Irish Life

AIB

Growth and governance in the nonprofit sector

Investment decision making in a low yield environment

Foreword

Welcome to this report 'Growth and Governance in the Nonprofit Sector, 2017'

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In the summer of 2016, Allied Irish Banks, p.l.c. (AIB) and Irish Life Assurance plc (Irish Life) commissioned PwC to conduct a survey entitled 'The Irish Nonprofit Sector Survey'. The Nonprofit sector continues to face increased regulation as well as constrained public and private funding resources. The aim of this research and report is to provide key insights and guidance to Nonprofits to support them in the management of these challenges. The sector spans a range of fields (Figure 1, p4), from health, education, sport, arts and culture, environment, development/ housing, religious orders and professional associations. The research has identified three key themes for Nonprofits – Financing Growth, Investment Management and Corporate Governance.

Public trust in the funding, governance and operation of some high profile charities in Ireland took another hit in 2016, but the research findings contained in this report point to a sector whose members are seriously embracing good governance, financial reporting, transparency, impact reporting and professional management. This commitment to best practice in all aspects of corporate governance is a direct driver of funding and investment into the sector.

The reporting regime for charities is changing presenting a challenge for Board members, management and practitioners. The Charities Act 2009 was commenced on 16 October 2014 and all charities were required to register with the Charities Regulatory Authority (Charities Regulator). The draft regulations on the form and content of charities' financial statements and annual reports are currently being refined and finalised following a recent public consultation. They are expected to require larger charities to prepare their financial statements in accordance with applicable Financial Reporting Standards (FRS102) and the applicable Statement of Recommended Practice (Charity SORP (FRS102)).

The research shows management and boards are now seeking to keep their operations on a sustainable footing while also funding growth opportunities. This necessitates a fine balancing act between risk and reward and management of the capital agenda. The interest rate environment has made it harder for charities that traditionally relied on low risk and low yielding strategies, such as cash deposits and capital guaranteed products. Moreover many now need their investments to deliver higher returns to help fund growth and expansion.

Defining an investment charter and strategy for a Nonprofit requires focus and specialist expertise to make the most of value creation opportunities whilst using a portfolio approach to manage risk and reward.

We believe that the additional knowledge sharing and methodologies described in this report are useful to those Nonprofits and trusts with existing well-honed investment strategies in order to benchmark themselves against others. For example, this report showcases performance trends across different asset classes during recent periods of market volatility triggered by economic and political shocks such as Brexit and the US election. The report may also act as a helpful reference guide for boards, trustees and sub-committees who are now charged with balancing risk and opportunity and capital preservation.

Drawing on our extensive Nonprofits' sector experience, AIB supports clients, advises on best practice, draws on bespoke skills and experience both internally and with external partner firms such as Irish Life to create value. We know that each Nonprofit is unique, yet successful players across diverse sectors also have much in common. Aligning mission, capital and impact strategies helps to secure sustainability and growth, whilst optimising efficiencies and balancing risk attitude and appetite.

If Nonprofits wish to maintain the support of business, government and civil society, their boards and executive management need to be better informed so that their operational and strategic behaviour ensures long-term viability, underpinned by good governance principles, improved sustainability and a comprehensive investment strategy.

AIB and Irish Life acknowledge and thank all the individuals who took part in the research on behalf of their nonprofit organisation and who gave up their time, including PwC who undertook the research, and those guest contributors who were interviewed or shared insights on the dynamic on the ground in an environment of changing regulation, reserves management, increased reporting and disclosure requirements.

We hope that you find this report interesting and informative.

Maura Moore

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Executive Summary

The results of the Nonprofit Survey carried out by PwC points to strong optimism about the future. A clear majority of organisations expect to grow rather than reduce or merely maintain current service levels while many expect to offer a wider variety of services or to expand their geographic coverage. This growth will bring its own challenges. Organisations will need to step up and consider how they fund expanded services and how enlarged entities are to be governed and managed.

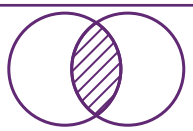
The main findings of the Irish Nonprofits Sector survey research include:

Growth outlook

In all, 64% of respondents expect to see their organisation expanding the scope of their services and activities with 14% planning to expand internationally. Of those organisations projecting growth 42% intend to offer new products or services, 24% expect to expand their missions, while 20% say they will move to new premises.

Some 32% said they expect to merge with other entities. This is to be welcomed as it offers potentially significant benefits in terms of cost sharing and resource efficiencies.

32%



expect to merge with similar organisations

Half of the organisations intending to expand will use cash reserves to do so, 45% will seek grant funding while 43% will carry out fundraising campaigns. Only 8% of organisations expect to use debt to finance their growth.

There are challenges to be faced when it comes to financing growth. Those organisations which are largely dependent on government funding will likely have to turn more to external fundraising and philanthropic donations while those which are already dependent on those sources will face increased competition for funding.

Investment Approach

Some 78% of respondents categorise themselves as low risk investors. Of those organisations with investment assets, 69% rank capital security as their top priority while almost three quarters (73%) ranked volatility as a top priority or somewhat important when thinking about investments.

The provision of income for ongoing activities was named as a goal by 52% of respondents. The creation of a reserve fund to cater for unforeseen needs was cited as important by 42% while 24% said they wanted to use it to smooth out irregular income streams. Funding capital projects was the objective of 44% of respondents and the funding of future as yet unspecified projects was a goal for 13%. Financing the living costs of members was the dominant theme among the religious orders surveyed.

Investment performance ambitions of the respondents were quite conservative with 42% having cash holdings only despite the historically low interest rates on offer; 23% of respondents have a deposit related objective and aim to outperform these cash deposit rates; 20% are seeking to outperform inflation; while 40% of organisations with investment assets have no target at all or just a general long term objective.

The average return achieved by respondents was 3.5%. The highest return achieved was 14% while 21% had a zero rate of return. Those with an objective of beating deposit rates achieved an average return of 3.6% and those with an inflation related target did even better with an average return of 5%.

