investment adviser.
2. *Correlation to style or peer group:* The product should be highly correlated to the asset class of the investment option. This is one of the most critical parts of the analysis since most of the remaining due diligence involves comparisons of the manager to the appropriate peer group.
3. *Performance relative to a peer group:* The product's performance should be evaluated against the peer group's median manager return, for 1-, 3- and 5-year cumulative periods.
4. *Performance relative to assumed risk:* The product's risk-adjusted performance (Alpha and/or Sharpe Ratio) should be evaluated against the peer group's median manager's risk-adjusted performance.
5. *Minimum track record:* The product's inception date should be greater than three years.
6. *Assets under management:* The product should have at least \$75 million under management.
7. *Holdings consistent with style:* The screened product should have no more than 20% of the portfolio invested in "unrelated" asset class securities. For example, a Large-Cap Growth product should not hold more than 20% in cash, fixed income and/or international securities.
8. *Expense ratios/fees:* The product's fees should not be in the bottom quartile (most expensive) of their peer group.
9. *Stability of the organization:* There should be no perceived organizational problems – the same portfolio management team should be in place for at least two years.

## **CONTROL PROCEDURES**

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### ***Performance Objectives***

The Foundation acknowledges fluctuating rates of return characterize the securities markets, particularly during short-term time periods. Recognizing that short-term fluctuations may cause variations in performance, the Foundation intends to evaluate manager performance from a long-term perspective.

The Foundation is aware the ongoing review and analysis of the investment managers is just as important as the due diligence implemented during the manager selection process. The performance of the investment managers will be monitored on an ongoing basis and it is at the Foundation's discretion to take corrective action by replacing a manager if they deem it appropriate at any time.

On a timely basis, but not less than quarterly, the Foundation will meet to review whether each manager continues to conform to the search criteria outlined in the previous section; specifically:

1. The manager's adherence to the portfolio's investment guidelines;
2. Material changes in the manager's organization, investment philosophy and/or personnel; and,
3. Any legal, SEC and/or other regulatory agency proceedings affecting the manager.

The Foundation has determined it is in the best interest of the Portfolio's participants that performance objectives be established for each investment manager. Manager performance will be evaluated in terms of an appropriate market index (e.g. the S&P 500 stock index for large-cap domestic equity manager) and the relevant peer group (e.g. the large-cap growth mutual fund universe for a large-cap growth mutual fund).

<b>Asset Class</b>	<b>Index</b>	<b>Peer Group</b>
<b>Large-Cap Equity</b>		
Blend	S&P 500	Large-Cap Blend
Growth	Russell 200 Growth	Large-Cap Growth
Value	Russell 200 Value	Large-Cap Value
<b>Mid-Cap Equity</b>	S&P 400	Mid-Cap Blend
<b>Small-Cap Equity</b>	Russell 2000	Small-Cap Blend
<b>International Equity</b>	MSCI EAFE	Foreign Stock
<b>Fixed Income</b>		

Intermediate-term Bond	Lehman Brothers Gov't/Credit Intermediate	Intermediate-Term Bond
Short-term Bond	Lehman Brothers 1-3 year Government	Short-Term Bond
<b>Money Market</b>	90 day T-Bills	Money Market Database

A manager may be placed on a Watchlist and a thorough review and analysis of the investment manager may be conducted, when:

1. A manager performs below median for their peer group over a 1-, 3- and/or 5-year cumulative period.
2. A manager's 3-year risk adjusted return (Alpha and/or Sharpe) falls below the peer group's median risk adjusted return.
3. There is a change in the professionals managing the portfolio.
4. There is a significant decrease in the product's assets.
5. There is an indication the manager is deviating from his/her stated style and/or strategy.
6. There is an increase in the product's fees and expenses.
7. Any extraordinary event occurs that may interfere with the manager's ability to fulfill their role in the future.

A manager evaluation may include the following steps:

1. A letter to the manager asking for an analysis of their underperformance.
2. An analysis of recent transactions, holdings and portfolio characteristics to determine the cause for underperformance or to check for a change in style.
3. A meeting with the manager, which may be conducted on-site, to gain insight into organizational changes and any changes in strategy or discipline.

The decision to retain or terminate a manager cannot be made by a formula. It is the Foundation's confidence in the manager's ability to perform in the future that ultimately determines the retention of a manager.

### ***Measuring Costs***

The Foundation will review at least annually all costs associated with the management of the Portfolio's investment program, including:

1. Expense ratios of each investment option against the appropriate peer group.
2. Custody fees: The holding of the assets, collection of the income and disbursement of payments.
3. Whether the manager is demonstrating attention to "best execution" in trading securities.

## **INVESTMENT POLICY REVIEW**

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The Foundation will review this IPS at least annually to determine whether stated investment objectives are still relevant and the continued feasibility of achieving the same. It is not expected that the IPS will change frequently. In particular, short-term changes in the financial markets should not require adjustments to the IPS.

Prepared:

Approved:

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Advisor  
September 1, 2002

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Foundation  
September 1, 2002