

Diocese of New Jersey Investment Advisory Committee Report to the 228th Convention – March 2, 2012

Background:

Resolutions 2011-4 and 2011-6 from the 227th Convention (reiterated as Resolutions 2012-4 and 2012-6 now before this Convention) addressed concerns about investment and spending policies of two specific Funds of the Diocese, namely the St. James Fund and the Venture in Mission Endowment ("VIME") Fund. This, in turn, highlighted the need for development and administration of an overall investment, spending and conflict of interest policy governing all Diocesan Trust Funds, which led to the activation of the Investment Advisory Committee ("IAC"), as provided for under Canon 25, and the referral of the 2011 Resolutions to the IAC for response.

Purpose:

The IAC was constituted to establish a small committee of qualified members with experience in institutional investing in order to:

1. proactively develop investment and spending policies that can be consistently applied across all Diocesan Trust Funds and thereby avoid reactive development of individual policies for specific funds based on individual issues,
2. act as a resource in administering said policies, guidelines and best practices, and
3. advise the Bishop, the various Boards of the Diocese with investment and/or spending authority over funds, and vestries and officers of Diocesan congregations, on questions which might arise concerning such policies, guidelines and best practices regarding the Funds for which they have fiduciary responsibility

Structure and Coordination:

All Diocesan Trust Funds with long-term investment objectives (and not required to be held by third-party trustees) are invested in the Diocesan Investment Trust ("DIT"), which is governed by its own set of Trustees. There are a number of Diocesan governing bodies – including Convention itself – with fiduciary responsibilities for the Funds invested in the DIT. It was therefore essential to ensure that we establish one policy to incorporate investment guidelines consistent with the DIT but also to address the related issues of spending and conflict of interest across all funds. Both the DIT guidelines and the policies we developed from them must comply with the requirements of The Uniform Prudent Management of Institutional Funds Act as adopted by the State of New Jersey.

Work of the Committee:

After meeting for the first time in early October of 2011, the investment, spending and conflict of interest policies which appear below were developed and introduced in draft form to Diocesan Council, the Trustees of Diocesan Trust Funds and the DIT Trustees at their October meetings, where comments and/or suggestions were solicited during a review period which lasted through December 31st, 2011, with none received. At the January meetings of those three groups, comments were once again solicited, again with none received, and notification then given that the draft policies would be consolidated into the final version which follows below, along with the implementing resolution requesting their adoption by Convention.

The Joint Task Force on Processing, Management and Reporting of Diocesan Trust Funds, during the course of finalizing its report to this Convention, raised the issue of the absence of any type of Diocesan gift acceptance policy and referred that question to the IAC. Lack of time precluded us from addressing that deficiency with the diligence it deserves in time for this report. However, we do acknowledge the need for such a policy and will address it as expeditiously as possible in order to develop guidelines for use by the various Boards of the Diocese and ratification by next year's Convention.

We believe the policies below (specifically Section 2, Subsection B and Subsection C, first paragraph, last sentence), in conjunction with the governing documents of the St. James Fund and VIME Fund, sufficiently address the issues raised in Resolutions 2011-4, 2011-6, 2012-4 and 2012-6. We therefore respectfully request that those resolutions be replaced by adoption of the following:

Implementing Resolution:

BE IT RESOLVED, that the Statement of Investment, Spending and Conflict of Interest Policies developed by the Investment Advisory Committee and presented as part of its report to the 228th Convention be adopted as the governing policy statement to be complied with by the Bishop and the various Boards of the Diocese with investment and/or spending authority over Diocesan Trust Funds.

In closing, I would like to express my gratitude to fellow IAC members Christopher McCrudden of Trinity Church, Princeton (former VP for Finance and Treasurer of Princeton University, now retired) and Charles Watson of Christ Church, Middletown (Financial Planning Specialist and Branch Manager, MorganStanley SmithBarney and Co-Chair of the Diocesan Planned Giving Committee). Their experience, diligence and wisdom enabled the completion of this project, which we offer together with prayers that it will enhance our collective stewardship of the precious resources with which God has blessed and entrusted our Diocese.

