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The Investment Policy Statement

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"Chance favors only the prepared mind." - Pasteur

Introduction.
Successful investing for long-term funds requires a strategic plan. This is true despite – indeed, because of – the fact that the future is unknowable. The plan must be specific, embodying in concrete terms the best thinking of the board of trustees about the investment pool, its goals and purposes; but it also needs to be sufficiently flexible to guide the board through environments that may be very different from those prevailing at the time of its adoption.

This paper reviews the key features of such a plan – the investment policy statement. Since investment policy statements are as varied as the organizations they serve, there is no one-size-fits-all solution. We do, however, include an appendix with two templates that may serve as examples for those who find it helpful to work from an existing model.

For institutions with endowed perpetual funds, one of the gravest risks is that, in periods of economic turmoil, crucial investment decisions may be made in haste, under pressure, and without adequate consideration of the long-term consequences. During the working lifetimes of many of today's trustees, market crises have occurred at a rate of around two per decade. In such cases, the temptation to listen to urgent voices claiming that 'this time is different' has been very difficult to resist. For trustees, the risk to the fund of a permanent loss of purchasing power as a result of poor investment decisions is compounded by the potential for after-the-fact second-guessing and possible legal challenge by attorneys general, donors and beneficiaries.

The investment policy statement sets forth in writing the operating plan of the board of trustees for the management, investment and spending of the investment pool. While strategic in approach and long-term in scope, the investment policy statement also sets forth parameters or ranges within which more tactical actions may be taken. Composed in calm to be used in crisis, it is both a shield, guarding trustees from the pressure to make unwise decisions in an atmosphere of panic, and a sword, by which the board establishes the territory it intends to occupy and cultivate, through its investment practice, as fiduciaries for the institution.

Components of the investment policy statement.
Endowed institutions differ in their missions, capabilities and resources, and investment policy statements naturally mirror these differences. In that sense, there is no single 'right' investment policy statement; each institution's board must craft a statement that responds to the needs of the institution and the preferences and risk tolerances of the trustees. Annual review of the statement by the board can help to ensure that it remains an appropriate distillation of the institution's investment philosophy and practice.

It can be said, however, that a properly-drafted investment policy statement should address, at a minimum, the following issues:

- What is the purpose of the investment pool? What is its role in supporting the mission of the institution?

- Is the fund intended to be perpetual in duration, or will it have a finite life? To what extent is maintenance of purchasing power an explicit goal?

- Who will have responsibility for investment decisions? What are the required qualifications of these individuals, and how are they to be recruited?

- If the board of trustees intends to delegate its authority to an investment committee or some other body or entity, how should that delegation be evidenced and documented? Which investment decisions, if any, should be delegated to outside advisors or investment managers? How should these and other service providers be selected and monitored?

- What is the investment pool's target return, both in nominal and real (i.e., after inflation) terms? What is its expected annual contribution as a proportion of the institution's operating budget or other relevant criterion?

- What should be the overall investment strategy of the fund, including asset allocation targets and ranges, permitted and prohibited investment strategies and instruments?

- What kind and degree of risk is the board prepared to take in pursuit of its investment goals? How are risks to be defined and measured?

- How much liquidity should be maintained by the fund, either for investment needs within the fund or for wider institutional purposes?

- How much of the endowment should be spent and how much reinvested? What rules determine how this amount is calculated?

- To what extent is the fund expected to assist in maintaining the balance sheet of the institution (for example, by supporting its credit rating)?

In the following sections, we review and discuss each of these issues.

Discussion.

Purpose of the investment pool. Endowments are typically composed of individual funds given by donors over time, usually to support particular activities or missions of the organization. Apart from these restricted funds, donors sometimes give with no restriction as to purpose. In addition, institutions themselves may elect to treat operating surpluses, unrestricted bequests and other similar amounts as 'quasi-endowment', to be invested and spent alongside other endowed funds.

These differing purposes influence the investment strategy for the funds. For example, a fund dedicated to providing scholarships at a college requires a steady flow of cash, year in and year out; ideally, the amount should not only remain steady but should rise with inflation. A fund, on the other hand, that is intended to cover the cost of awarding an occasional prize every five years does not have the same need for ready cash. These two funds have different tolerances for year-to-year fluctuation in their value and for liquidity, among other characteristics; and their asset allocation may, as a result, be different.

Duration of the pool: perpetual or not? Historically, most donors to endowments have contemplated a perpetual life for their funds. In recent years, however, some endowments – including some very large ones such as the Bill and Melinda Gates Foundation – have been established with a finite life. The expected lifespan, or term, of a fund is an important factor to consider when crafting an investment policy.

In this context, the maintenance of purchasing power, also called intergenerational equity, becomes an issue of key importance for a perpetual fund. While donors may occasionally state that intergenerational equity is not a goal for their fund, under the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which is the law in virtually all the states, maintenance of purchasing power is assumed to be the intention of donors in the absence of a specific provision to the contrary.[1]

[1] For a summary discussion of UPMIFA and its requirements, see Sedlacek and Jarvis, "Endowment Spending: Building a Stronger Policy Framework" (2010), pp. 2-4. For other information about the law, see http://www.upmifa.org.

For example, a series of funds to endow the conductor's and section chairs' positions at a symphony orchestra will need to be invested with a perpetual horizon in mind, including considerations of intergenerational equity. On the other hand, a fund dedicated to constructing a new concert hall for the symphony ten years from now does not need to generate any cash during its life and should, accordingly, be invested using a different strategy (although a fund for ongoing maintenance of the hall would be perpetual).

Who has responsibility for investment decisions? Authority over institutional investment pools such as endowments, foundations and pension funds resides with the governing board, the members of which are fiduciaries. Under common-law concepts of fiduciary duty, and also under UPMIFA, whoever has responsibility for investment decisions must exercise prudence.[2] UPMIFA sets forth a list of factors that those responsible for endowed funds must observe in managing and investing, and states that "a person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds."[3] Thus, while the law is flexible in not demanding that board or investment committee members exercise expertise that they do not possess, it also implicitly disapproves of arrangements whereby an illustrious individual lends his or her name without actually participating in debate and decision-making.

Apart from purely legal considerations, the task of recruiting a competent and committed group of individuals to oversee the investment pool requires a nominating process that acknowledges the seriousness of this portion of the organization's mission. If the board as a whole is to retain this responsibility, then trustee nominations should include an assessment of candidates' financial literacy and investment-related experience.

[2] UPMIFA § 3(b). http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.pdf, p. 11.

[3] Ibid. § 3(e)(6), p. 13.

Delegation to a committee, a consultant, or a manager. Delegation of the trustees' responsibilities with respect to a particular fund is permitted under UPMIFA, unless prohibited by the donor.[4] Under this standard, the board can delegate its fiduciary responsibility for investment matters to a committee or to outside advisors, but must exercise prudence in doing so.[5] Upon accepting the delegation, the new fiduciaries are bound by the same standard as the trustees in carrying out their new responsibilities. And if an investment committee or similar body is to be created, the committee chair (who should be a trustee) should seek out members – whether trustees or not – who have sufficient skill, experience and commitment to be good fiduciaries for the pool. All of these actions should be evidenced by appropriate board discussion and action, and recorded in the minutes.

What is the right size for an investment committee, and what kind of individuals should be asked to serve? Data taken from the most recent *NACUBO-Commonfund Study of Endowments and Commonfund Benchmarks Studies*[6] show that the investment committees of educational institutions, operating charities and nonprofit healthcare organizations number about 8 voting members on average. Foundations have smaller committees of around 6 voting members, since for many foundations the committee is composed of the founder's family and a few outside advisors. Within the investment committee, around 4 or 5 members are investment professionals (for foundations, the number of investment professionals is around 3). Between 2 and 3 members across all types of institution have alternative strategies experience, a key requirement for fiduciaries of highly diversified portfolios.

