Faith-based Investment Governance

February 2024

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INTRODUCTION

This paper explores the topic of investment governance for faith organizations. FaithInvest's earlier paper, [From Faith Values to Investment], focused on the importance of investment policy statements (IPS) and guidelines for institutional faith-based asset owners, as the essential governing documents required for the successful integration of faith values with investments. This paper, co-authored by FaithInvest and NEPC, looks at the broader framework of investment governance.

Investment governance is described by the CFA Institute Research Foundation as '...the effective use of resources – people, policies, and systems – by an individual or governing body seeking to fulfill a fiduciary duty to a principal in addressing an underlying investment challenge.'*

Faiths, as values-based organizations serving a public purpose, operate in an environment that also requires a range of faith-based considerations, because many faith groups hold that investment governance should reflect faith-specific values, integrated throughout the governance framework.

Faith organizations provide spiritual and moral guidance for their adherents, and often – but by no means always – seek to reflect their faith values in their investments. The recently released second instalment of our annual research study "Good Intentions: What Faiths Say About How They Invest ~ And How They Can Do More" serves as an FCI Index of faith organizations' emphasis on faith values in their investments. The report found that just 55% of the studied faith-based asset owners (FBAOs) indicated a clearly stated faith role in their IPS. For the remaining 45%, there was no mention of faith in the IPS.

*Investment Governance for Fiduciaries, Michael E. Drew, Adam N. Walk, 2019 CFA Institute Research Foundation p.1

Nonetheless, as the majority of FBAOs in the FCI Index study include a faith component in their IPSs, it follows that many faith groups now consider it essential to look more closely at their broader governance framework to ensure full integration of faith values throughout.

Faith organizations require funds for their various programs – 'good works' – a portion of which is often generated on the returns from investments, alongside donations and grants. This can create tension, or perceived tension, between the need to generate adequate investment returns and the desire to invest in line with values. On the other hand, failure to address potential misalignment of investments and faith-values can often lead to reputational risk or other kinds of unintentional harm.

How should this potential source of tension be addressed? What degree of added complexity for governance personnel and systems can the faith group support? Addressing issues such as these involves a collaboration with a range of stakeholders from within the faith community, including spiritual leaders, faith business leaders, and lay members of the organization, which can be greatly facilitated by a robust governance framework, as we'll see.

Notably, these issues can have an even greater impact on smaller faith organizations, which tend to lack the resources to deal with the additional complexity and stresses related to investment program design and implementation and the educational needs of the community. This was described in FaithInvest's earlier paper, "Faith-consistent Investing and Smaller Organisations: Implementing Faith-consistent Investment Programmes with Limited Resources".

We'll begin with a review of the typical structure, attributes, and characteristics of investment governance.

For this review, we will turn to our partners at NEPC, an investment consultant with an extensive history of working with faith-based organizations.

The Essentials of Good Governance

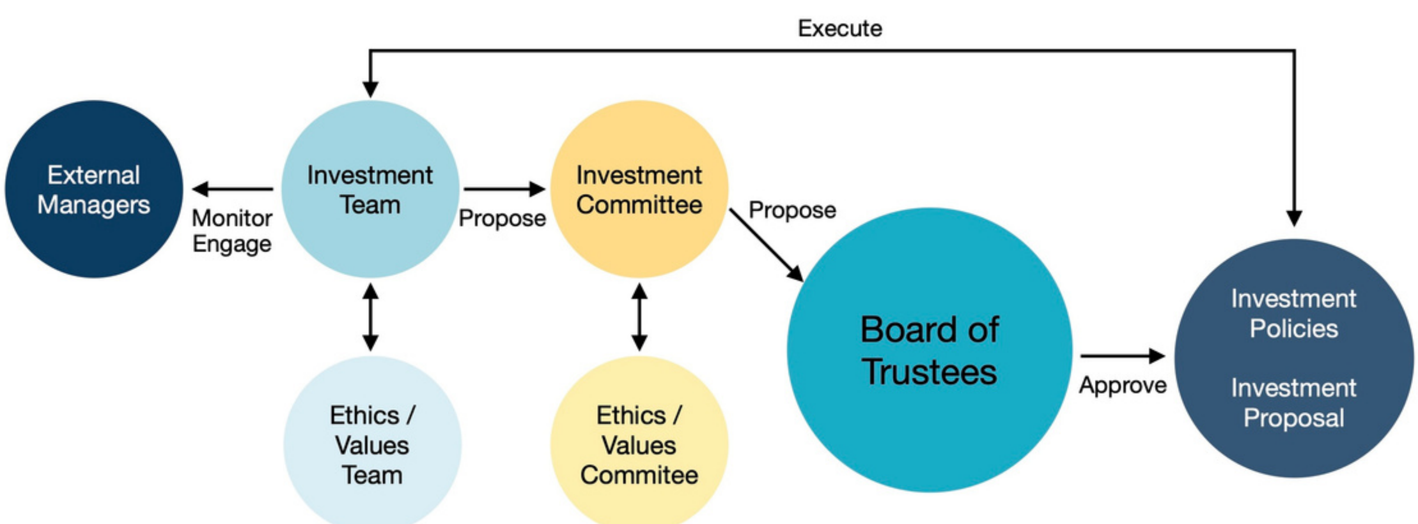
By Rick Ciccione, Partner at NEPC, in collaboration with FaithInvest

