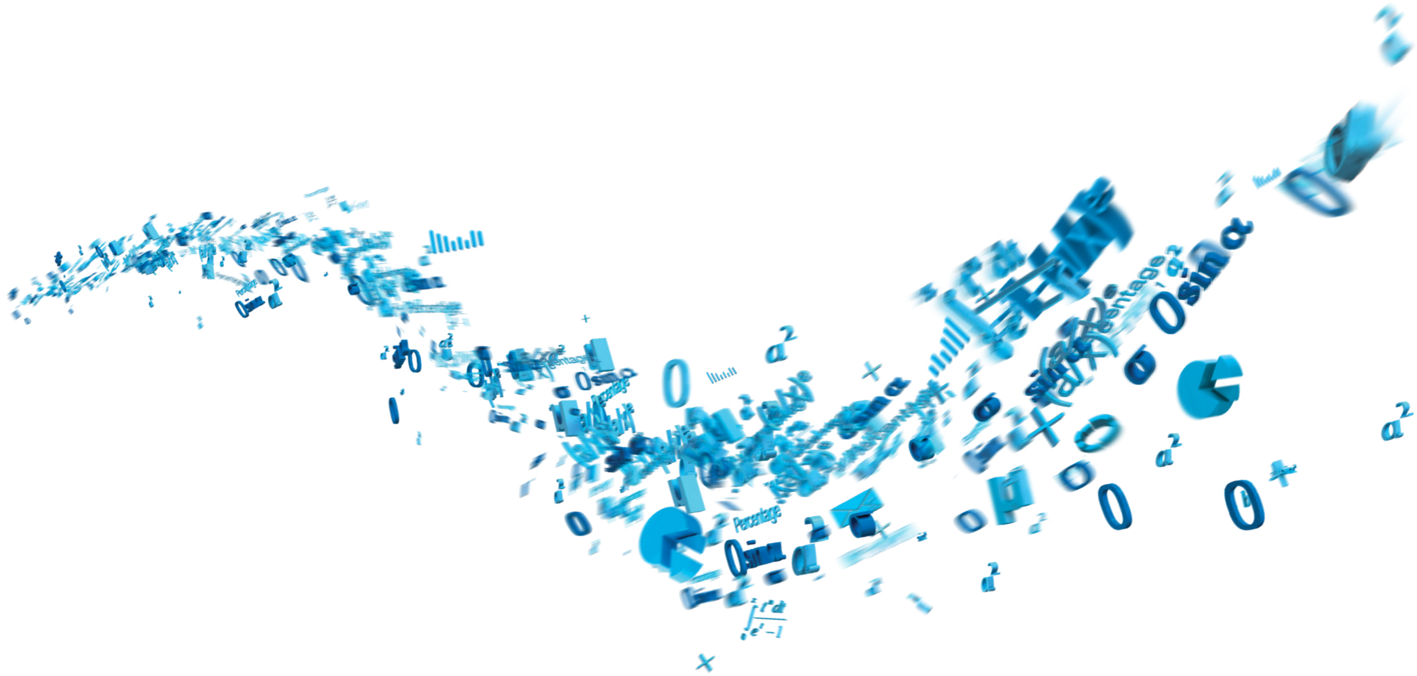

Key Topics for Non-Profit Organizations in 2018

Topics to Consider

Each year, we identify a few key topics where non-profit fiduciaries should focus. While our guidance and engagement is primarily targeted at investment pools and the fiduciaries of such pools, we approach our work with non-profit organizations from a holistic perspective. Thus, several of our topics should resonate beyond the Investment/Finance Committee (IC).[1] Finally, we rarely expect radical shifts from our previous year's list, but nuanced differences shaped by the events of the previous year and expectations for the coming year do emerge. Our 2018 key topics are:

- Effective Governance
- Enterprise Risk Management
- Policy & Regulatory Reform
- Portfolio Strategy
- ESG and its Sister Strategies

1 The term "Investment Committee"/ "IC" is used as a generic term recognizing that some organizations have a finance committee or other named committee which serves as the IC.

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Key Topics for Non-Profit Organizations in 2018

Effective Governance

Much has been written about the importance of good governance structures, but it is imperative to remain mindful of how easy, and often unintended, it is to upset a well-functioning governing process. One or two changes to Board or IC members may have tremendous impact on the cohesiveness of the governing bodies, either positive or negative. Don't shy away from tackling the issue of whether your structure is meeting your needs. For most non-profits, the primary goal for your investment pool(s) is to remain in perpetuity thus to avoid permanent loss of capital. If your governance structure isn't working and may harm your ability to meet your goals, consider alternative structures. Given that investing continues to increase in complexity, perhaps consider whether your needs would be better met by evolving the structure from one where the IC assumes much of the day-to-day responsibilities of oversight and management to one with partial or full outsourcing of the investments, often called outsourced chief investment officer (OCIO).