It is thus apparent that in recruiting trustees, investment committee members, and others who will have responsibility for managing endowment funds, care must be taken to select individuals who will understand and be able to fulfill their duties as fiduciaries and will bring their particular skills to bear in overseeing or managing the funds. It is important to note that, while UPMIFA does not set a minimum standard for those to whom the responsibility is delegated, it does require that the board, in choosing those individuals, act prudently.[7] Thus, sound investment policy would indicate that those to whom the responsibility for managing institutional funds is assigned (whether trustees or others) should, at a minimum, have some familiarity with and experience in investment management.

[4] Ibid. § 5(a), p. 29.

[5] Ibid.

[6] Citations are to data for FY2010 drawn from the NACUBO-Commonfund Study of Endowments (NCSE) and the *Commonfund Benchmarks Study* volumes on foundations, operating charities and healthcare organizations.

[7] Ibid.

What about outside investment managers, consultants and other advisors? Most smaller and mid-sized nonprofit organizations lack the financial and staff resources to manage their own portfolios, and so must rely on such outside entities, overseen by volunteer boards of trustees or investment committees that meet several times a year. Many commentators have criticized this model as lacking in rigor, but it remains the standard for most nonprofits.

Across the nonprofit sector, internal staff resources are minimal. The NCSE and Benchmarks Study research shows that the average number of full-time equivalent (FTE) staff overseeing investments is between 1 and 2 FTEs. Only at institutions with endowments above $300 million do the data show higher staffing levels. Yet manager use, even by smaller nonprofits, is high: institutions with assets below $100 million use a total of 9 to 10 managers on average across all asset classes, while for endowments above $100 million it is not unusual to see 6 to 11 separate managers hired directly for various alternative strategies, in addition to between 3 and 5 managers for each of the traditional asset classes such as domestic equities, fixed income, international equities and cash.

Nevertheless, the fiduciary standards outlined above require that the same prudence be exercised in retaining, monitoring, evaluating and dismissing these advisors as in all other matters undertaken by the board. And, given the highly diversified portfolios that underpin the endowment model of investing, it is not surprising that the NCSE and Benchmarks research shows that between one-quarter and one-third of institutions have decided to delegate their investment responsibilities, in full or in part, to outsourced investment providers. Even here, however, the same standards of prudence and diligence in choosing and monitoring the provider apply.

Target return and endowment dependence. If the board aspires to maintain the purchasing power of the investment pool over time, then assumptions must be made about the long-term spending rate from the endowment, the anticipated rate of inflation and any other costs the fund may incur. As to the spending rate, both practical experience and economic modeling tools have demonstrated that it is not possible to spend in excess of five percent of the portfolio each year without suffering erosion in purchasing power over time. A proxy rate of no more than five percent, therefore, is frequently used. Inflation has fluctuated considerably over the past half-century, but in recent years has been negligible; an assumed long-term rate of three percent is common. And administrative and other costs are typically considered to add one percent to the expense base. Thus, five plus three plus one, or nine percent, is often the target return cited as necessary to maintain purchasing power.

It is important to try to reduce this number, because a nominal nine percent return, year after year, is probably unachievable without incurring a level of risk that most trustees would deem unacceptably high. Academic research has shown that, in the United States, the long-term equity premium over the risk-free rate of return has averaged approximately six percent, of which two percent has been dividends rather than capital appreciation.[8] To the extent that a portfolio is diversified away from U.S. equity securities – for example, into fixed income – this long-term return is even lower. Therefore, the assumptions for spending, inflation and expenses need to be examined carefully.

Spending, in particular, is the largest item of these three and is most directly within the control of the board. The NCSE and Benchmarks research shows that policy spending rates for educational institutions and operating charities average between 4.5 percent and 4.9 percent. Among foundations, the federally-required minimum annual spending rate of 5 percent for private foundations means that policy spending rates range between 5.1 percent and 5.5 percent, highlighting the challenges that face these institutions in maintaining intergenerational equity.

Equally important, when considering long-term return targets, is the degree to which the institution's operating budget is dependent upon support from the long-term investment pool. This ratio of endowment dependence ranges from zero, at institutions for which the pool is truly a 'rainy-day fund', to much higher figures – for example, the 30-50 percent endowment dependence ratios that are observed at well-endowed U.S. private colleges and universities. The NCSE and Benchmarks research shows that endowment dependence ratios at institutions of higher education average 10.5 percent, from a low of just 5.3 percent at institutions with endowments under $25 million to a high of 17.1 percent at those with institutions with assets over $1 billion. For operating charities, the average endowment dependence is even higher, at 38.3 percent.

An endowed institution ideally would like to receive a steady, and steadily increasing, amount of dollar support each year from its endowment. Where endowment dependence is high, the institution's tolerance for volatility in this amount becomes lower, and the imperative for realism in setting expected returns and acceptable risk levels becomes correspondingly more urgent.

[8] Dimson, Marsh and Staunton, *Triumph of the Optimists* (2002), pp. 163-175.

Investment strategy of the fund, asset allocation, and permitted and prohibited investment strategies and instruments. The investment strategy section forms the conceptual core of the investment policy statement (for operational ease, it may be contained in an appendix to the main body of the document). Its chief component is a table in which target allocations for each permitted asset class and strategy are specified. The table also prescribes ranges or bands around the target allocations, within which they will be permitted to fluctuate. It is important that the ranges not be so broad that they lack discipline or fail to reflect the actual portfolio construction preferences and risk tolerances of the institution. For this reason, where possible, financial modeling using long-term simulation tools should be used to help the board or investment committee to understand the range of probable outcomes and risk parameters of various alternative portfolio choices.

Rebalancing is another key component of the asset allocation policy. Different asset classes and investment strategies will of necessity produce different returns over the same investment period, with the result that the portfolio's actual allocations to each asset class or strategy will become higher or lower than the targets. To the extent that the allocations move outside the permitted bands as a result of such market fluctuations, rebalancing is required. Across all the different types of endowed nonprofits surveyed in the NCSE and Benchmarks research, this practice is nearly universal: around 80 percent of institutions report having rebalanced their portfolios during the past fiscal year.

The process is somewhat counterintuitive, since it involves selling investments that have appreciated in value and using the proceeds to purchase investments that have declined; but the result, from an investment policy point of view, is highly beneficial as the institution is able to reap gains on successful investments and buy other investments that are desired components of the portfolio cheaply.

The two most frequently used approaches to rebalancing are those in which the process is conducted a certain number of times a year (calendar-based) and those in which rebalancing takes place whenever the targets or ranges in the asset allocation table have been exceeded (target/range-based). In the former the portfolio may be rebalanced monthly, quarterly, annually or at some other time interval; in the NCSE and Benchmarks research, around one-fourth of institutions report rebalancing quarterly. In the latter, as noted above, the rebalancing is triggered when the ranges or bands are exceeded; around three-fourths to four-fifths of survey participants report using this method, probably in coordination with one of the calendar-based alternatives. Rebalancing may also be triggered in response to major gifts or other changes in cash flow, in order to ensure that the portfolio remains within its permitted asset allocation ranges. Whichever method is used, it is important that the rebalancing process itself not become the subject of subsequent debate (apart, that is, from the annual review of the investment policy). If it is regarded as optional, the board or committee may be tempted to engage in market timing and the policy will lose its effectiveness.

The investment policy statement should also contain descriptions of permitted and prohibited asset classes, investment strategies and instruments. The purpose of this list is to enable the board or committee to focus on the role of the various strategies in the context of the portfolio and its goals. To this end, it should include not only strategies that the institution intends to use immediately, but those that it may use in the future. For example, the statement might permit certain classes of alternative investments while assigning them a weighting of zero in the current portfolio. Going through the work of considering and describing their potential role and advantages enables the board or committee to be prepared for the time when a place will be made for them in the portfolio.