Investment decisions are made by the board in 59% of cases while less than half (47%) of the organisations with investment assets have a documented investment policy in place. 41% of respondents have some form of ethical investment policy in place. 40% use an external adviser to assist them with their investment strategies while 37% use expertise available internally; 17% take advice from their investment manager; and 46% use a combination of external and internal sources.

59%

of investment decisions are made by the board

36% of respondents with long term investments invest exclusively through unit funds; 14% invest directly in bonds, shares and other assets; a mixed approach combining funds with direct holdings was favoured by 41%; 9% hold all of their non-cash investments in property.

These results point to a need among nonprofits to reconsider their risk appetite and investment goals. If additional revenue is required from their investments they will have to revisit their investment strategies and policies. This need is particularly acute for the 59% of organisations who expect to use investment income to fund ongoing activities and projects.

78%

view themselves as low risk investors

Those organisations without a strategy or policy should put one in place as a matter of urgency and more use should be made of specialist finance or investment sub-committees to improve strategic decision making in this vital area.

Governance

The results of the survey indicate that the overall Irish nonprofit sector enjoys a strong governance structure and culture. In 93% of cases the board meets more than four times a year with 70% of boards having more than nine members with just 2% having less than four. Boards are central to decision making with 87% of respondents saying they are either the most important or second most important actor in this respect.

Committee usage is strong with 94% of boards having committees reporting to them; 82% have an audit and risk committee; 56% have a remuneration committee; 49% have a strategy committee; 39% have a fundraising committee; and 44% have an investment committee.

Irish nonprofits file regulatory returns to up to five different entities depending on the nature of their activities – the Companies Office, the Charities Regulator, the Revenue Commissioners, the Housing Agency, and the Department of Education. Ongoing regulatory developments such as the Companies Act 2014 received a broad welcome by the sector with respondents believing the sector will benefit from the requirement to have proper Constitutions and reporting documents.

On the other hand, several respondents said that the Charities Regulator will need to find the right balance between assisting the growth of well-run charities, and ensuring the regularisation of non-performing entities. Some respondents also expressed a concern that resource constraints may diminish the Charities Regulator ability to ensure compliance and achieve the required impact.

The research points to a well governed sector overall. Boards could be made effective through greater use of committees, however, rotation rules should be examined to ensure that they do not compromise the board's ability to make long-term investment decisions.

Research Methodology

AIB and Irish Life commissioned PWC to conduct an online survey among Senior Executives in a variety of Irish nonprofit organisations in the summer of 2016.

The survey yielded 175 respondents from a variety of sectors but despite their differences, a number of common attributes and challenges emerge from their responses. The last time AIB researched this sector was in 2014, against a backdrop of economic uncertainty and funding pressures. In 2016, there is a more optimistic landscape. Most organisations are planning to grow rather than retrench, and expect to broaden the level of services they provide to the community. While optimism persists, the sector is not without its challenges:

Investment markets have been volatile, and deposit rates have significantly fallen – challenging the ability of investments to provide for the future in a way that might have been expected. Governance and regulation have evolved since the sector was reviewed last. Not only are there more requirements now in terms of accounting and reporting requirements, but the Sector is increasingly in the spotlight where governance has been questioned.

In this report, we identify the key themes which we see across the Sector from their responses to this survey:

- Development plans and financing growth
- Investment objectives, performance and oversight
- Corporate governance and strategic decision making.

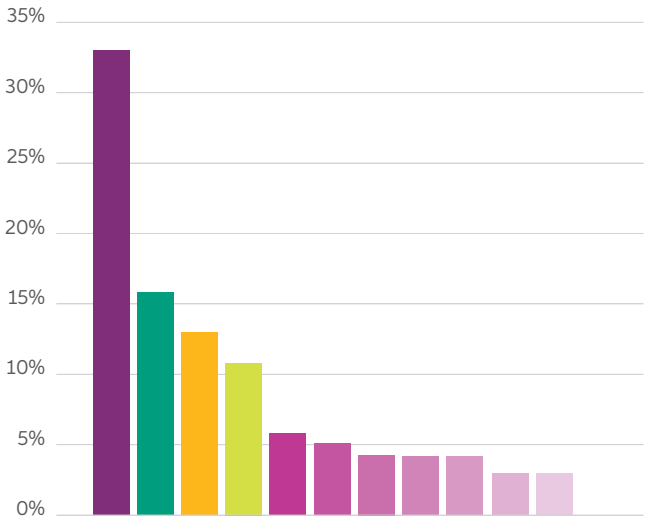
AIB and Irish Life would like to acknowledge and thank the nonprofit organisations for taking the time to participate in this survey.

Participant Profile

This survey covers a variety of nonprofit organisations at the larger end of the spectrum, and reveals how they are structured and governed, their future priorities and concerns, and how they expect to fund their future growth. The findings are reflective of the scale of the organisations. 48% of respondents were either CEOs or Finance Directors of their nonprofit. There was an even spread of gender amongst respondents with 56% male and 44% female.

63% of the respondents held no affiliation to an international group and 75% held their main office in Dublin. Given the size of responding organisations, it is no surprise that they are significant employers. The overall average respondent has 487 full time employees and 141 part timers. However, this is inflated by a skew in the sector between a small number of very large entities, and the majority who have less than 50 full time staff. The median organisation has 40 full time and six part time employees.