Respectfully submitted on behalf of the IAC,
Katherine F. Lowry, Chairperson
Senior Vice President, Institutional Investments – PNC Bank
St. John's, Little Silver

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SECTION 1 – INVESTMENT POLICIES AND OBJECTIVES

Introduction and Statement of Purpose:

This Statement of Investment Policies and Objectives is intended to govern the investment management of Diocesan Trust Funds (the "DTF" or the "Trusts") until modified by Diocesan Convention, Diocesan Council and the Trustees of the six incorporated trust funds of the Diocese (collectively, the "Trustees") as conditions warrant. For purposes of clarity, the six incorporated trust funds of the Diocese are enumerated as follows: The Trustees of the Episcopal Fund of the Diocese of New Jersey; The Trustees of the Aged and Infirm Clergy Fund of the Diocese of New Jersey; The Trustees of the Missionary Funds of the Diocese of New Jersey; The Trustees of Church Property of the Diocese of New Jersey; The Trustees of the Widows, Widowers, and Orphans of Clergy Fund of the Diocese of New Jersey; and the Trustees of the Venture in Mission Endowment Fund of the Diocese of New Jersey. The Trustees, together with the Trustees of the Diocesan Investment Trust ("DIT"), will review the Statement and the guidelines set forth herein periodically. The Trustees also will expect the Trusts' investment advisors to propose revisions in the guidelines if in the advisors' view such guidelines aren't consistent with the Trusts' investment objectives.

The purpose of the DTF is to provide a level of financial support for the Diocese and its constituent organizations which choose to be shareholders and to offer convenient and attractive investment mediums for the endowment, reserve, or savings funds of such constituents.

The Trustees hereby acknowledge and confirm that:

1. It is the policy of the Trustees that diocesan investment funds that are long-term in nature shall be invested in the DIT. Subsections A through F which follow are intended to reflect the underlying investment strategy applicable to these funds.
2. Certain funds where the underlying investment strategy is short-term in nature may be invested outside the DIT.
3. Certain trusts exist of which the Trustees are beneficiaries and the trust document which established the trust imposes certain restrictions on investment strategies, or requires an outside trustee to hold the funds. In such cases the restrictions imposed by the trust supercede the investment strategy of the Trustees.

The Loan Funds of the Diocese of New Jersey must be invested in accordance with the terms and conditions as set by Canon 21, Section 4. This requirement would apply to the three existing Loan Funds listed in Canon 21, namely the Capital and Revolving Loan Fund, the R. Bowden Shepherd Loan Fund, and the Venture in Mission Loan Fund, as well as any funds which may be received in the future for similar purposes.

A. Investment Objectives

Asset growth, exclusive of share purchases and redemptions, should exceed the rate of inflation in order to preserve the Trust's real value, its purchasing power. The DIT's specific objective is to achieve a compound annualized total return that exceeds the weighted average return of the applicable Equity and Fixed Income benchmarks, as defined below, over the measurement period.

The DIT's asset value should grow over the long term at a satisfactory rate consistent with acceptable investment risk.

B. Dividend Policy

While the DIT's investment portfolio should recognize its policy of regular monthly dividends to its shareholders, the Trustees embrace the total return concept and do not require that current income from portfolio investments fund dividend payments.

The current dividend policy provides a) the dividend payout is to be reviewed annually at the October meeting of the DIT Trustees; b) the dividend will be set for the following year in an amount equal to approximately 4 ½% per annum of the mean share price of DIT shares for the preceding 12 quarters ending at September 30; c) dividends declared at the October meeting will be payable beginning on January 31, to shareholders of record January 2.

The Trustees have the authority to pay dividends in excess of this amount if they feel this would be appropriate based on the needs of the Diocese of New Jersey and the participating congregations and would not negatively impact the long term viability of the DIT Fund.