The question of permitted and prohibited investment strategies and instruments has gained in importance today because the complex nature of many investment products can make it difficult for a client to understand clearly what investment practices are being employed by a manager. Many disclosure documents and offering memoranda are lengthy and densely written, and can as a result be hard to understand, even if the information in them is accurate. The board should not find itself in a situation where, as a result of this complexity, the language in the investment policy conflicts with decisions actually taken. If, for example, an investment policy statement prohibits instruments such as derivatives or strategies such as short selling, the committee should be careful not to invest with a hedge fund that uses derivatives and routinely goes short unless it has first inserted language in the investment policy statement to allow for the use of derivatives and short-selling as part of a hedging strategy. The institution should know what it is investing in and be sure that permissions and prohibitions in the investment policy statement reflect the reality of the decisions being made for the portfolio.

Risks the board is prepared to take in pursuit of its investment goals. Historically, most investment policy statements treated investment risk as an undesirable by-product of investing rather than as an essential precondition to earning investment returns. References to risk typically spoke of it as something to be 'managed' in a general sense, while avoiding specific metrics or parameters. Where risk was defined in investment policy statements, it was usually as volatility of returns, measured in terms of standard deviation – a definition first used by Markowitz in his Modern Portfolio Theory dating from the 1950s.

The 2007-2009 market collapse, and the subsequent (and as yet incomplete) recovery, have brought home to fiduciaries the inadequate nature of this definition and the multiple nature of the risks that are undertaken in investing. Investment risk is now understood to comprise a wide variety of potential threats, chief among which is the risk of loss that would be permanent or require an unacceptably long time to recoup. Financial models are available to enable fiduciaries to estimate the probability and range of possible losses associated with given investment strategies over time, but it is important to emphasize that while risk can be modeled and to some degree understood, it cannot be eliminated if the portfolio's goal is to achieve a long-term return after spending and costs that is in excess of inflation. The question for fiduciaries, then, becomes whether the risks described are acceptable. How many years in twenty, for example, will the board be faced with a decline in dollar spending from year to year? What is the projected worst loss, and how many years would be required for the portfolio to recover its purchasing power? These important questions should be asked and resolved as part of the investment policy formation process.

Liquidity: How much and for what purposes? During the financial crisis, many nonprofits found themselves with insufficient liquidity. For these institutions, the normal process of selling investments to raise cash for payroll and ongoing operations became a harrowing race to the bottom as sellers greatly outnumbered buyers and even high-quality securities could not be sold except at steep discounts from their previous prices. This situation called into question the validity of the 'Endowment Model', which uses a highly diversified portfolio with a higher-than-usual tolerance for illiquidity. Under the Endowment Model, endowment cash was held in small amounts, primarily to satisfy capital calls for partnership investments and to provide 'dry powder' to take advantage of attractive investment opportunities. Cash and near-cash allocations in excess of these requirements were viewed as a drag on performance and kept to a minimum. The crisis greatly increased the need for liquidity at the time when it was least available, and led to a reassessment of the place of cash in the endowment. Data from the NCSE and Benchmarks Studies show that most institutions now include a larger allocation to endowment cash in their policy portfolios – between 5 percent and 9 percent – than at any time in the past ten years.

Spending versus reinvestment and the rules guiding it. Endowments have different purposes and uses for different organizations. At one end of this broad spectrum are institutions whose philosophy is to spend nothing and simply let the investment pool grow. These endowments are typically not composed of restricted funds (or at least not of those that require regular spending) and their institutions are, by definition, not heavily dependent on the endowment for support of the operating budget. It may be that trustees want to build up a rainy-day fund or have some other long-term goal in mind, such as a major capital project. At the other extreme are those funds that are not intended to be perpetual in duration, where spending during a set period is part of the donor's purpose. As noted above, some very large private foundations are currently operating on this basis.

Occupying the middle ground, and defining the vast majority of institutions and assets, are those institutions whose goal is that the endowment provide a source of perpetual support for the mission of the institution. The touchstones for this goal are prudent investing and spending, concepts that inform UPMIFA. Under UPMIFA, trustees may spend or accumulate as much of an endowment fund—including principal or income, realized or unrealized appreciation—as they deem prudent, taking into account the intended duration of the fund, the fund's purposes, economic conditions, expected inflation or deflation, investment returns, other institutional resources and the institution's investment policy.[9] This direct reference to investment policy highlights the central role of the statement in forcing an explicit consideration and articulation, in the statement itself, of the respective roles of investment and spending in the endowment.

[9] UPMIFA § 4(a). http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.pdf, p. 19.

Role of the fund in supporting the institution's balance sheet. Most endowments have as their primary goal the support of the institution's operating budget. In some cases, however, an endowment may have different, or even multiple, roles. For example, unrestricted or quasi-endowment may be pledged to secure a credit line, or it may support a bond rating. In the case of nonprofit healthcare organizations, bond rating agencies have requirements for liquidity and underlying assets; these considerations affect asset allocation, and must be worked into the organization's risk and return expectations. In this sense, the question of the purpose of the investment pool, which we considered at the outset, continues to inform the endowment management process even in areas that are not directly related to investment decision-making.

Indeed, there is a strong case to be made for linking the investment policy not only with the institution's balance sheet but also with its long-term strategic plan. A growing number of institutions are doing this, and many are also addressing gifts and debt either in their investment policy or in separate but coordinated policy documents.

Conclusion.

In the past, many investment policy statements gave relatively cursory treatment to risk, its quantification and its potential impact on the asset pool. The market collapse and credit crisis of 2007-2009 demonstrated that many institutions' portfolios carried unacknowledged risks, that their risk profiles in general were higher than they thought, and that the risk tolerance of their fiduciaries was lower than acknowledged. Today, then, it is entirely appropriate to put risk at the top of the process of investment policy development.

Financial models, as the crisis demonstrated, are anything but infallible and, when consulted, must be used with care and a healthy degree of skepticism. It is nonetheless true that the results of an appropriate simulation or modeling study can assist fiduciaries in going beyond traditional risk definitions such as volatility to examine such critical parameters as the risk of permanent loss, year-to-year declines in spending, and recovery periods. These metrics both enable and force a discussion about tolerable levels of risk, the conclusions from which can be used to guide the construction of a range of potential portfolios that embody those risks that are deemed acceptable. Projected returns from these portfolios are an outcome which, if considered insufficient, indicate either acceptance of lower contributions for the acceptable level of risk or mandate a more robust discussion about the relationship between risk assumption and needed long-term returns.

Thus, in this proposed structure, instead of starting with return, committees work toward it. If, ultimately, the projected range of returns is seen as 'too low' compared to anticipated institutional needs, then the fiduciaries must either reconcile themselves to the fact that the target return is beyond their reach given their risk limits, or accept the necessity of embracing additional risks and explicitly acknowledge them in the investment policy statement.

Appendix

Sample Investment Policy Statement Templates

This section contains two templates for the Board of Trustees or Investment Committee of an endowed nonprofit organization to use in crafting an investment policy statement.

The **Risk-based Investment Policy Statement** is designed for organizations with access to financial simulation and modeling tools (sometimes called Monte Carlo models) that can be used to estimate ranges of future returns for given portfolio choices and create "stress-testing" scenarios to examine the performance of portfolios in illiquid or non-normal market environments. This approach requires more intensive quantitative work on the part of the Board or Committee, usually in partnership with the organization's investment advisor; the result is a more dynamic investment policy process that places risk and liquidity considerations on an equal footing with portfolio returns in making asset allocation and spending decisions.

The **Traditional Investment Policy Statement** is designed for organizations that do not have access to, or choose not to use, the financial simulation and modeling tools employed in the Risk-based Investment Policy Statement. It places asset allocation at the center of the investment policy, does not focus on multiple levels or types of risk parameters to the same degree as the Risk-based Statement, and does not require the same degree of dynamic involvement by the Board or Committee in the investment process.

Both templates comprise a main body, which forms the permanent text of the Statement; this is followed by an appendix containing the Operating Guidelines that set forth the working parameters to be used by the Board or Committee in managing the portfolio. This structure is intended to facilitate the Committee's annual review of the Statement, and to make the process of revision relatively simple and clear.