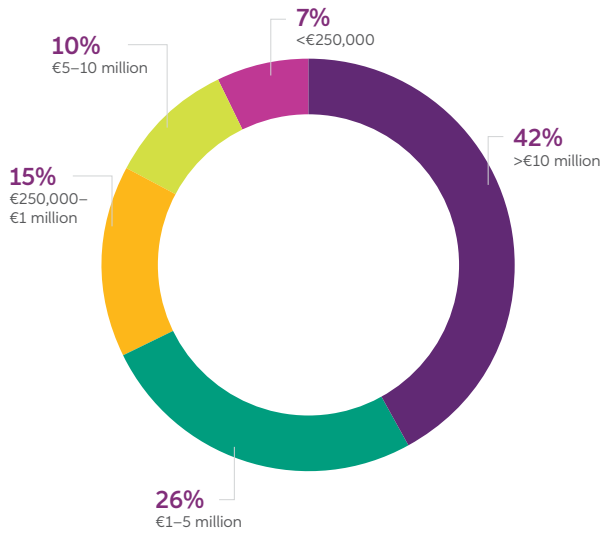
Figure 1: Industry Sector



Education & Research	33%
Healthcare	16%
Disability Services	13%
Religious Order	11%
Trade, Business & Professional Associations	6%
Philanthropic intermediaries & voluntarism promotion	5%
Economic, Social & Community Development	4%
Social Housing Services	4%
Recreation & Sports	4%
Social Services	3%
Law, Advocacy & Politics	3%

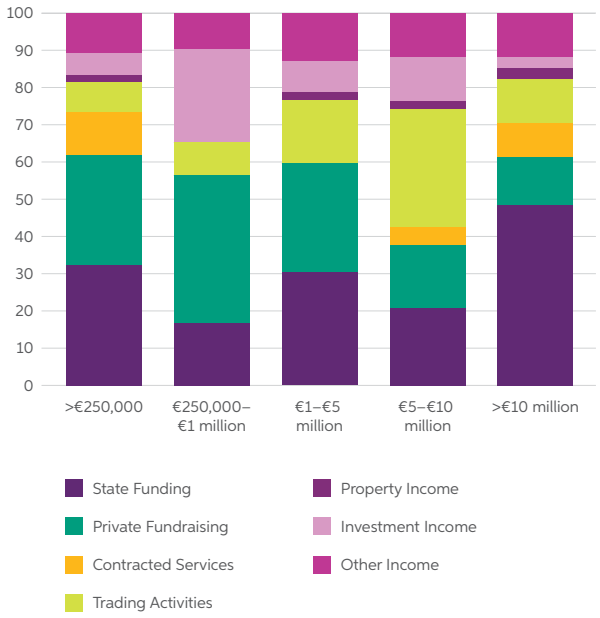
This chart shows the profile of responding organisations; showing the diversity of the sector and highlighting Education, Healthcare and Disability Services formed over 50% of the total respondents.

Figure 2: Annual Income



The sector has significant income – 77% of respondents have income over €1 million p.a. and 42% more than €10 million.

Figure 3: Annual Income Sources



Funding is dominated by government funding and private fundraising – which together make up over 50% of income in all income bands except one. The €5-10m band is dominated by Education and Research services and earns a high proportion of income from trading activities. The income band most dependent on government funding is the largest, where income is greater than €10m p.a. 65% of these respondents receive more than 50% of their income from the State.

The Charities Regulator identifies the two principal methods of establishing a Charity as by incorporation or by a Deed of Trust. Of the responses received, 75% of respondents are structured as incorporated entities, limited by guarantee and governed by a memorandum and articles of association. A further 3% of responding organisations are structured as charitable Trusts. There are other nonprofit organisations that are not covered by the Charities Act 2009, and these include various chartered bodies, trades union, political parties and entities established by Acts of the Oireachtas.

Growth Outlook

Possibly the most striking feature of the survey is the high level of optimism exhibited by a significant majority of Irish nonprofits. This optimism was most clearly in evidence in the growth plans and intentions of the organisations surveyed. In all, 64% of respondents expect to see their organisation expanding the scope of their services and activities with 14% planning to expand internationally.

Only 28% of respondents expect to either maintain service at current levels or cease operations entirely. This figure was skewed more than slightly by the large number of religious orders who expect either to maintain services or cease operations. This is a continuing societal trend which is by no means confined to Ireland.

Of those organisations projecting growth 42% intend to offer new products or services, 24% expect to expand their missions, while 20% say they will move to new premises.

Contributing factors

These findings are probably due to a combination of factors including the strongly recovering economy, a natural increase in demand for services in sectors such as healthcare and education as a result of an aging and growing population, and ongoing issues and crises in areas such as housing. In other words, many of the organisations are perforce to expand service provision whether they wish to or not.

Indeed, 76% of respondents in the Education and Research sector anticipate growth with half of those expecting to add new product or service offerings and 36% expecting to move to new premises.

The merger agenda

A particularly interesting finding is that almost one third of the respondent organisations said they expect to merge with other entities. Consolidation has been a feature of the trade union movement for many years and more latterly the credit union movement. However, a feature of the nonprofit sector has been increasing fragmentation with large numbers of new organisations being founded to cater for increasingly niche needs over time.

The fact that consolidation is high on the agenda for so many organisations at present must be seen as an encouraging sign as it offers potentially significant benefits in terms of cost sharing and resource efficiencies. That said, entities considering merger should ensure that full due diligence is carried out in relation to the other party or parties and that governance standards are not compromised in any way by the enlargement of the organisation.

Financing the growth

Financing growth is always going to be a challenge for the nonprofit sector due to the uncertainty of income streams such as public and philanthropic donations as well as State grants. Indeed, the nonprofit sector was among the worst hit by the expenditure cuts which resulted from the still recent crisis in the public finances.

Interestingly, 50% of the organisations intending to expand will use cash reserves to do so. This suggests that the scale of the envisaged expansion may not be very significant.

On the other hand, 45% will seek grant funding while 43% will carry out fundraising campaigns. This highlights the dependence of the sector on state and public funding. It also reflects the large number of capital projects identified by respondents – 44% expect to carry out such projects in future. Grant funding and one-off fundraising campaigns are particularly well suited for such purposes.

Only 8% of organisations expect to use debt to finance their growth. This probably relates to the sometimes precarious nature of the income streams of nonprofits as well as a natural caution on the part of those involved in the sector.