Like any asset owner, faith institutions have extensive governance duties regarding their investment planning, designed to ensure that the organization generates sustainable long-term income within risk guidelines. This is no small task, and the consequences of poor investment decision-making can be severe.

Within NEPC's role as an investment consultant to both faith-based and secular institutions, we have found that success starts with the board of directors. The organization's board must oversee a long-term investment strategy for its assets and ensure that strategy is properly executed. An effective governance framework establishes a process around investment decisions that relies on input from key members of the organization, as well as outside support.

The Roles of Good Governance

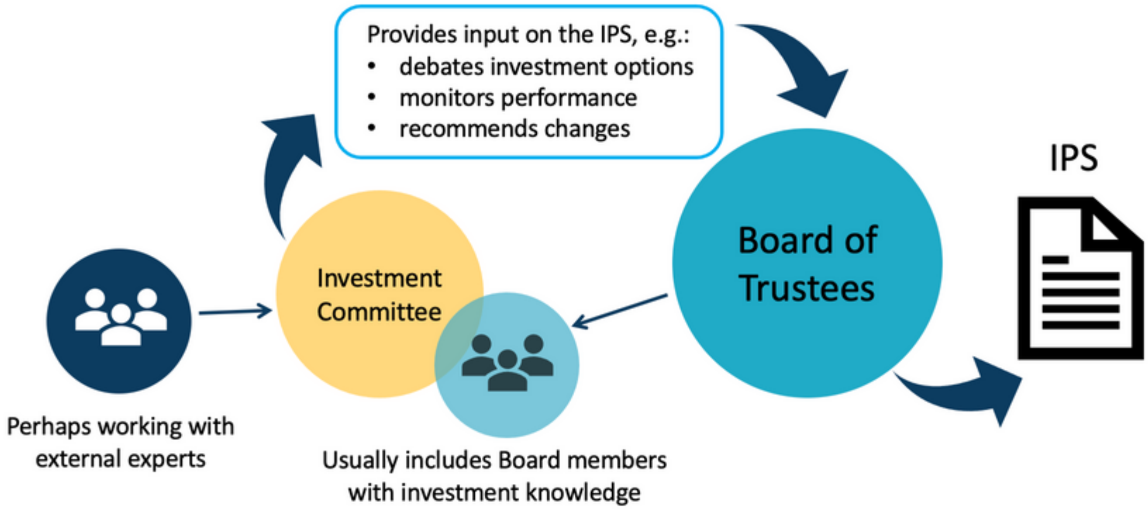
Effective investment governance lies at the intersection of detailed financial analysis and the organization's mission and culture. As a result, at larger organizations investment decisions should be made by multiple teams working in concert, each with a specific role and set of responsibilities. At smaller organizations, a small team or one or two responsible people, working with a board, and possibly a consultant or advisor, may in combination fulfill the investment and ethics roles. A graphic of typical governance bodies is shown below.



Source: University of Zurich

The **board of directors** (sometimes simply called the board, or by other names, such as governance committee or oversight committee), holds a central position in overseeing investment decisions.

Ideally, boards have individuals with diverse expertise, including investment experience, and a shared commitment to the organization's mission. Their role is less to make specific investment decisions than to identify priorities, set an overall investment strategy, provide guidance on risk tolerance, monitor the resulting investment program and results, and provide communication to relevant interested parties on their oversight activities, investment holdings and results. They are primarily responsible for approving the organization’s investment policy statement (IPS), which creates guidelines for all future investment decisions.



In the above example, the IPS is developed based on input from the investment committee, which also debates investment options, monitors performance, and recommends changes. This group usually includes board members with investment knowledge, perhaps working with external experts. Investment committees may oversee an investment team of internal or external investment experts who are responsible for executing investment policies.