Both statements also incorporate references to the investment, fiduciary and spending standards of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which is the law in virtually all states of the United States. It is recommended that an institution consult its counsel to confirm that the Investment Policy Statement conforms to the version of UPMIFA adopted in its state.

Template I:

Risk-based Investment Policy Statement

[NAME OF INSTITUTION]

Statement of Investment Policy

Adopted: [Date]

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Statement of Purpose

The purpose of this Investment Policy Statement (together with its Appendix, the "Statement") is to set forth the policies and procedures that shall guide the Board of Trustees (the "Board of Trustees" or the "Board") of [name of institution] ("XYZ") in supervising and monitoring the management of XYZ's investable assets (the "Fund").

General Principles

The risk parameters and related return objectives set forth in this Statement shall form the basis for the Fund's investment strategy, as more fully described herein.

XYZ shall diversify the investments of the Fund unless the Board and, if applicable, the Investment Committee (the "Investment Committee" or the "Committee"), after appropriate deliberation, reasonably determine that because of special circumstances the purposes of the Fund are better served without diversification.

The Fund shall be managed in accordance with high standards of fiduciary duty and in compliance with applicable laws and regulations.[10]

Standards for risk, return, asset allocation, diversification and liquidity shall be determined from a strategic perspective and measured over successive market cycles.

Roles and Responsibilities

If the Board of Trustees elects to oversee investment matters directly, it shall undertake the roles and responsibilities prescribed for the Investment Committee herein. Otherwise, the Investment Committee shall implement the management process and monitor the Fund in accordance with this Statement. The Chair of the Committee shall be a current member of XYZ's Board of Trustees; other Committee members need not be Trustees.

The Investment Committee, acting pursuant to this Statement and to instructions from the Board of Trustees, shall have direct responsibility for the oversight and management of the Fund and for the establishment of investment policies and procedures.

[10] Including but not limited to the version of the Uniform Prudent Management of Institutional Funds Act enacted in this state, if applicable.

The Investment Committee shall, as more fully described herein, manage the Fund via a set of risk and return parameters at the asset class level, combined with policy liquidity and asset allocation mixes for the portfolio.

In fulfilling its responsibilities under this Statement, the Investment Committee shall, among other activities, recommend to the Board of Trustees the hiring and dismissal of investment managers, fiscal agents and other advisors.

Reports on the Fund shall be provided quarterly to the Investment Committee. The [insert title of appropriate staff person] shall be responsible to the Investment Committee for maintaining detailed records of all invested funds and for carrying out the investment policies and procedures established by the Board of Trustees and the Investment Committee.

Policy Review

This Statement shall be reviewed annually by the Investment Committee and any recommendations for changes presented to the Board of Trustees.

Goals and Objectives

Objectives of the Fund

The Fund has a long-term investment horizon. The primary investment objectives of the Fund are to:

- Maintain the real purchasing power of the Fund after inflation, costs and spending (i.e., achieve “intergenerational equity”);

- Maximize the Fund’s risk-adjusted returns; and

- Provide a stable source of liquidity and financial support for the mission of XYZ.

Investment Philosophy

While acknowledging the importance of preserving capital, the Board of Trustees also recognizes the necessity of accepting risk if the Fund is to be able to meet its long-term investment goals. It is the view of the Board of Trustees that choices made with respect to asset allocation and liquidity risk will be the major determinants of investment performance. The Committee shall seek to ensure that the risks taken are appropriate and commensurate with the Fund's goals.

Modeling Assumptions and Process

In setting risk and liquidity parameters for the management of the Fund, the Committee shall use appropriate financial simulation models to determine the Fund's portfolio structure and calculate risk levels. In so doing, the Committee shall not assume that normal market environments will prevail, but shall instead engage in "stress testing" scenarios for the portfolio. These stress scenarios, including "left tail" or loss scenarios, shall form the basis for the risk and liquidity parameters that shall guide the management of the Fund.

Investment Policies and Procedures

Operating Guidelines

The Fund shall be managed in accordance with the Operating Guidelines for risk and liquidity described in this section, a template for which is set forth in Appendix A. Once the Operating Guidelines have been approved by the Board, the Investment Committee shall have the authority to manage the Fund within the Operating Guidelines without further authorization from the Board. The following policy descriptions refer to items in the corresponding sections in Appendix A.

Risk and Liquidity

Definition of Risk: Using appropriate financial simulation models, the Committee shall begin by specifying its goals for the following parameters over a 20-year period:

– Probability of achieving intergenerational equity (expressed as a percentage)
– Maximum cumulative drawdown for the Fund, from absolute market cycle peak to trough (expressed as a percentage of asset value)
– Conditional Value at Risk (CVaR) for the aggregate portfolio (expressed in basis points)
– Risk of not meeting payout requirements (expressed as the percentage of occasions when the amount spent declines from one period to the next)

Liquidity Policy: From the above inputs, the model will produce a target asset allocation for the Fund, which shall be designed to achieve the above objectives and entered in Appendix A.

– The Committee shall determine the liquidity mix of this target portfolio as of the present time, in normal market conditions, and in conditions representing market stress, giving due regard to the operating needs of the institution. These three liquidity mixes shall be depicted in, respectively, the "Current Portfolio", "Normal Market" and "Stress Testing" subsections of the "Liquidity Policy" section in Appendix A.

– The overall liquidity constraints of the Fund for the target portfolio shall be closely derived from the "Stress Testing" subsection, and shall be entered in the "Liquidity Mix" section of Appendix A.

Current Risk Metrics: The Fund shall be managed on a risk-adjusted basis to maintain purchasing power after inflation, costs and spending, within the "Stress Testing" liquidity environment.

– On an ongoing basis, the aggregate portfolio shall be managed to the 12-month average CVaR for the Fund. The Committee shall also monitor trends and changes in this metric.

– When possible, the Committee shall monitor and compare the Fund's performance relative to:

- Absolute return objectives for the Fund
- The respective benchmarks for each asset class or strategy in which the Fund is invested, as set forth in the asset allocation table in Appendix A
- A representative group of peer institutions identified by the Committee
- A representative group of peer investment managers

Investment Policy

– *Asset allocation.* The Committee shall, consistent with the above sections, invest the Fund using an asset allocation that is designed to meet the Fund's long-term goals. The allocation will be based on the objectives of the Fund as set forth above.

– *Illiquid investments.* Because of their long-term nature, investments in and commitments to illiquid investment strategies, including but not limited to private capital, private equity real estate, natural resources, distressed debt and other similar private investments, shall be analyzed and discussed by the Committee separately.

– *Targets and ranges.* The asset allocation shall be implemented using a policy portfolio, with target allocations and ranges for each investment strategy. Due to the need for diversification and the longer funding periods for certain investment strategies, the Committee recognizes that an extended period of time may be required to fully implement the asset allocation plan. It is expected that market value fluctuations will cause deviations from the target allocations to occur.

– *Rebalancing.* The purpose of rebalancing is to maintain the Fund's policy asset allocation within the targeted ranges, thereby ensuring that the Fund does not incur additional risks as a result of having deviated from the policy portfolio. Rebalancing will take place on a portfolio basis to reduce expenses as far as practicable. More frequent tactical rebalancing of asset classes within their ranges will also be permitted in order to take advantage of shorter-term market conditions, as long as such changes or reallocations do not, in the opinion of the Committee, cause undue risk or expense to the Fund.

– *Standard of conduct.* In managing and investing the Fund, the Committee shall:

- act in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances;

- incur only costs that are appropriate and reasonable in relation to the assets, the purposes of XYZ and the skills available to XYZ;

- make a reasonable effort to verify facts relevant to the management and investment of the Fund;

- consider the following factors, if relevant:

  (a) general economic conditions;
  (b) the possible effect of inflation or deflation;
  (c) the expected tax consequences, if any, of investment decisions or strategies;
  (d) the role that each investment or course of action plays within the overall investment portfolio of the Fund;
  (e) the expected total return from income and the appreciation of investments;
  (f) other resources of XYZ;
  (g) the needs of XYZ and the Fund to make distributions and to preserve capital; and
  (h) an asset's special relationship or special value, if any, to the charitable purposes of XYZ;

- make management and investment decisions about an individual asset not in isolation, but rather in the context of the Fund's portfolio of investments as a whole and as a part of XYZ's overall investment strategy, including the risk and return parameters set forth in this Statement.