That caution is also reflected in the finding that only 11% of organisations expect to use investment income to finance growth. It is certainly not because the organisations concerned do not have funds to invest. Among the 41% of respondents with investment assets of over €5 million, just 15% expected to use those investments to finance expansion. For the other 85%, investment assets are predominantly earmarked either as a reserve against fluctuations in funding – a rainy day fund – or to finance capital projects.

Given the uncertainty surrounding funding experienced by many nonprofits the survey asked respondents to outline the extent to which they have been able to plan their future cash flows. Carrying out and regularly updating cash flow projections can help organisations to make decisions for the longer term. Having visibility of future spending patterns enables strategic decisions to be taken in a more confident manner – for example by identifying opportunities to take long term risk whether through investments or debt,

without compromising the organisation's ability to fund itself in the short and medium term.

Some 49% of all respondents have carried out analysis to consider the cash flows they will require, dividing their projections into either short, medium and long term, or breaking them down by year. Of the remaining 51%, 11% have not carried out any projections to date, while 40% categorise themselves as having a broad understanding of their requirements.

Looking only at those organisations who expect to grow in the future, the proportion that have analysed future cash flows is 51%, with 36% having a broad understanding and 12% having carried out no projections whatsoever.

This is not to suggest any shortcomings in relation to those organisations which have not carried out cash flow projections, however. Revenues may be so unpredictable in some organisations that such projections are difficult to complete while in others funding is so certain that long term cash flow planning is possible.

The fact that more than half of the respondents to the survey do carry out such exercises is very encouraging and points to a high degree of financial professionalism among those entities.

64%

expect to expand their organisation

Conclusions

While the general trend towards growth and expansion in services may be encouraging Irish nonprofits still face severe challenges when it comes to financing it. Those organisations which are largely dependent on government funding will likely have to turn more to external fundraising and philanthropic donations if they are to meet their growth ambitions while those which are already dependent on those sources will face increased competition for funding.

Increased demand for services from a growing and aging population means that many of these organisations have little choice but to grow and will therefore either have to find funding or greater efficiencies to provide for that.

This may be one of the drivers behind the trend towards consolidation which was evident among one third of respondents. Debt and investment income come very low down the list when it comes to funding sources for future growth and this is likely to remain the case given the cautious and risk-averse nature of the sector.

Investment Approach

It comes as little surprise that the great majority of respondents (78%) categorise themselves as low risk investors. After all, their main focus is on ensuring that funds are available to fulfil their missions. This is reflected in their attitudes to investment.

Of those organisations with investment assets, 69% rank capital security as their top priority while almost three quarters (73%) ranked market volatility as somewhat important when thinking about investment strategy.

Goals

Investment goals reflect the nature of the organisations involved with the provision of income for ongoing activities cited by 52% of respondents. The creation of a "rainy day" reserve fund to cater for unforeseen declines in funding was named as a goal by 42% while, on the same theme, 24% had a goal of using investment income to smooth out irregular income streams.

Funding capital projects was the objective of 44% of respondents and the funding of future as yet unspecified projects was a goal for 13%. This is in line with the finding that only 8% of nonprofits see debt as a means of financing their growth.

Another goal worth noting was that of financing living costs of members. This was a key priority for the religious orders which took part in the survey.

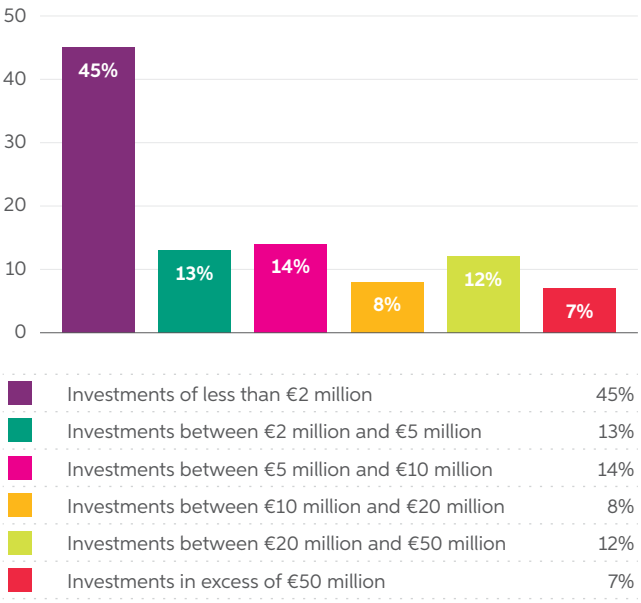
58%

do not have a rainy day fund

Scale of investment assets

More than two in five respondents (41%) are managing investment assets valued at more than €5 million.