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C. Portfolio Composition and Asset Allocation

To achieve its investment objectives, the DIT's investments shall be allocated between equities and fixed income investments. The purpose of the DIT's fixed income investments (including cash equivalents) is to provide a deflation hedge, to reduce the overall volatility of the DIT and to produce current income in support of DIT dividend distributions. The purpose of the DIT's equity investments is to provide a total return, an increase in both principal and income to preserve the DIT's purchasing power and to support increases in DIT dividends at or above the rate of inflation.

The Equity Benchmark is 65% of Trust assets at market value, but the actual percentage invested may vary in an acceptable range of 50% and 80% of market value with fixed income in a 20% to 50% range depending on market and economic conditions. It is recognized that equity investment entails greater variability and risk.

The Trustees may alter any of these asset allocations at their discretion. While it is expected that such changes will be infrequent, overall asset allocation will remain under regular review so it is not allowed to be the residual of advisors' decisions and market movements. The Trustees may invest in investments that might not be categorized as equity or fixed, such as alternative investments, if the Trustees feel this investment would reduce investment risk and enhance return in the DTF.

D. Investment Goals

As an objective, the Trust's total rate of return should exceed the weighted average return of the applicable Equity and Fixed Income benchmarks, as defined below, over the measurement period.

The fixed income rate of return should be competitive with the return of the appropriate benchmark as determined by the DIT Trustees. Cash and cash equivalents are included in fixed income for performance measurement.

The equities' rate of return should be competitive with the appropriate benchmark as determined by the DIT Trustees. Goals are expected to be attained over running 3-year periods. It is recognized real return objectives may be difficult to attain in each 3-year period, but should be attainable over a series of 3-year periods.

E. Investment Guidelines

The DIT will be diversified by asset allocation and within asset classes, viz., within equities by economic sector and industry. Diversification is to assure no single security or category of securities will have an aberrant impact on Trust performance.

All assets are to be readily marketable and have readily ascertainable market values. Corporate bond holdings shall be direct obligations (not derivatives) and rated at least investment grade by Moody's or Standard & Poor. Mortgage-backed securities of the highest investment grade are permitted. There are no restrictions on obligations issued or guaranteed by the U.S. Government.

Equities are to be broadly diversified according to economic sectors and industry. It is recognized, however, to achieve its investment objectives equities must be actively managed and therefore cannot be fully diversified. Decisions as to individual stock selections, position size, number of issues, industries and sectors, current dividend levels and turnover are left to the broad discretion of the advisors, subject to the customary standards of fiduciary responsibility.

Investments in any one common stock are limited to 5% of each advisor's portfolio at the time of purchase.

F. Monitoring of Objectives and Results

The DIT Trustees shall review investment performance with the DIT's advisors at each of the regular quarterly meetings.

The Investment Advisory Committee shall review the Statement of Investment, Spending and Conflict of Interest Policies and Objectives at least once each year. Any recommendations or changes made as a result of this review

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shall be voted upon and approved by the DIT Trustees no later than the end of January, to be presented for ratification at the next Diocesan Convention.

If at any time an advisor believes any policy guideline is inhibiting his investment performance, it is his responsibility to communicate his view to the Trustees.

SECTION 2 – SPENDING POLICIES AND OBJECTIVES

A. Statement of Purpose

This spending policy is meant to:

- 1) govern the determination of the distribution amounts from the various funds (or accounts) that are under the control of or benefit the Diocese of New Jersey,
- 2) specify who has the authority to approve distributions in excess of DIT dividend guidelines, and
- 3) acknowledge that restrictions placed on an outside trustee by terms of the trust supercede the spending policy of the Trustees

B. Reinvested dividends

All dividends received from investment in shares of the DIT shall be considered income. It shall therefore be the policy of the Trustees that the dollar value of dividends reinvested into any investment account shall be considered income available for distribution at a future date, not an addition to principal.