– *Delegation.* Subject to any specific limitation set forth in a gift instrument, the Committee may delegate to an external agent the management and investment of all or part of the Fund to the extent that XYZ could prudently delegate under the circumstances. The Committee shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances in: (1) selecting an agent; (2) establishing the scope and terms of the delegation, consistent with the purposes of XYZ and the Fund; and (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

In this regard, the Committee shall engage qualified external professional investment managers that have demonstrated competence in their respective investment strategies. These managers shall have full discretion and authority for determining investment strategy, security selection and timing of purchases and sales of assets subject to the guidelines specific to their allocation.

– *Investment manager reporting and evaluation.* The investment managers responsible for the investment of the Fund's assets shall report quarterly on their performance. Reports shall include, at a minimum, the following information:

- Comparative returns for the Fund assets under management against their respective benchmarks.
- A complete accounting of all transactions involving the Fund during the quarter.

Each investment manager shall review the portfolio with the Investment Committee at least annually; these review meetings may be supplemented by such other meetings as the Committee may think necessary.

Asset Allocation, Investment Strategies, Guidelines and Restrictions

The Fund shall be diversified both by asset class and within asset classes. Within each asset class, investments shall be diversified further among economic sector, industry, quality and size. The purpose of this diversification is to provide a reasonable assurance that no single security or class of securities will have a disproportionate impact – positive or negative – on the overall performance of the Fund.

The Operating Guidelines, a template for which is set forth in Appendix A, contain the Fund's target asset allocation and range for each asset class or investment strategy, together with the applicable guidelines and restrictions. Taken together, these constitute a framework to assist XYZ and its investment managers in achieving the Fund's investment objectives at a level of risk consistent with the parameters set forth in this Statement.

Spending[11]

– *Policy spending rate.* The policy spending rate for the Fund shall be [ ] percent.[12]

– *Spending formula.* The amount available for appropriation during each fiscal year shall be calculated by applying the policy spending rate to the average of the previous three fiscal years' beginning-period endowment values.

– *Special appropriations and decisions not to spend.* Any special appropriation or decision not to spend the amount indicated by the spending formula must be approved in advance by the Board of Trustees.

– *Standard of conduct.* Subject to the intent of a donor expressed in a gift instrument, XYZ may appropriate for expenditure or accumulate so much of the Fund as the Board of Trustees determines to be prudent for the uses, benefits, purposes and duration for which each of the separate endowments in the Fund is established. In making a determination to appropriate or accumulate, XYZ shall act in good faith, with the care of an ordinarily prudent person in a like position would exercise under similar circumstances and shall consider, if relevant, the following factors:

(1) the duration and preservation of the Fund;
(2) the purposes of XYZ and the Fund;
(3) general economic conditions;
(4) the possible effect of inflation or deflation;
(5) the expected total return from income and the appreciation of investments;
(6) other resources of XYZ; and
(7) XYZ's investment policy.

[11] A spending policy must be based on an institution's own specific spending requirements. Examples of the main spending formulas currently in use include spending a percentage of a moving average of market value; a fixed percentage; increasing spending dollars each year by an inflation measure; and using a hybrid or weighted average approach.

[12] Where the version of UPMIFA passed in the state contains the provision creating a rebuttable presumption that spending above a specified amount is imprudent, the spending rate set forth in this section must fall within the permissible range. New York state institutions are reminded that the version of UPMIFA passed in that state (New York Prudent Management of Institutional Funds Act, New York Not-for-Profit Corporation Law (N-PCL) §§ 550-558) establishes requirements for record-keeping on spending decisions.

Appendix A: Operating Guidelines

Investment Policy Metrics

Modeling Results

NB: These Allocations Are Samples and are Provided for Illustrative Purposes Only

Definition of Risk

Probability of Achieving Intergenerational Equity
(Percent Probability) (60%)

Conditional VaR for Aggregate Portfolio
(Basis Points) (3-4)

Maximum Drawdown (Absolute)
(Percent of Asset Value) (35%)

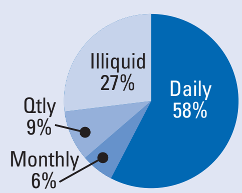
Risk of not meeting payout
(Percent Negative Spend)

Liquidity Policy

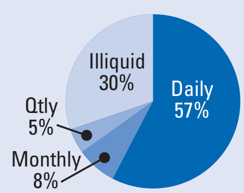
- ***Daily >20%***
- ***Monthly >25%***
- ***Quarterly<25%***
- ***Illiquid<40%***

TOTAL

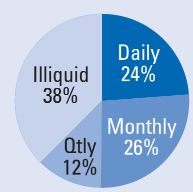
Current Portfolio



Normal Market



Stress Test



Hypothetical Target Asset Allocation

NB: These Allocations Are Samples and are Provided for Illustrative Purposes Only

	Minimum	Target	Maximum	Benchmark
Equity Strategies	**30%**	**40%**	**60%**	**MSCI All Country**
Domestic Equity	10%	15%	30%	Russell 3000
International Equity	5%	15%	30%	MSCI All Country ex U.S.
Private Capital	0%	5%	10%	Russell 3000 + 4%
Distressed Debt	0%	5%	10%	Merrill Lynch High Yield + 4%
Fixed Income (Deflation Hedging)	**10%**	**20%**	**40%**	**Barclays U.S. Aggregate**
Cash & Equivalents	0%	3%	10%	3 Month T-Bill
U.S. Treasuries	0%	5%	20%	Barclays U.S. Treasury Index
Core Bonds	5%	7%	25%	Barclays U.S. Aggregate
Global Bonds	0%	5%	15%	World Govt Bond Index
Real Assets (Inflation Hedging)	**5%**	**20%**	**40%**	**CPI + 4%**
TIPS	0%	0%	10%	Barclays TIPS
Commodities	0%	5%	10%	Dow Jones-UBS Commodities
Natural Resources	0%	8%	10%	Goldman Sachs Commodities + 4%
Private Real Estate	0%	7%	15%	NCREIF 50% Leveraged
Directional & Relative Strategies	**10%**	**20%**	**35%**	**LIBOR + 5%**
Long/Short Directional	0%	10%	20%	S&P 500
Relative Value	0%	10%	20%	3 Month T-Bill + 4%

Investment Strategies, Guidelines and Restrictions

– *Equity Securities.* The purpose of equity investments, both domestic and international, in the Fund is to provide capital appreciation, growth of income, and current income. This asset class carries the assumption of greater market volatility and increased risk of loss, but also provides a traditional approach to meeting portfolio total return goals. This component includes domestic and international common stocks, American Depository Receipts (ADRs), preferred stocks, and convertible stocks traded on the world's stock exchanges or over-the-counter markets.

Public equity securities shall be restricted to high quality, readily marketable securities of corporations that are traded on the major stock exchanges, including NASDAQ, and have the potential for meeting return targets. Equity holdings must generally represent companies meeting a minimum market capitalization requirement of respective asset class profiles with reasonable market liquidity where customary. Decisions as to individual security selection, number of industries and holdings, current income levels and turnover are left to manager discretion, subject to the standards of fiduciary prudence. However, investments in securities of issuers representing a single major industry (as determined by the Committee) shall not at time of investment exceed 10 percent of the Fund's total market value, and investments in securities of any one issuer shall not at time of investment exceed 5 percent of the Fund's total market value, unless approved by the Committee.

Within the above guidelines and restrictions, the Fund's investment managers shall have complete discretion over the selection, purchase and sale of equity securities.