Based on recommendations from the investment team, the investment committee will select and engage external portfolio managers. Their role is to manage the day-to-day activity within the organization’s accounts, make buy and sell decisions, manage risk exposures, and report regular updates.

Some organizations, notably faith-based groups, establish an ethics committee to assess the ethical implications of potential investments, and establish, review, approve or recommend ethics related policy and guidelines. Ethics committees can take many forms – they may be an independent committee, for example, or a sub-team of the board or investment committee – but their primary role is to determine if the organization’s financial strategies are in alignment with its mission and ethical standards. Please refer to Ethics in Faith-based Investment Governance later in the report for more details on the roles and makeup of an ethics committee.

The Tools of Governance

At larger organizations, these various committees and teams make investment decision-making a multi-layered process involving many points of view. This is by design. Any nonprofit program must successfully balance the needs and concerns of the organization, the community, and the donors. It is not always effective to rely on a single team – or even an outside expert – to set that balance correctly.

For that reason, the two best tools of investment governance are:

- A clear delineation of roles and responsibilities among the various people, teams or service providers (e.g. investment consultant or advisor) that provide input, and a defined process for how they interact.

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- Regular communication and collaboration between the board and other decision-making bodies to ensure that the team's actions align with the overarching goals and values of the nonprofit, or in the context of this report, the faith organization.

Roles, Responsibilities, and Process. As noted earlier, the board sets the overarching vision and goals for the investment program, which is captured in the IPS. The investment committee evaluates specific investment alternatives, while the ethics committee contributes to the establishment of investment guidelines and flags decisions that could be in conflict with the organization's values. The investment team executes the strategies and reports results, often with the help of outside advisors or managers.

It is common for roles and responsibilities to blur, particularly at smaller organizations. Board members may want to make the call about specific investment options, or investment teams and external managers might wish to "fill in the gaps" on their own when an issue arises that isn't covered in the IPS. For example, consider what happens when an unexpected market event causes portfolio value to drop sharply in a short period of time. In the interest of speed, should the external investment manager have the discretion to change course without seeking formal approval from the board?

Considering how quickly markets can change, unexpected issues like this can arise often. When they do, your organization benefits when everyone in the decision-making chain understands their role and how they need to proceed.

Communication. Consistent, planned communication is one of the best ways to ensure organizations make good decisions with their investment plans, even in the midst of stressful market events or changes in staffing.

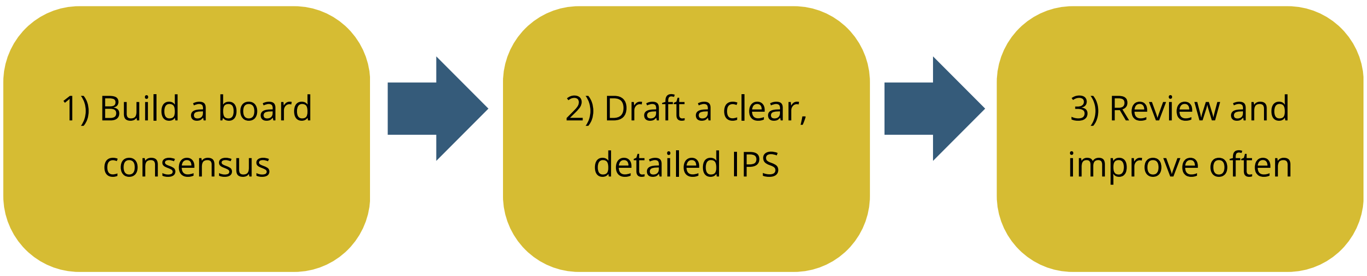
Of course, the primary goal of communication between the committees and the board is to ensure that investment actions align with the overarching goals and values of the organization. But regular communication can also help build consensus around other challenging topics.

One such topic is striking the right balance between risk and return, particularly as market trends evolve. Talking on a regular basis about investment risk, particularly in different risk environments, can help your organization establish risk management protocols that are more likely to stand the test of time.

Furthermore, regular assessments of the organization's investment performance are essential. Boards should establish metrics for success, track key performance indicators, and use the insights gained to refine investment strategies. Continuous communication, including regular reporting to stakeholders and donors, allows for better transparency and accountability. Ultimately transparency is the hallmark of effective governance.

The Best Practices of Governance

Having the right roles and processes in place is foundational to governance success in the nonprofit sector. But there are three areas of investment decision-making where what you do is less important than how you do it. Meeting these three goals can go a long way toward establishing a consistently effective governance structure.