C. Distributions in excess of DIT dividends

For distributions in excess of DIT dividend guidelines, for any specific fund that is invested in the DIT or Trusts held elsewhere, prior approval of the governing body(ies) having either trusteeship over and/or the authority to disburse for that particular fund must be obtained and documented. In addition, timely, clear and transparent reporting of this distribution (as well as normal distributions) must be made on an annual basis to the appropriate governing body and to Convention. For purposes of clarity, it shall be the policy of the Trustees that any fluctuation in net asset value of DIT shares shall be considered capital in nature and shall therefore increase or decrease principal, as the case may be.

All governing bodies of the Diocese of New Jersey with trusteeship over and/or authority to disburse funds of the Diocese acknowledge that they are governed by and will comply with the Uniform Prudent Management of Institutional Funds Act as adopted by the State of New Jersey. Therefore, as part of the approval process for excess distributions, consideration will be given to each of the seven factors listed below in determining whether such excess distribution is considered “prudent”:

- 1) the duration and preservation of the Fund
- 2) the purpose of the organization and the Fund
- 3) general economic conditions
- 4) the effect of inflation or deflation
- 5) the expected total return from income and appreciation
- 6) other resources of the organization and
- 7) the investment policy of the organization.

D. Monitoring of the Spending Policy

This spending policy should be reviewed at least annually, if not more frequently based upon market conditions, by each governing body for the funds over which it has either trusteeship or the authority to disburse.

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SECTION 3 – CONFLICT OF INTEREST POLICIES AND OBJECTIVES

Introduction and Statement of Purpose

The Trustees have confidence in the loyalty and integrity of their fellow trustees, officers and diocesan staff. Proof of their high ethical standards has been demonstrated on numerous occasions. With the current emphasis being given the subject of conflicts of interest, however, the Trustees consider it desirable to emphasize their policy on this subject. It is vitally important that both the fact and the appearance of conflicting interests be avoided.

A conflict of interest may be considered to exist in those instances where the actions or activities of an individual on behalf of the Trustees also involve (a) the obtaining of an improper personal gain or advantage; (b) an adverse effect on the Trustees' interest; or (c) the obtaining by a third party of an improper gain or advantage. Conflicts of interest can arise in other instances. While it is impossible to list every circumstance giving rise to a possible conflict of interest, the following will serve as a guideline to the types of activities which might cause conflicts and which should be fully reported to the Trustees.

A. Interests

- 1) Holding by a trustee, officer, or diocesan staff member, directly or indirectly, of a position or of a material financial interest in any outside concern (a) from which the Trustees secure goods or services (including the services of buying or selling stocks, bonds, or other securities), or (b) which provides services competitive with the Trustees. A financial interest may be material, if, for example, the investment represents a substantial portion of the assets of the outside concern or a substantial portion of the assets of the trustee, officer or diocesan staff member.
- 2) Competition with the Trustees by such an individual, directly or indirectly, in the purchase or sale of property or property rights or interests.

B. Outside Activities

- 1) Rendition by a trustee, officer, or diocesan staff member of directive, managerial, or consultative services to any outside concern which does business with, or is a competitor with, services of the Trustees.
- 2) (Applicable only to diocesan staff members, including officers who are diocesan staff members.) Participation by such an individual in any activity (whether for personal profit or incident to industry, civic or charitable organization affairs) if it is likely to involve use of the individual's time during normal business hours or which might tend to adversely affect the efficiency of the individual in providing services to the Trustees.

C. Gifts, Gratuities and Entertainment

- 1) Acceptance by a trustee, officer, or diocesan staff member of gifts, excessive or unusual entertainment, or other favors from any outside concern which does, or is seeking to do business with, or is a competitor of the Trustees under circumstances from which it might be inferred that such action was intended to influence the individual in the performance of his duties.
- 2) This does not include the acceptance of items of nominal or minor value that are of such a nature as to indicate that they are merely tokens of respect or friendship and not related to any particular transaction or Trustees activity.

D. Inside Information

- 1) Disclosure or use of Trustees information by a trustee, officer, or diocesan staff member for the personal profit or advantage of such individual or any other person, firm or corporation.
- 2) Full disclosure of any situation in doubt should be made so as to permit an impartial and objective determination. It should be particularly noted that this disclosure relates not only to such individual, but also to their immediate family.