– *Fixed Income Securities.* Domestic and international fixed income investments are intended to provide diversification and a dependable source of current income. Fixed income investments should reduce the overall volatility of the Fund's assets and provide a deflation or inflation hedge, where appropriate.

The fixed income asset class includes the fixed income markets of the U.S. and the world's other developed economies. It includes, but is not limited to, U.S. Treasury and government agency bonds, non-U.S. dollar denominated securities, public and private corporate debt, mortgages and asset-backed securities, and non-investment grade debt. Also included are money market instruments such as commercial paper, certificates of deposit, time deposits, bankers' acceptances, repurchase agreements, and U.S. Treasury and agency obligations. The investment managers shall take into account credit quality, sector, duration and issuer concentrations in selecting an appropriate mix of fixed income securities. Investments in fixed income securities should be managed actively to pursue opportunities presented by changes in interest rates, credit ratings, and maturity premiums.

Within the above guidelines and restrictions, the Fund's investment managers shall have complete discretion over the selection, purchase and sale of fixed income securities.

– *Cash and Equivalents.* The Fund's investment managers may invest in the highest quality commercial paper, repurchase agreements, U.S. Treasury Bills, certificates of deposit, and money market funds to provide income, liquidity for expense payments, and preservation of the Fund's principal value. Investments in the obligations of a single issuer shall not at time of investment exceed 5 percent of the Fund's total market value, with the exception of the U.S. Government and its agencies.

Since the Investment Committee does not consider short-term cash equivalent securities to be appropriate investment vehicles for long-term portfolios, uninvested cash reserves shall be kept to a minimum except where needed to comply with the Fund's liquidity parameters. However, such vehicles are considered appropriate (i) as a depository for income distributions from longer-term investments, (ii) as needed for temporary placement of funds directed for future investment to longer-term investment strategies and (iii) for contributions to the current fund or for current operating cash.

Within the above guidelines and restrictions, the investment managers shall have complete discretion over the selection, purchase and sale of cash equivalent securities.

– *Alternatives.* The following alternative strategies shall be permitted investments for the Fund, subject to the respective guidelines set forth in each section. Investments in alternative strategies shall not at time of investment exceed 25 percent of the Fund's total market value, unless approved by the Committee.

Marketable Alternative Strategies - Investments may include (among other strategies) equity-oriented or market-neutral hedge funds (i.e. long/short, macro event driven, convertible arbitrage, and fixed income strategies), which can be both domestic and international market oriented. These components may be viewed as equity-like or fixed income-like strategies as defined by their structures and exposures.

Private Capital - Investment allocations may include venture capital, private equity and international private capital investments, typically held in the form of professionally managed pooled limited partnerships. Such investments must be made through funds offered by professional investment managers.

Energy & Natural Resources - Investments may include oil, gas, and timber investments, typically held in the form of professionally managed pooled limited partnerships, as well as commodity-based investments. All such investments must be made through funds offered by professional investment managers.

Private Equity Real Estate - Investments may include equity real estate, held in the form of professionally managed, income producing commercial and residential property. Such investments may be made only through professionally managed pooled real estate investment funds.

Distressed Debt - Investments may include the debt securities of companies undergoing bankruptcy or reorganization. Such investments may be made only through professionally managed funds.

– *Derivatives and Derivative Securities.* Certain of the Fund's managers may be permitted under the terms of their specific investment guidelines to use derivative instruments. Derivatives are contracts or securities whose market value is related to the value of another security, index, or financial instrument. Investments in derivatives include (but are not limited to) futures, forwards, options, options on futures, warrants, and interest-only and principal-only strips. No derivative positions can be established that have the effect of creating portfolio characteristics outside of portfolio guidelines.

Examples of appropriate applications of derivative strategies include hedging market, interest rate, or currency risk, maintaining exposure to a desired asset class while making asset allocation changes, gaining exposure to an asset class when it is more cost-effective than the cash markets, and adjusting duration within a fixed income portfolio. Investment managers must ascertain and carefully monitor the creditworthiness of any third parties involved in derivative transactions.

Each manager using derivatives shall (1) exhibit expertise and experience in utilizing such products; (2) demonstrate that such usage is strategically integral to their security selection, risk management, or investment processes; and (3) demonstrate acceptable internal controls regarding these investments.

– *Investment Restrictions.* The Investment Committee may waive or modify any of the restrictions in these guidelines in appropriate circumstances. Any such waiver or modification shall be made only after a thorough review of the investment manager and investment strategy involved. An addendum supporting such waiver or modification shall be maintained as a permanent record of the Investment Committee. All such waivers and modifications shall be reported to the Board of Trustees at the meeting immediately following the granting of the waiver or modification.

Adherence to the restrictions in these guidelines shall be measured as of the time of initial investment. It is recognized that subsequent market action may result in the investment or strategy ceasing to adhere to these restrictions, through no fault of the XYZ staff or the respective outside manager. In such a situation, XYZ and the manager shall make reasonable attempts to bring the investment or strategy back within adherence to these restrictions, bearing in mind the long-term interests of XYZ and the Fund and the desirability of avoiding harmful forced sales of assets.

Investments in mutual funds or commingled funds shall be reviewed and approved by the Investment Committee on a case-by-case basis and, if approved, may vary from this Statement. For each such mutual or commingled fund, the prospectus, offering memorandum or Declaration of Trust documents of the respective fund will govern the investment policies of the fund investments. While the Investment Committee understands that such funds have their own stated guidelines which cannot be changed for individual investors, those guidelines should be similar in principle and spirit to the guidelines stated herein. To the extent that a mutual or commingled fund departs from any or all of such guidelines, the Investment Committee shall make itself aware of the possible consequences and be confident that the investment manager thoroughly understands the risks being taken, has demonstrated expertise in such investment strategies and has guidelines in place for monitoring their risk-adjusted performance.

Template II:

Traditional Investment Policy Statement

[NAME OF INSTITUTION]

Statement of Investment Policy

Adopted: [Date]

Table of Contents

Statement of Purpose

The purpose of this Investment Policy Statement (together with its Appendix, the "Statement") is to set forth the policies and procedures that shall guide the Board of Trustees (the "Board of Trustees" or the "Board") of [name of institution] ("XYZ") in supervising and monitoring the management of XYZ's investable assets (the "Fund").

General Principles

1. XYZ shall diversify the investments of the Fund unless the Board and, if applicable, the Investment Committee (the "Investment Committee" or the "Committee"), after appropriate deliberation, reasonably determine that because of special circumstances the purposes of the Fund are better served without diversification.

2. The Fund shall be managed in accordance with high standards of fiduciary duty and in compliance with applicable laws and regulations.[13]

3. Standards for return, asset allocation and diversification shall be determined from a strategic perspective and measured over successive market cycles.

Roles and Responsibilities

If the Board of Trustees elects to oversee investment matters directly, it shall undertake the roles and responsibilities prescribed for the Investment Committee herein. Otherwise, the Investment Committee shall implement the management process and monitor the Fund in accordance with this Statement. The Chair of the Committee shall be a current member of XYZ's Board of Trustees; other Committee members need not be Trustees.

The Investment Committee, acting pursuant to this Statement and to instructions from the Board of Trustees, shall have direct responsibility for the oversight and management of the Fund and for the establishment of investment policies and procedures.

The Investment Committee shall, as more fully described herein, manage the Fund via a set of asset allocation targets and ranges for the portfolio.

[13] Including but not limited to the version of the Uniform Prudent Management of Institutional Funds Act enacted in this state, if applicable.

In fulfilling its responsibilities under this Statement, the Investment Committee shall, among other activities, recommend to the Board of Trustees the hiring and dismissal of investment managers, fiscal agents and other advisors.

Reports on the Fund shall be provided quarterly to the Investment Committee. The [insert title of appropriate staff person] shall be responsible to the Investment Committee for maintaining detailed records of all invested funds and for carrying out the investment policies and procedures established by the Board of Trustees and the Investment Committee.