Figure 4: Investment assets breakdown



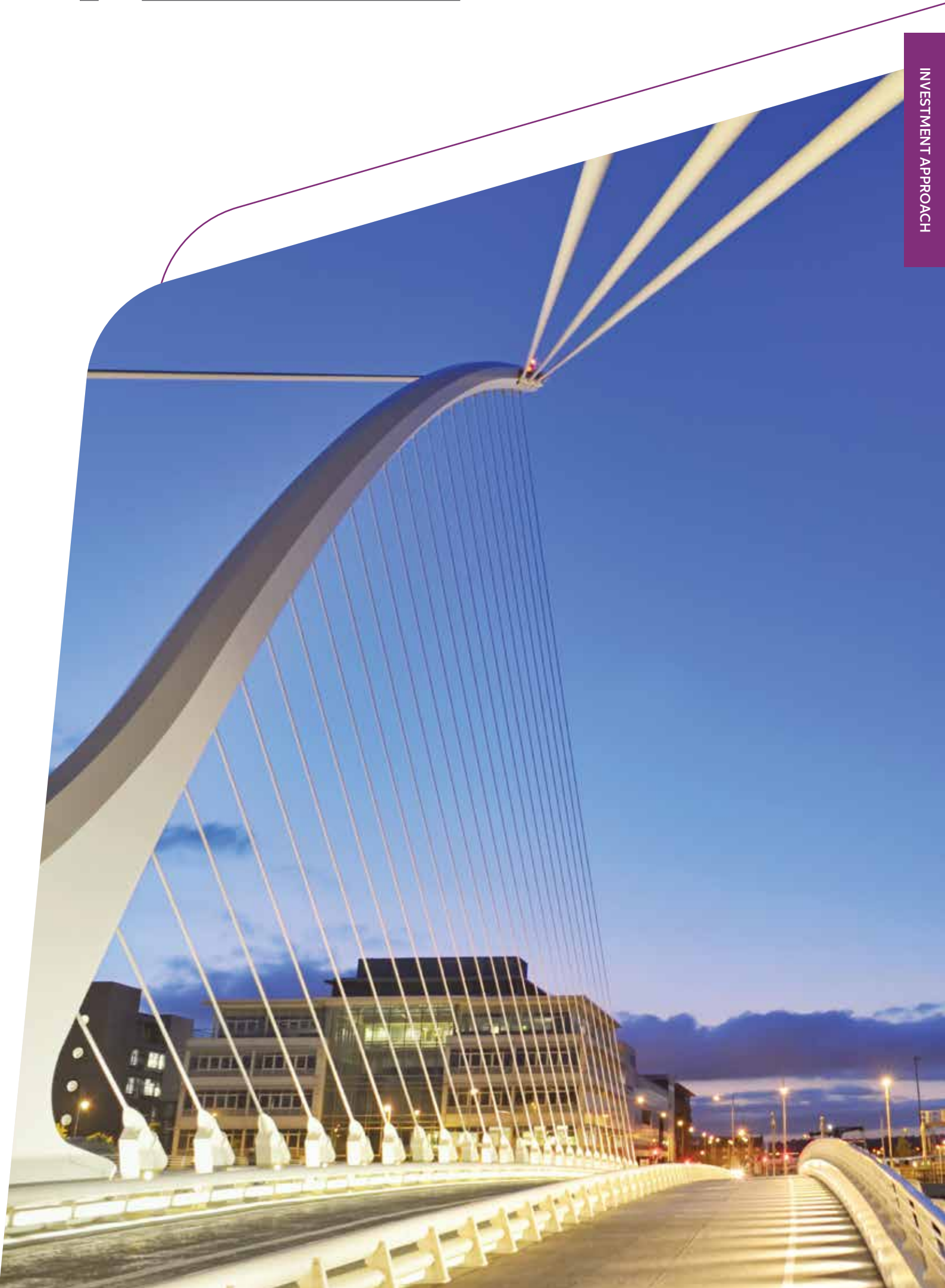
The large scale of the investment assets held suggests that lack of funds had little to do with the selection of goals, or indeed the targeted returns.

Performance targets

In line with the risk-averse nature of the sector the investment performance ambitions of the respondents were at the lower end of the scale. For example, 42% of respondents have cash holdings only which means that they have to be satisfied with current historically low deposit rates, which have fallen from 3.9% at the end of 2006 to just 0.22% at the end of May 2016 (Period Preceding Survey).

23% of respondents have a deposit related objective; that is they aim to outperform cash deposit rates. A further 20% are seeking to outperform inflation and this group was mainly comprised of religious orders and healthcare organisations who are seeking to meet the cost of care and recurring income needs.

Some 40% of investing organisations actually have no target at all or just a general long term objective. Again this fits in with the overall risk profile of the organisations concerned.



Performance achieved

Interestingly, despite the quite conservative targets set by the organisations concerned the returns achieved were highly respectable in the current environment. The average return achieved by respondents was 3.5% – well above deposit rates and bond yields. The highest return achieved was 14% while 21% had a zero rate of return.

Those with an objective of beating deposit rates achieved an average return of 3.6% with returns ranging from 1% to 10%. Those seeking to beat inflation did even better on average with a return of 5% recorded and a range of 1% to 8%.

As would be expected those with no set target or clear goal had the greatest range of returns as well as some of the poorest performances varying from negative to 12%. This suggests that the lack of clarity impacted the decision making process in relation to investments.

The majority believed their returns were either in line with or lower than their target while only 17% said their objectives had been exceeded. This is quite an interesting finding as the returns achieved were actually quite strong given the low risk profile of the organisations. This probably reflects the lack of formal investment strategies in many nonprofits.

40% €

are managing assets of more than €5 million

Investment strategy

Investment approaches varied greatly among the respondents and this was due at least in part to the scale of the assets invested. Investment decisions are made by the board in 59% of cases while more than half (53%) of the organisations with investment assets have a documented investment policy in place. Those with longer term investment horizons of greater than five years tended to be the ones with formal investment policies in place.

In addition, 41% of respondents said they have implemented some form of ethical investment policy to guide decisions; in some cases this means they invest solely in ethically screened funds. However, another notable finding was that 49% saw ethical considerations as the least important factor when choosing an investment manager.

40% of the respondents use an external adviser to assist them with their investment strategies while 37% use expertise available within their boards; 17% take advice from their investment manager; 46% use a combination of external and internal sources.

