

## **Phillips Theological Seminary Endowment Policy**

### **Background:**

On November 1, 2007, the Uniform Prudent Management of Institutional Funds Act (UPMIFA) went into effect for the State of Oklahoma. This act impacted the investment and management of a non-profit corporation's restricted endowment assets. As result of the new legislation, Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 117-1 in August 2008 requiring disclosure of an organization's endowment policy and the Board's interpretation of UPMIFA.

### **Definitions**

In response to accounting standards and interpretation of UPMIFA, PTS recognizes the following definitions in regards to our endowment policy:

Permanent Endowment- permanent donor restricted fund whose principal must be preserved in perpetuity as a condition imposed by the donor.

Temporarily Restricted Endowment- donor restricted fund but for a fixed term or stated purpose.

Quasi Endowment- unrestricted fund on which the Board voluntarily imposes some or all of the conditions of a permanent or temporarily restricted endowment.

### **Policy**

PTS interprets UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, PTS classifies as permanently restricted net assets (a) the original value of gifts donated to a permanent endowment fund, (b) the original value of subsequent gifts to a permanent endowment fund, and (c) accumulations to a permanent endowment fund made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets (that is, realized and unrealized gains) is classified as temporarily restricted net assets.

The spending policy for endowment funds is based upon the following considerations:

- General economic conditions
- Duration and preservation of the endowment fund
- Purpose of the institution and the endowment fund
- Possible effect of inflation or deflation
- Expected total return from income and appreciation
- Other resources of the institution
- Investment policy of the institution

Under UPMIFA, the Board is permitted to determine and continue a prudent payout amount, even if the market value of the fund is below historic-dollar-value. There is an expectation by the Board that, over time, the permanently restricted amount will remain intact. This perspective is aligned with the accounting standards definition that permanently restricted funds are held in perpetuity even though the historic-dollar-value may be dipped into on a temporary basis.

The Board has approved an annual endowment draw not to exceed 5% of the fair market value of the endowment for the preceding 3 years and based upon institutional budgetary requirements. The endowment draw for the fiscal year will be approved annually by the Board as part of the budgeting process.

The Investment Committee of the Board is responsible for managing endowment funds in a prudent manner with regard to preserving the purchasing power of principal, while providing an adequate total return to meet the budgetary needs of the Institution. In making investment and management decisions, the Investment Committee considers the general economic condition, effects of inflation and deflation on the portfolio, other resources available to the institution, current needs, expected rate of return, and portfolio composition. A long-term investment horizon has been adopted with an emphasis on diversification such that the chances and duration of investment losses are carefully weighed against the long-term potential returns after withdrawals are taken to support operations.

All funds shall be invested with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity would use in the conduct of an enterprise of a like character and with like aims to accomplish the purposes of that fund(s).

The following statements represent the investment principles and philosophy governing the investment of funds for which the Investment Committee is responsible. It is a written expression of the commonly held investment concepts that underlie the decision making process in the design, implementation and management of endowment funds.

#### A. General

The Investment Committee believes that good governance practices are a key ingredient to the success of this investment program. Committee members are fiduciaries and must act prudently. Fiduciary prudence includes acting solely and exclusively in the interest of the seminary. It also includes acting in a fair, independent and unbiased manner.

#### B. Active Vs Passive Investment

We believe that, in the U.S. equity asset class in particular and the foreign equity asset class in general, it is difficult even for the largest institutions to consistently identify active managers who can add value and that the odds of finding such managers are not in the favor of the investor, particularly in the long term. The difficulty of finding and engaging such managers is much more difficult, on a net return basis (i.e. after manager fees, etc) for the relatively modest amounts the seminary has to invest in any single

manager. The seminary's modest size also makes it extremely difficult to adequately diversify its holdings. Consequently, the Investment Committee may use index mutual funds (or other similar passive index instruments) for its equity allocations.

#### C. Long Term Strategies and Avoiding Market Timing

We believe that the capital markets are "mean reverting" by nature and we will therefore adhere to long-term asset allocation strategies and periodic, regular rebalancing. We believe market timing is ineffective as a long-term investment strategy and we will remain fully invested in all long-term asset allocations and avoid material allocations to cash.

#### D. Intermediate Bonds

We believe that core bonds, as exemplified by the Lehman Aggregate Bond Index, offer the best combination of long-term fixed income risk and return. We believe long-duration bonds add significant volatility without adding any material increase in total return; consequently, we will avoid such bonds.

#### E. Active Fixed Income Manager

Strategies employing laddered maturities, buy-and-hold to maturity, and/or investment grade only, are historically sub-optimal in the long term. The relatively limited size of the seminary's fixed asset allocation does not allow the Investment Committee on its own to efficiently invest and constantly monitor its holdings, or to adequately diversify its individual holdings. Therefore the Committee has elected to use an active manager for its fixed income funds.

#### G. Investment Expenses

We believe that investment expenses (manager fees, transaction costs, custodian fees, reporting, etc.) matter when measured against future expected returns. We will use the most cost efficient approaches for each asset class. Accordingly, we will measure returns net of all costs.

#### H. Asset Allocation

We believe that the most important factor of long-term investment return is asset allocation. In this connection, the Investment Committee emphasizes the importance of timely rebalancing according to adopted asset allocations and rebalancing procedures stated elsewhere.

#### I. Investment Manager Selection, Retention, and Termination Philosophy

We believe the Investment Committee has as one of its primary responsibilities, with the assistance and advice of its investment advisor, to directly and independently select, retain, and terminate investment funds/trusts in the case of passive investments and investment managers in the case of active investments. We believe manager turnover is expensive and disruptive to the efficient and productive investment program. All investment vehicles should be engaged with a long-run view.

The duties and responsibilities of the Investment Committee include:

1. Develop investment policies and spending policies for the endowment fund to be reviewed every two years.
2. Determine asset classes that will be used.
3. Determine the long-run asset allocation among those asset classes
4. Determine appropriate use of active/passive methods for each asset class and the related use of mutual funds/trusts or investment managers.
5. Directly select, retain, and terminate mutual funds/trusts, investment managers, custodians, and investment advisors.
6. Effectively communicate the investment philosophy and policies to managers, custodians, advisors, and appropriate constituencies.
7. Monitor adherence to philosophy and policy.
8. Annually evaluate each investment manager, advisor, custodian and any other service providers.
9. Determine related investment policy issues such as rebalancing, social constraints, proxy voting, directed commissions (if active equity managers employed), securities litigation and compliance with state and Federal rules and regulations.
10. Annually evaluate percentage of investments assigned to securities and fixed instruments.
11. Recommend to the Board the annual spending rate from the endowment fund, in consultation with the Finance Committee.

The primary responsibilities of the Investment Advisor include:

1. Assist the Investment Committee in establishing and implementing the investment policies. Assist the Investment Committee in periodic assessments of asset allocation and spending policies. Assist in determining manager structure and use of appropriate index funds.
2. Provide quarterly reports on the asset allocation, performance versus adopted benchmarks, and general compliance with established policies.
3. Monitor for events or trends that may affect the suitability of investment managers/index funds, custodian, and other service providers. The investment advisor will report in a timely manner substantive developments that may affect the management of any of the seminary's assets.
4. Immediately notify the Investment Committee of any changes in the firm or its ownership that would compromise its independence.

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