Policy Review

This Statement shall be reviewed annually by the Investment Committee and any recommendations for changes presented to the Board of Trustees.

Goals and Objectives

Objectives of the Fund

The Fund has a long-term investment horizon. The primary investment objectives of the Fund are to:

- Maintain the real purchasing power of the Fund after inflation, costs and spending (i.e., achieve "intergenerational equity");

- Provide a stable source of liquidity and financial support for the mission of XYZ.

Investment Philosophy

While acknowledging the importance of preserving capital, the Board of Trustees also recognizes the necessity of accepting risk if the Fund is to be able to meet its long-term investment goals. It is the view of the Board of Trustees that choices made with respect to asset allocation will be the major determinants of investment performance. The Committee shall seek to ensure that the risks taken are appropriate and commensurate with the Fund's goals.

Investment Policies and Procedures

Operating Guidelines

The Fund shall be managed in accordance with the Operating Guidelines described in this section, a template for which is set forth in Appendix A. Once the Operating Guidelines have been approved by the Board, the Investment Committee shall have the authority to manage the Fund within the Operating Guidelines without further authorization from the Board.

Investment Policy

– *Asset allocation.* The Committee shall, consistent with the above sections, invest the Fund using an asset allocation that is designed to meet the Fund's long-term goals. The allocation will be based on the objectives of the Fund as set forth above.

– *Illiquid investments.* Because of their long-term nature, investments in and commitments to illiquid investment strategies, including but not limited to private capital, private equity real estate, natural resources, distressed debt and other similar private investments, shall be analyzed and discussed by the Committee separately.

– *Targets and ranges.* The asset allocation shall be implemented using a policy portfolio as set forth in Appendix A, with target allocations and ranges for each investment strategy. Due to the need for diversification and the longer funding periods for certain investment strategies, the Committee recognizes that an extended period of time may be required to fully implement the asset allocation plan. It is expected that market value fluctuations will cause deviations from the target allocations to occur.

– *Rebalancing.* The purpose of rebalancing is to maintain the Fund's policy asset allocation within the targeted ranges, thereby ensuring that the Fund does not incur additional risks as a result of having deviated from the policy portfolio. Rebalancing will take place on a portfolio basis to reduce expenses as far as practicable. More frequent tactical rebalancing of asset classes within their ranges will also be permitted in order to take advantage of shorter-term market conditions, as long as such changes or reallocations do not, in the opinion of the Committee, cause undue risk or expense to the Fund.

– *Standard of conduct.* In managing and investing the Fund, the Committee shall:

- act in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances;

- incur only costs that are appropriate and reasonable in relation to the assets, the purposes of XYZ and the skills available to XYZ;

- make a reasonable effort to verify facts relevant to the management and investment of the Fund;

- consider the following factors, if relevant:

  (a) general economic conditions;
  (b) the possible effect of inflation or deflation;
  (c) the expected tax consequences, if any, of investment decisions or strategies;
  (d) the role that each investment or course of action plays within the overall investment portfolio of the Fund;
  (e) the expected total return from income and the appreciation of investments;
  (f) other resources of XYZ;
  (g) the needs of XYZ and the Fund to make distributions and to preserve capital; and
  (h) an asset's special relationship or special value, if any, to the charitable purposes of XYZ;

- make management and investment decisions about an individual asset not in isolation, but rather in the context of the Fund's portfolio of investments as a whole and as a part of XYZ's overall investment strategy, including the risk and return parameters set forth in this Statement.

– *Delegation.* Subject to any specific limitation set forth in a gift instrument, the Committee may delegate to an external agent the management and investment of all or part of the Fund to the extent that XYZ could prudently delegate under the circumstances. The Committee shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances in: (1) selecting an agent; (2) establishing the scope and terms of the delegation, consistent with the purposes of XYZ and the Fund; and (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

In this regard, the Committee shall engage qualified external professional investment managers that have demonstrated competence in their respective investment strategies. These managers shall have full discretion and authority for determining investment strategy, security selection and timing of purchases and sales of assets subject to the guidelines specific to their allocation.

– *Investment manager reporting and evaluation.* The investment managers responsible for the investment of the Fund's assets shall report quarterly on their performance. Reports shall include, at a minimum, the following information:

- Comparative returns for the Fund assets under management against their respective benchmarks.
- A complete accounting of all transactions involving the Fund during the quarter.

– Each investment manager shall review the portfolio with the Investment Committee at least annually; these review meetings may be supplemented by such other meetings as the Committee may think necessary.

When possible, the Committee shall monitor and compare the Fund's performance relative to:

- Absolute return objectives for the Fund
- The respective benchmarks for each asset class or strategy in which the Fund is invested, as set forth in the asset allocation table in Appendix A
- A representative group of peer institutions identified by the Committee
- A representative group of peer investment managers

Asset Allocation, Investment Strategies, Guidelines and Restrictions

The Fund shall be diversified both by asset class and within asset classes. Within each asset class, investments shall be diversified further among economic sector, industry, quality and size. The purpose of this diversification is to provide a reasonable assurance that no single security or class of securities will have a disproportionate impact – positive or negative – on the overall performance of the Fund.

The Operating Guidelines, a template for which is set forth in Appendix A, contain the Fund's target asset allocation and range for each asset class or investment strategy, together with the applicable guidelines and restrictions. Taken together, these constitute a framework to assist XYZ and its investment managers in achieving the Fund's investment objectives at a level of risk consistent with the parameters set forth in this Statement.

Spending[14]

– *Policy spending rate.* The policy spending rate for the Fund shall be [ ] percent.[15]

– *Spending formula.* The amount available for appropriation during each fiscal year shall be calculated by applying the policy spending rate to the average of the previous three fiscal years' beginning-period endowment values.

–*Special appropriations and decisions not to spend.* Any special appropriation or decision not to spend the amount indicated by the spending formula must be approved in advance by the Board of Trustees.

– *Standard of conduct.* Subject to the intent of a donor expressed in a gift instrument, XYZ may appropriate for expenditure or accumulate so much of the Fund as the Board of Trustees determines to be prudent for the uses, benefits, purposes and duration for which each of the separate endowments in the Fund is established. In making a determination to appropriate or accumulate, XYZ shall act in good faith, with the care of an ordinarily prudent person in a like position would exercise under similar circumstances and shall consider, if relevant, the following factors:

(1) the duration and preservation of the Fund;
(2) the purposes of XYZ and the Fund;
(3) general economic conditions;
(4) the possible effect of inflation or deflation;
(5) the expected total return from income and the appreciation of investments;
(6) other resources of XYZ; and
(7) XYZ's investment policy.

[14] A spending policy must be based on an institution's own specific spending requirements. Examples of the main spending formulas currently in use include spending a percentage of a moving average of market value; a fixed percentage; increasing spending dollars each year by an inflation measure; and using a hybrid or weighted average approach.

[15] Where the version of UPMIFA passed in the state contains the provision creating a rebuttable presumption that spending above a specified amount is imprudent, the spending rate set forth in this section must fall within the permissible range. New York state institutions are reminded that the version of UPMIFA passed in that state (New York Prudent Management of Institutional Funds Act, New York Not-for-Profit Corporation Law (N-PCL) §§ 550-558) establishes requirements for record-keeping on spending decisions.