> Don't shy away from tackling the issue of whether your structure is meeting your needs.

Enterprise Risk Management

The concept of "enterprise risk management" continues to gain traction. We advocate that all fiduciaries must remain attentive not only to the risks inherent in managing asset pools but also to the extensive risks impacting your organization. Understanding the linkages between the assets and liabilities (in the broadest sense of the word) should be beneficial. Examples of such include 1) recognizing how the management and strategy of health care assets may impact a health care organization's credit rating and 2) managing the repercussions on an endowment from the misuse of donor funds or the inappropriate activities elsewhere in the institution. Communication, transparency and access to the right tools should strengthen your enterprise risk management activities. Consider adopting a risk "dashboard" to ensure you are tracking the risks that you have identified as mattering most. Embrace the concept of "what is measured is managed."

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Policy Regulatory Reform

Ongoing vigilance of government driven policies and regulatory reform are of vital importance. We began 2018 with the most significant update to the U.S. tax code in many years impacting institutions in a myriad of ways. For instance, there are several components of the new tax code that affect non-profit hospitals and higher education; in addition, non-profit organizations are waiting to see how the increase in standard deductions may affect them.[2] We are not tax experts, so we encourage our clients to seek professional tax advice to understand the impact of the law on their institution. Understanding and responding to tax reform and the potential for a trickle down squeeze on your assets could play out as such: the federal government puts more pressure on individual states, states place additional pressure on higher education institutions to self-fund thus requiring additional donor dollars, and these dollars may be more difficult to come by given the expected impact to charitable giving.

2 www.irs.gov

> Engage and challenge yourself to find strategies that may work well for you in your objectives.

Portfolio Strategy

As investment fiduciaries, it is essential to remain ever mindful of portfolio strategy. We live in interesting times, markets have been relatively strong but uncertainty is always present and the outlook for strong returns is bleak. Being disciplined in spending is often challenging but is mandatory, especially for those organizations with limited inflows and required payouts. We expect that the primary focus for fiduciaries will continue to be the ongoing search for return, the balance of assuming illiquidity risk with the hopes of attaining further return, and responding to stakeholder pressures. Not all non-profit asset pools are the same; as a fiduciary, the role you fill is ensuring that the portfolio is best structured for the needs of your institution. Investing is not a "set it and forget it" strategy; engage and challenge yourself to find strategies that may work well for you in meeting your objectives while aligned with your mission. Don't "settle" for a 100 percent passive long-only portfolio if you are doing so from complacency. Yes, it may be the best solution for your institution, but be active in the decision of how to invest. Be confident that you know why your portfolio is invested as it is.

ESG and its Sister Strategies

The integration of Environmental, Social and Governance (ESG) and its sister strategies of impact investing, mission-related investing (MRI) and socially responsible investing (SRI) all fall under the umbrella of Responsible Investing (RI). We encourage all of our non-profit clients to be informed and have a stance on RI. We believe that the integration of ESG factors may have beneficial impacts in either return enhancement or risk reduction. In addition, there are certain RI strategies that may meet the overall objectives of your institution. Asset growth continues in this area, and your stakeholders want to know what you are doing. Be conscious of the decision you make with regard to such strategies. Encourage your stakeholders to join in a conversation as to why they are passionate about a particular segment of this market. If you are in higher education, challenge students, check in with them each year, engage and include them on committees and boards. Push to really evaluate 1) the potential impact on the growth of your investment pools and 2) what matters to your institution. Stand up for your beliefs and recognize that not all aspects of RI are of interest to nor appropriate for all investors.

Summary

As you think about the discussions you will have in your 2018 IC meetings, add at least a couple of these topics to your agenda. Take action such as:

- Conduct a survey to evaluate whether all fiduciaries believe the current governance structure is functioning well.
- Develop a risk dashboard tracking the risks that matter most.
- Learn about the impact of tax reform on your institution and its asset pools.
- Consider new investment strategies.
- Discuss and document what your beliefs are with regard to RI. Evaluate whether your portfolio aligns with your beliefs.

Those of you serving as fiduciaries recognize the many challenges and multiple masters you serve; the balancing act of providing a certain spend amount with consideration of liquidity, uncertain capital markets and oftentimes conflicting priorities. Don't be complacent; as a fiduciary you are responsible for ensuring that the management of your investment pools is done in a prudent manner. Remain vigilant of the overall vision for your organization.

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About Aon Hewitt Investment Consulting, Inc.

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