1. Build a board consensus

An organization's leaders – and its stakeholders – may have differing opinions about how assets should be invested. But when an IPS includes vague statements, unclear compromises, or half measures, investment teams and portfolio managers will find it difficult to successfully implement the board's guidance. For this reason, investment decision-making must start with clear guidance from a unified board.

Trustees are likely to face tricky questions on the way to achieving consensus. Perceptions of risk may vary widely, as will expectations of return.

Investment committees and external managers can answer questions and raise potential issues, but strategic decisions must be made by the board. As with any key organizational issue, unanimous agreement can be hard to achieve. Make use of board voting procedures that are appropriate to the organization to define the priorities for the organization's investment policies.

2. Document board decisions in a clear, detailed Investment Policy Statement

The IPS may be the most critical document an organization has in terms of the health and efficacy of its investment program. It captures board guidance, and it establishes the standards and rules that will become essential measuring sticks for the investment committee and external manager.

Whatever the board's decisions are, they must be documented in detail within the IPS. Ideally, the IPS will include not just broad goals or general outcomes that the board is seeking, but also data-driven guidelines and measurements.

This task can be challenging when values-based considerations are included in the IPS, because the language around non-financial considerations can be less precise than with financial information. However, without unified and well documented board guidance, the investment committee and external managers will struggle to find investments that are a good fit for the organization.

3. Review and update the IPS regularly

Most organizations already review their investment programs on a quarterly basis to examine performance and assess success in meeting financial goals. This is also an excellent opportunity to talk about risk decisions and market changes. These pro forma updates should culminate in a discussion around whether updates to the IPS are needed.

IPSs are not "set it and forget it" documents. They are meant to capture the best thinking of the board, and they need to evolve as the board assesses new information and seeks to make improvements. Updating the IPS gives the investment committee and their partners better information and encourages a focus on continual improvement.

Take the time at least annually to ask rigorous questions of the investment consultants and raise issues that require board guidance. Vote on updates and document them in the IPS.

Best Practices Help Create Better Outcomes

These roles, tools, and best practices don't guarantee that an organization won't face losses or difficult financial considerations from time to time. But they do ensure that an organization has a well-organized and properly governed process for making financial decisions.

As a result, the organization will:

- Be less likely to make major or persistent mistakes that undermine its mission.
- Have more and better options to address financial challenges.
- Be prepared to answer questions and build confidence among stakeholders and internal staff.

These practices are generally accepted as universal. Now let's turn our attention to the special governance considerations that apply to faith-based organizations. To do so, we will tap into the knowledge base of FaithInvest.

Unique to the Faiths: Implications for Faith-consistent Governance

by Mathew Jensen, CFA, Director of Faith-Consistent Investing, FaithInvest

A faith organization's beliefs, teachings and values can be integrated or "mapped" to important documents such as investment policy statements (IPSs). Taking this further, faith values can also be integrated into a faith organization's overall governance structure, including processes and responsibilities related to the board, investment committee, ethics committee, and internal and external managers. This requires bringing a questioning spirit of faithful discernment to each aspect of governance, both when the organizational elements are being initially constructed and as the structure is enhanced or improved over time.

For all the investment governance elements and components within a faith organization, **the IPS remains the essential governing document required for the successful integration of faith values with investments**. We will now review some of the issues specifically related to faith-based IPSs.

First, faith-based investment guidelines should be as detailed and measurable as their secular counterparts.

- At the strategic policy level, faith-based IPS statements should indicate the extent to which the organization will invest across the investment spectrum, from traditional investments that may offer competitive returns, to "impact first" investments, all the way through to philanthropy.
- Faith-based investment guidelines should apply both to how the investment return is being earned and how well the investments are meeting non-financial mission-oriented goals.

All faith-based organizations grapple with the tension created between more aspirational faith-aligned goals and investment "pragmatism" — instances where a faith organization may decide to "not let the perfect be the enemy of the good." At the same time, there is growing demand for investment managers to provide more faith-aligned product offerings to help address this issue.

This brings us to an essential element of investment governance for the faiths, the ethics committee.

Ethics in Faith-based Investment Governance

A helpful report from the University of Zurich's Center for Sustainable Finance and Private Wealth, entitled Unleashing the Potential of Faith Based Investors for Positive Impact and Sustainable Development, asserts that "the existence of an ethics committee is fairly unique to faith-based investors". While ethics committees are not necessarily the exclusive domain of faith-based investors, their contribution to achieving faith-consistent integration is essential.