Appendix A: Operating Guidelines

Hypothetical Target Asset Allocation

NB: These Allocations Are Samples and are Provided for Illustrative Purposes Only

	Minimum	Target	Maximum	Benchmark
Equity Strategies	**30%**	**40%**	**60%**	**MSCI All Country**
Domestic Equity	10%	15%	30%	Russell 3000
International Equity	5%	15%	30%	MSCI All Country ex U.S.
Private Capital	0%	5%	10%	Russell 3000 + 4%
Distressed Debt	0%	5%	10%	Merrill Lynch High Yield + 4%
Fixed Income (Deflation Hedging)	**10%**	**20%**	**40%**	**Barclays U.S. Aggregate**
Cash & Equivalents	0%	3%	10%	3 Month T-Bill
U.S. Treasuries	0%	5%	20%	Barclays U.S. Treasury Index
Core Bonds	5%	7%	25%	Barclays U.S. Aggregate
Global Bonds	0%	5%	15%	World Govt Bond Index
Real Assets (Inflation Hedging)	**5%**	**20%**	**40%**	**CPI + 4%**
TIPS	0%	0%	10%	Barclays TIPS
Commodities	0%	5%	10%	Dow Jones-UBS Commodities
Natural Resources	0%	8%	10%	Goldman Sachs Commodities + 4%
Private Real Estate	0%	7%	15%	NCREIF 50% Leveraged
Directional & Relative Strategies	**10%**	**20%**	**35%**	**LIBOR + 5%**
Long/Short Directional	0%	10%	20%	S&P 500
Relative Value	0%	10%	20%	3 Month T-Bill + 4%

Investment Strategies, Guidelines and Restrictions

– *Equity Securities.* The purpose of equity investments, both domestic and international, in the Fund is to provide capital appreciation, growth of income, and current income. This asset class carries the assumption of greater market volatility and increased risk of loss, but also provides a traditional approach to meeting portfolio total return goals. This component includes domestic and international common stocks, American Depository Receipts (ADRs), preferred stocks, and convertible stocks traded on the world's stock exchanges or over-the-counter markets.

  Public equity securities shall be restricted to high quality, readily marketable securities of corporations that are traded on the major stock exchanges, including NASDAQ, and have the potential for meeting return targets. Equity holdings must generally represent companies meeting a minimum market capitalization requirement of respective asset class profiles with reasonable market liquidity where customary. Decisions as to individual security selection, number of industries and holdings, current income levels and turnover are left to manager discretion, subject to the standards of fiduciary prudence. However, investments in securities of issuers representing a single major industry (as determined by the Committee) shall not at time of investment exceed 10 percent of the Fund's total market value, and investments in securities of any one issuer shall not at time of investment exceed 5 percent of the Fund's total market value, unless approved by the Committee.

  Within the above guidelines and restrictions, the Fund's investment managers shall have complete discretion over the selection, purchase and sale of equity securities.

– *Fixed Income Securities.* Domestic and international fixed income investments are intended to provide diversification and a dependable source of current income. Fixed income investments should reduce the overall volatility of the Fund's assets and provide a deflation or inflation hedge, where appropriate.

The fixed income asset class includes the fixed income markets of the U.S. and the world's other developed economies. It includes, but is not limited to, U.S. Treasury and government agency bonds, non-U.S. dollar denominated securities, public and private corporate debt, mortgages and asset-backed securities, and non-investment grade debt. Also included are money market instruments such as commercial paper, certificates of deposit, time deposits, bankers' acceptances, repurchase agreements, and U.S. Treasury and agency obligations. The investment managers shall take into account credit quality, sector, duration and issuer concentrations in selecting an appropriate mix of fixed income securities. Investments in fixed income securities should be managed actively to pursue opportunities presented by changes in interest rates, credit ratings, and maturity premiums.

Within the above guidelines and restrictions, the Fund's investment managers shall have complete discretion over the selection, purchase and sale of fixed income securities.

– *Cash and Equivalents.* The Fund's investment managers may invest in the highest quality commercial paper, repurchase agreements, U.S. Treasury Bills, certificates of deposit, and money market funds to provide income, liquidity for expense payments, and preservation of the Fund's principal value. Investments in the obligations of a single issuer shall not at time of investment exceed 5 percent of the Fund's total market value, with the exception of the U.S. Government and its agencies.

Since the Investment Committee does not consider short-term cash equivalent securities to be appropriate investment vehicles for long-term portfolios, uninvested cash reserves shall be kept to a minimum except where needed to comply with the Fund's liquidity parameters. However, such vehicles are considered appropriate (i) as a depository for income distributions from longer-term investments, (ii) as needed for temporary placement of funds directed for future investment to longer-term investment strategies and (iii) for contributions to the current fund or for current operating cash.

Within the above guidelines and restrictions, the investment managers shall have complete discretion over the selection, purchase and sale of cash equivalent securities.

– *Alternatives.* The following alternative strategies shall be permitted investments for the Fund, subject to the respective guidelines set forth in each section. Investments in alternative strategies shall not at time of investment exceed 25 percent of the Fund's total market value, unless approved by the Committee.

Marketable Alternative Strategies - Investments may include (among other strategies) equity-oriented or market-neutral hedge funds (i.e. long/short, macro event driven, convertible arbitrage, and fixed income strategies), which can be both domestic and international market oriented. These components may be viewed as equity-like or fixed income-like strategies as defined by their structures and exposures.

Private Capital - Investment allocations may include venture capital, private equity and international private capital investments, typically held in the form of professionally managed pooled limited partnerships. Such investments must be made through funds offered by professional investment managers.

Energy & Natural Resources - Investments may include oil, gas, and timber investments, typically held in the form of professionally managed pooled limited partnerships, as well as commodity-based investments. All such investments must be made through funds offered by professional investment managers.

Private Equity Real Estate - Investments may include equity real estate, held in the form of professionally managed, income producing commercial and residential property. Such investments may be made only through professionally managed pooled real estate investment funds.

Distressed Debt - Investments may include the debt securities of companies undergoing bankruptcy or reorganization. Such investments may be made only through professionally managed funds.

– *Derivatives and Derivative Securities.* Certain of the Fund's managers may be permitted under the terms of their specific investment guidelines to use derivative instruments. Derivatives are contracts or securities whose market value is related to the value of another security, index, or financial instrument. Investments in derivatives include (but are not limited to) futures, forwards, options, options on futures, warrants, and interest-only and principal-only strips. No derivative positions can be established that have the effect of creating portfolio characteristics outside of portfolio guidelines.

Examples of appropriate applications of derivative strategies include hedging market, interest rate, or currency risk, maintaining exposure to a desired asset class while making asset allocation changes, gaining exposure to an asset class when it is more cost-effective than the cash markets, and adjusting duration within a fixed income portfolio. Investment managers must ascertain and carefully monitor the creditworthiness of any third parties involved in derivative transactions.

Each manager using derivatives shall (1) exhibit expertise and experience in utilizing such products; (2) demonstrate that such usage is strategically integral to their security selection, risk management, or investment processes; and (3) demonstrate acceptable internal controls regarding these investments.

– *Investment Restrictions.* The Investment Committee may waive or modify any of the restrictions in these guidelines in appropriate circumstances. Any such waiver or modification shall be made only after a thorough review of the investment manager and investment strategy involved. An addendum supporting such waiver or modification shall be maintained as a permanent record of the Investment Committee. All such waivers and modifications shall be reported to the Board of Trustees at the meeting immediately following the granting of the waiver or modification.

Adherence to the restrictions in these guidelines shall be measured as of the time of initial investment. It is recognized that subsequent market action may result in the investment or strategy ceasing to adhere to these restrictions, through no fault of the XYZ staff or the respective outside manager. In such a situation, XYZ and the manager shall make reasonable attempts to bring the investment or strategy back within adherence to these restrictions, bearing in mind the long-term interests of XYZ and the Fund and the desirability of avoiding harmful forced sales of assets.

Investments in mutual funds or commingled funds shall be reviewed and approved by the Investment Committee on a case-by-case basis and, if approved, may vary from this Statement. For each such mutual or commingled fund, the prospectus, offering memorandum or Declaration of Trust documents of the respective fund will govern the investment policies of the fund investments. While the Investment Committee understands that such funds have their own stated guidelines which cannot be changed for individual investors, those guidelines should be similar in principle and spirit to the guidelines stated herein. To the extent that a mutual or commingled fund departs from any or all of such guidelines, the Investment Committee shall make itself aware of the possible consequences and be confident that the investment manager thoroughly understands the risks being taken, has demonstrated expertise in such investment strategies and has guidelines in place for monitoring their risk-adjusted performance.