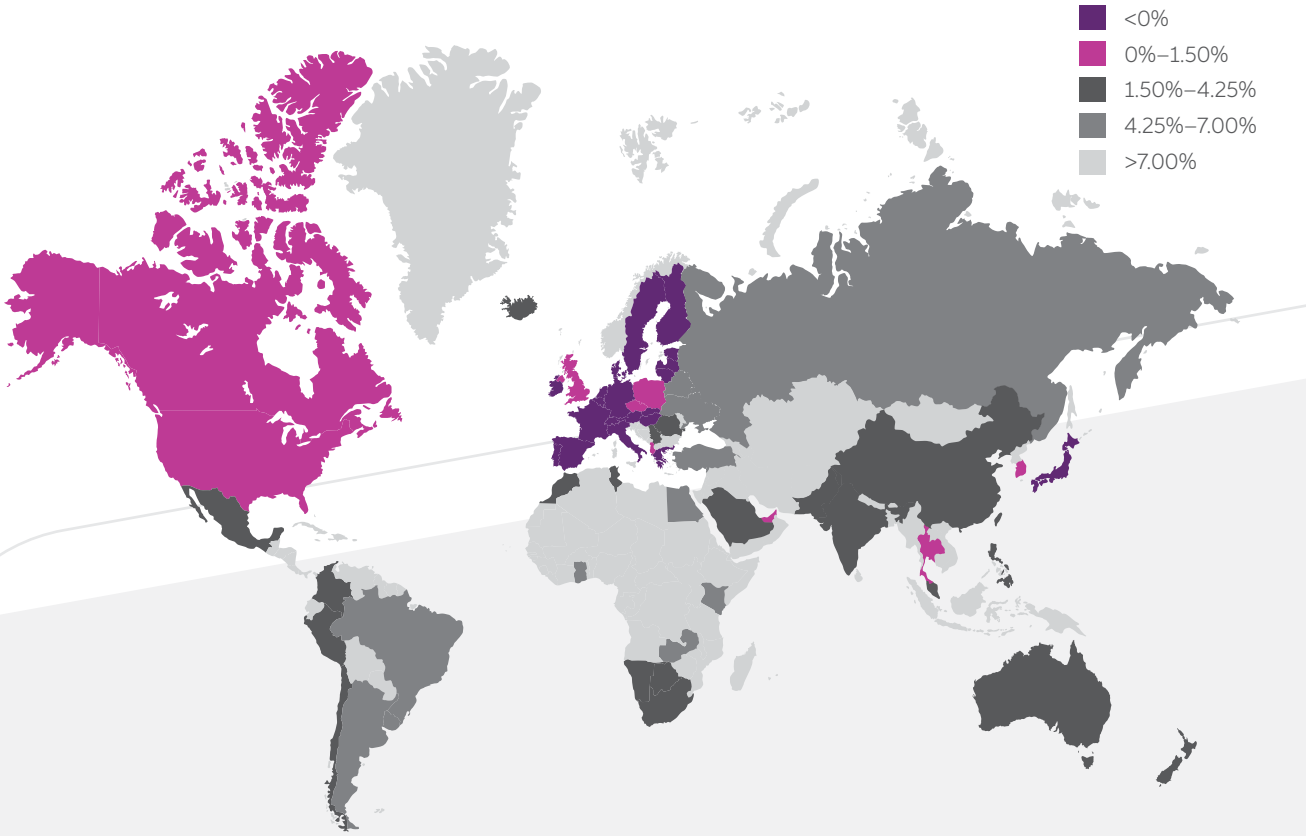
No dominant or unifying theme emerged as a causative factor in relation to those with no clear investment strategy. Some said they had simply never thought about it, others cited the risk-averse nature of their organisation as a reason for not considering investment strategies, 17% said they didn't have the structures in place to develop and implement such strategies, while 13% just said they didn't have time for it.

The overall conservative approach to investing was reflected in the range of assets held and the investment products and structures utilised. For example, 36% of respondents with long term investments take a more hands-off approach and invest exclusively through unit funds where the investment managers chooses the assets in accordance with a set goal or defined mandate.

A significant number (14%) invest directly in bonds, shares and other assets but a mixed approach combining funds with direct holdings was favoured by 41%. 9% hold all of their non-cash investments in property.

Figure 5: Global interest rates (as of July 2016)

Source: Credit Suisse



Conclusions

The gap between investment expectations and strategy needs to be addressed. While the majority of respondents describe themselves as low risk and place a high priority on capital protection some still expressed disappointment at returns of 3.5% and above in the present environment of historically low interest rates and bond yields.

Such organisations will therefore need to reconsider their risk appetite and indeed their investment goals. If additional revenue is required from their investments they will have to revisit their investment strategies and policies. However, this should only be done in a fashion which ensures that a healthy cash balance is maintained in order to meet short term needs.

The need to reassess strategies and attitudes to risk is particularly acute for the 59% of organisations who expect to use investment income to fund ongoing activities and projects. Investment strategies for a low yield environment are covered in a separate article in this report.

The strong returns which were achieved by respondents, despite their low risk appetite, suggests a possible mismatch between the organisations' definition of low risk and the market reality. Again, this points to a need to revisit and reassess investment strategies.

Those organisations without a strategy should put one in place as a matter of urgency. Without a specific policy or goal to use as a benchmark it is almost impossible for boards to gauge the success or failure or indeed the suitability of investments. The fundamentals of investment policy for nonprofits are discussed elsewhere in this report.

Finally, the role of boards in making investment decisions should be examined. Large boards with long agendas mainly focused on operational issues affecting the organisation are not necessarily best placed to make investment decisions or set strategy. Specialist finance or investment sub-committees would be able to bring considered recommendations to boards and therefore improve strategic decision making in this vital area. It is a matter of concern that only 15% of respondents devolve responsibility for investment policy and strategy to a finance committee, and just 13% use an investment sub-committee.

Governance

Overall, the results of our survey reveal that the Irish nonprofit sector aspires to have a strong governance structure and culture. This is particularly encouraging given some of the adverse news coverage relating to the charity sector in recent months and years.

In the overwhelming majority of cases (93%) the board meets more than four times a year while 70% of boards have more than nine members with just 2% having less than four. This points to a very healthy state of affairs across the sector.

Of course, frequency of meeting is of little value if boards are not properly engaged. All the evidence points to very strong levels of engagement on the part of nonprofit boards with 97% of them being very or somewhat familiar with the organisation's governing documents such as the Memorandum and Articles of Association and Constitution. Even in quite complex areas such as the Trust Deed only 9% of boards were said to be unfamiliar with the documents.

Boards are also central to decision making. According to 87% of respondents the board is either the most important or second most important actor when it comes strategic decision making. Only the management and executive team had a higher ranking at 89%.