The activities of the ethics committee can include:

1. Make or recommend investment and/or engagement policy
2. Monitor or manage the funds under its control in support of an ethical stance in accordance with the aims of the faith organization
3. Evaluate the faith organization's broader ethical questions and concerns
4. Respond to investment managers' questions and clarifications regarding the application of ethical criteria
5. Oversee accreditations or collaborations with groups such as the Principals for Responsible Investments (PRI)

Successful integration of ethical oversight requires dedicated people and resources, which highlights the importance of having a well-resourced ethics team, and a committee consisting of respected individuals of solid standing in the organization, as well as clear protocols at the board level for resolving disagreements.

The makeup of an ethics committee deserves careful consideration, as the issues it addresses span finance, faith, important societal, political, or environmental dynamics and topics internal to the faith organization itself. The committee's scope and remit therefore benefit from a breadth of viewpoints and knowledge that committee members bring to the process. Committee composition often includes members who represent the religious leadership of the faith, representatives from internal values-based groups or committees (e.g., "racial equity" or "environmental action" efforts within the faith organization), along with financial and investment representatives.

Some organizations, depending on their governance, will also invite a youth representative, or "at large" participants from a general assembly to participate, along with an investment consultant, outside board member, or other key party to the investment process. These members may be asked to join as a "non-voting" participant in order to enhance the committee's discussions and decision making.

The relationship of the ethics committee with the board or senior decision maker or group typically takes one of two forms:

1. **Advisory**: the committee considers topics within its activity remit and makes recommendations or proposals on responses, policies, and actions, to the ultimate decision makers.
2. **Decision-making**: the committee considers topics within its activity remit and authoritatively determines and directs appropriate policy responses and actions.

In either case, the board will typically "pass" issues to the ethics committee and expect an appropriate response in the time allotted. The ethics committee may also choose to address certain issues or receive topics for consideration from committee members representing their constituents and areas of activity. Careful recordkeeping is key, as the committee should consider periodic reporting on its activities – to the board or other internal groups, and possibly external audiences too, and to document decision rationales for future committees revisiting issues addressed in years past.

Case Study: Church of Scotland

Church of Scotland
General Assembly 2023

FaithInvest worked with the Church of Scotland to support the establishment of an ethical investment committee between the Church and The Church of Scotland Investors Trust (COSIT). The committee is made up of members of COSIT and the Church of Scotland and acts as an advisory body to COSIT.

Most of the Church of Scotland's investments are looked after by COSIT, which was set up by an Act of Parliament and was therefore not bound by the Church of Scotland's highest decision-making body, the General Assembly. Instead, COSIT is bound by Trust law, which means it is responsible for the Trust's assets. Normally that means an investment is there to provide good financial returns, but it can do so in keeping with the Trust's aims and values.

For some time, Church of Scotland General Assembly members asked how they could work more closely with COSIT to enable the Church's concerns around ethical issues to be taken into account in its investment decisions. The decision to set up the ethical investment committee as an advisory body to COSIT was the result of two years of deliberations and was formally approved at the Church's 2023 General Assembly meeting.

This was an example of a faith-based organization enhancing its investment governance structure, in this case with the addition of an ethics committee, to become more faith-aligned.

The Church of Scotland

Conclusion: Avoiding Mistakes, Finding Resources, and Getting Support

The most effective investment governance structures avoid loosely defined roles. Instead, they provide clarity for the responsibilities and limits of discretionary action of all involved, across various roles and capacities.

Further, the establishment of the various governing bodies may be only half the battle: challenges can arise when various governance bodies exist "on paper" but fail to function as intended. This may happen, for example, in cases where an investment committee overrides the structure to make unilateral decisions. An organization-wide commitment to incorporating faith values with fiduciary considerations is required to overcome such challenges, along with the conviction that these values and considerations need not be mutually exclusive.

There are resources and solutions available for faith organizations seeking to construct robust investment governance structures, including networks such as FaithInvest and consultants such as NEPC.

We encourage all faith-based organizations to pursue best practices in order to achieve a high degree of faith-consistency within the investment portfolios that serve their mission.

Important Information

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FaithInvest
c/o Stone King LLP, Boundary House
91-93 Charterhouse St
London, EC1M 6HR, UK

Email: info@faithinvest.org
Phone: +44 (0)117 214 1720
Web: www.faithinvest.org

Registered charity: 1187015
Registered company limited
by guarantee: 11862410

NEPC
255 State Street
Boston
MA 02109, USA

Email: www.nepc.com/contact-us/
Phone: +1 (617) 374-1300
Fax: +1 (617) 374-1313
Web: www.nepc.com