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Investment policy statements (IPS) for nonprofits

A step-by-step guide to formally outlining an organization's investment goals and objectives.

Effective management of long-term reserves is crucial to ensuring the sustainability and success of a nonprofit organization. An essential tool for prudent financial management is an investment policy statement (IPS). A well-designed IPS provides the framework for the effective implementation and review of a nonprofit's investment program. Below are seven steps you can take to build an effective policy for your organization.

STEP 1: DEFINE THE PURPOSE AND OBJECTIVES

Before diving into the specifics, it's vital to establish the purpose and objectives of the IPS. This document should lay out an easy-to-understand investment objective that clearly informs any reader about an investment portfolio's purpose without using complicated financial jargon. Starting simply provides a clear framework for your IPS.

STEP 2: IDENTIFY RESPONSIBLE PARTIES

Delineate the roles and responsibilities of the individuals or committees responsible for managing your organization's investments. This often includes the board of directors, investment committee and investment manager. A clear governance structure should outline how decisions are made and which governing body is responsible for each action or item for approval.

STEP 3: ESTABLISH INVESTMENT GUIDELINES

Nonprofits must define investment guidelines that align with their unique missions and tolerance for risk. These guidelines can encompass various aspects, such as:

- Asset allocation: Determine the appropriate mix of asset classes, such as stocks, bonds and alternative investments, based on your organization's risk tolerance and time horizon.
- Risk management: Specify the acceptable level of risk and the measures in place to mitigate it.
- Liquidity needs: Outline your organization's anticipated cash-flow requirements and ensure investments can meet these needs.
- Ethical considerations: Detail any social or ethical investment criteria that must be followed.
- Investment restrictions: Set limits on specific investments or asset classes to prevent excessive concentration of risk.

STEP 4: DEFINE PERFORMANCE METRICS

Clearly articulate how your organization will measure the success of its investment strategy. The IPS should establish a realistic investment return target based on updated asset-class return forecasts (capital market assumptions) and the current economic and market landscape.

This section should detail:

- Benchmark indices: Identify relevant benchmarks against which investment performance will be compared.
- Time horizons: Specify the evaluation periods (e.g., quarterly, annually).
- Return objectives: Establish target returns based on the organization's financial goals. This may tie directly to a strategic plan objective or future initiative.

STEP 5: RISK MANAGEMENT AND MONITORING

Develop a comprehensive risk management strategy that outlines how your organization will handle investment risks. This should include:

- Risk assessment: Regularly evaluate the portfolio's risk profile and adjust the investment strategy as needed.
- Rebalancing: Set guidelines for when and how to rebalance the portfolio to maintain the desired asset allocation.
- Reporting: Define reporting requirements for investment performance, risk exposure and compliance with the IPS.
- Contingency plans: Establish procedures for responding to unforeseen events or market volatility.

STEP 6: REVIEW AND REVISION

An IPS is not a static document. It should evolve and be reviewed and revised annually, or whenever significant changes in your organization's financial circumstances occur. This ensures that the investment strategy remains aligned with goals and objectives over time.

STEP 7: SEEK PROFESSIONAL GUIDANCE

Crafting an effective IPS can be complex, especially for nonprofits with limited investment expertise. Partnering with experienced investment consultants or hiring outsourced chief investment officers (OCIOs) who specialize in nonprofit organizations can give insights to industry best practices.

While a board can never offload their fiduciary duty, working with your OCIO can help ensure that you are constructing an IPS that will guide sound investment decisions.

> The IPS is the "blueprint" for both current and future committee members. As nonprofit boards experience frequent turnover, having a document that states an easy-to-understand investment objective and clearly tells readers the purpose of the investment portfolio will continue a culture of prudent financial management.

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INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863 // RAYMONDJAMES.COM