External stakeholders were ranked as having an important input into strategic decision making in only a minority of cases. There was a clear pattern in evidence, however, with education and research organisations tending to rank government and government bodies higher, reflecting the greater degree of state funding involved in these areas. Furthermore, disability and education services organisations also ranked service users first or second in relation to decision making influence.

Interestingly, private philanthropy had the least input to decision making overall. This indicates a healthy level of independence from private funders on the part of the nonprofit sector.

There is also a high level of professionalism in evidence among nonprofit boards with the vast majority making use of committees. Indeed, 94% of boards had committees reporting to them with 82% having an audit and risk committee and 56% having a remuneration committee.

80%

understand the changes required under FRS102

Very encouragingly, 49% of respondents said they have a strategy committee, 39% have fundraising committee, and 44% have an investment committee. This reinforces the finding that the sector is generally well governed.

Board rotation was another strong feature with 92% of respondents having such a policy; 56% rotate members every three to four years while 31% have terms of five years or more. This offers a range of benefits including constant refreshment of personnel, thinking and ideas as well as protection against the possibility of boards becoming subservient to dominant chief executives or sub-groups.

80% of the respondents were satisfied that their Boards have the wide set of professional and other diverse skills necessary to help them respond to the varying pressures being placed on them and to meet the challenges which lie ahead.

Regulatory and reporting environment

The Irish nonprofit sector is quite diverse in nature with respondents to the survey representing a wide variety of sectors including healthcare, social services, community development, social housing, religious orders, and sports bodies.

This diversity, by its nature can mean that nonprofit organisations file regulatory returns to up to five different entities depending on the nature of their activities – the Companies Office, the Charities Regulator, the Revenue Commissioners, the Housing Agency, and the Department of Education.

Ongoing regulatory developments in the space such as the Companies Act 2014 actually receive a broad welcome by the sector with respondents believing it will benefit from the requirement to have proper Constitutions and reporting documents. There was also a belief that more stringent oversight should ensure that funds are used appropriately and more transparently.

In this context, only 30% of respondents expect these developments to have a significant impact on their operations, with 47% expecting only a moderate impact. Of the 23% who expect little or no impact the majority have been preparing for the changes for a number of years.

In addition, 80% said they have a clear understanding of the likely required disclosures and accounting policy changes required under FRS102.

With an eye to some recent scandals a number of respondents noted that the Charities Regulator will need to find the right balance between assisting the growth of well-run charities, and ensuring the regularisation of non-performing entities. However, respondents also expressed a concern that resource constraints may diminish the Charities Regulator ability to ensure compliance and achieve the required impact.

One respondent summed this up as follows: "I think any charity worth its salt recognises the need for an overhaul of governance in the sector, but the issue of how much is expended in terms of resources without any additional staff or funding is huge."

Conclusions

Board effectiveness

While the survey results demonstrate that the Irish nonprofit sector is well governed there is a question over board effectiveness in larger organisations. It was found that the larger the organisation the larger the board with 70% having more than nine members. The challenge here is to manage a large number of participants in a limited time and yet remain effective. This requires clear action oriented agendas, clarity on decision making processes and roles, and potential greater use of sub-committees to feed into the process.

Committees

As well as contributing to the overall effectiveness of boards, committees are a useful method of generating discussion and debate about long term issues facing organisations. While the findings of the survey indicate widespread use of committees among nonprofits there is room for a greater variety of committees to be established in order to develop a deeper understanding of specific issues and to inform Board discussions and decisions.

A case in point is investments. Any organisation who has an investment portfolio should consider devolving responsibility for developing and reviewing strategy to a sub-committee. This can be time-consuming work, which by its nature demands significant time input.

Board rotation

While board rotation is a healthy thing in itself a balance needs to be struck to ensure that longer term perspectives are not lost. Board rotation should ensure that fresh perspectives are constantly brought to bear on opportunities and challenges, but if the rotation period is excessively short it may be at odds with the organisation's long term objectives. For example, where a Social Housing organisation is considering long term debt financing or an endowment fund is setting investment strategy, Boards are likely to be making decisions whose impacts will not be felt until their terms have long expired. These decision horizons need to be built into the rotation rules.


Assets
Charities Regulation
Board Effectiveness
Sustainability
Financial Reporting
Investment Charter
Reserves
Committees
Nonprofits
Charities SORP
Fundraising
Voluntary Regulation Code
Trust
Mission
Civil Society
Public Confidence
Government
Risk Appetite
Volatility
Impact Reporting
Financing Growth
Investment Strategy
State Funding
Capital Security
Investment Policy
Charities Act
Professionalism
Transparency
Capital Projects
Cash Flow Projections
Good Governance
Mergers

2016 Trends in Charity Regulation: Mergers, Governance and the need to focus on Reserves

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It is now two years since the establishment of the Charities Regulator and the creation of the Charities Register. The Regulator and Register are responsible for charities – a small but important subsector of the larger nonprofit sector. Nonprofits that pursue charitable purposes, as set out in the Charities Act 2009 (s.3), and that provide public benefit are required by law to register as charities and to meet the regulatory standards now set out in the Charities Act. Of the estimated 19,268 nonprofit organisations in Ireland,[1] the Charities Regulator currently has 7,891 charities on its register[2] while Revenue lists 8,149 organisations availing of charitable tax exemption in 2016.[3] Over the past two years, we have seen a greater emphasis on transparency and accountability with the requirement now on all charities to file an annual report with the Charities Regulator and for unincorporated charities to file their annual statement of accounts directly with the Regulator also.

As charities become accustomed to the new statutory requirements of registration and regulation, an increase in charity mergers and consolidations with like-minded entities is not surprising.

New regulation often provides an opportunity for organisations to take stock of their mission, existing governance structures and real-life operations.

Such reflection can lead to internal restructuring and re-organisation and ultimately consolidation. The effect of such reorganisation can substantially reduce the regulatory burden on registered charities and create new economies of scale. Thus a trend towards charity merger is a common feature in jurisdictions new to statutory charity regulation. Some notable examples include the merger of Gorta and Self Help Africa in 2014 and the 2016 amalgamation of religious charities CORI and the IMU to form the Association of Missionaries and Religious in Ireland (AMRI). Another successful consolidation is the recent merger of ICTR and Fundraising Ireland to form Charities Institute Ireland, illustrating that mergers are not limited to any one field of charitable endeavour.

The spotlight on good governance has been a major driver of change in 2016, the impetus coming from both positive and not so positive sources. The RTE PrimeTime revelations of the poor governance and mismanagement of the charity Console in 2016 placed the focus very firmly on the need for a better understanding of how good boards work, the necessary safeguards required to protect charitable assets and the importance of properly audited accounts. The Console case was a major motivating factor behind the commencement of Part 4 of the Charities Act in September 2016 which gives the Charities Regulator

1 See Benefacts at https://benefacts.ie/
2 See the Register of Charities maintained by the Charities Regulator at http://www.charitiesregulatoryauthority.ie/en/cra/pages/search_a_charity and click on the url to download the register
3 See the Revenue Commissioners' lists as at October 25, 2016, at http://www.revenue.ie/en/about/publications/charities_alpha.xls

power to protect charitable organisations, to investigate charities and, where appropriate, to impose intermediate sanctions.

On a more positive note, the inaugural Good Governance Awards, hosted by the Carmichael Centre in October 2016, provided a valuable opportunity to recognise and celebrate adherence to good nonprofit governance practice by community and voluntary organisations across Ireland. Assessing the Directors' Reports and Annual Financial Statements of nominee organisations under a multiplicity of headings, the judging panel scrutinised matters ranging from the setting out of organisations' mission and vision, strategy and performance, and output and outcome impact, right through to matters of how goverance and funding were dealt with in the reports and the overall quality of the financial reporting. Emerging as exemplars in their fields were Jigsaw (with annual turnover > €500,000) and Care Alliance Ireland (annual turnover between €100,000 and €500,000). Practice of the good governance code principles should be on the New Year's Resolution list of all charities, particularly larger organisations that suffer the risk of greater loss and public exposure when something goes wrong. The Good Governance Awards judges' checklist may thus form the basis for a useful reference resource for all bodies interested in raising their game in 2017.[4] Continuing media interest in the nonprofit sector and the emergence of the public database Benefacts as a valuable source of extensive information on the nonprofit sector are likely to keep governance issues very much to the fore in the coming year.

The focus on financial reporting standards is also set to continue apace in 2017 with the Charities Regulator recent conclusion of a public consultation on the draft Charities (Accounting and Reporting) Regulations 2016. The effect of these regulations will be to introduce a uniform way of preparing both simplified and accrual accounts for unincoporated charities with the introduction of the Charities SORP as the standard for the latter.

The Charities Act's requirements to keep proper books of accounts, to prepare annual statements and to be either independently examined or audited do not currently apply to charitable companies. Instead, incorporated charities are required to comply with the Companies Act 2014 in terms of their financial reporting requirements.

With over 60% of registered charities taking the form of charitable companies (either CLGs or DACs), this exclusion from Charities Regulator control creates a regulatory anomaly that should be revisited and addressed in 2017.

What do these regulatory themes mean for the charities and nonprofits that are the subject of this report? They illustrate the importance of three things: the ongoing importance of good governance; the increasing importance of good financial reporting and the continuing public interest in how charities fund their charitable objectives, whether through public fundraising, state grants or contracts or private funding or investment. Some of the key findings of this report highlight the important role played by a nonprofit's financial reserves. When one looks at the main use made of investments by respondents (52% seeking an income for ongoing activities; 44% seeking to fund capital projects; 42% creating a fund for unforeseen needs and 24% seeking to smooth out irregular income streams), the importance of a reserves policy comes to the fore.

A reserves policy should cover all unrestricted funds including designated funds and should explain whether such funds are readily available for spending or not. Usually, the term 'reserves' excludes endowments and restricted funds, as well as any unrestricted funds not available for spending (e.g. fixed assets).

The Revenue Commissioners require charities intending to accumulate funds over a period in excess of two years to seek their prior permission and to specify the reason why those funds are being accumulated rather than applied for charitable purposes. The Charity SORP also requires a charity to explain any policy it has for holding reserves and to state the amounts of those reserves and the reasons why they are held. If the trustees have decided that holding reserves is unnecessary, the report must disclose this fact and provide the reasons behind this decision.

Developing and maintaining a reserves policy serves an important function

4 See http://goodgovernanceawards.ie/judging-criteria/

5 It is interesting to compare these with the Charity Commission of England and Wales 2003 findings that in England, charities held reserves for the following reasons: to ensure continuity in the event of a large variation of income (71%); spend in emergencies (41%); pay for specific future projects (40%); bridge cash flow problems (37%); cover specific liabilities (29%) and to generate income (20%) – CCEW, Charity Reserves (RS3, 2003) at 9.

in a well-governed charity. Reserves are held to help you manage financial risks, particularly for volatility of income. Without a reserves policy, it may be difficult to determine your ability to meet commitments or to plan for new activities. Good financial planning requires a board to review its reserve policy and the level of reserves held at least annually.

Reserve levels that are too high risk damaging the charity's reputation for hoarding cash instead of meeting beneficiaries' needs, having a detrimental effect on its ability to obtain funding and creating a conflict with the duty to apply funds to the charitable purpose in a reasonable time. Low reserves can threaten a charity's continued existence.

It is of some concern that less than half of the charity respondents to this report have a formal investment policy in place (44%). Time spent by trustees developing a formal reserves policy and thinking through the active management of such funds by way of investment would be time well spent for all nonprofit boards in 2017.

Fundamentals of an investment policy for nonprofits

Risk management and good governance practices have taken centre stage as many nonprofits struggle with illiquid assets, falling donations, and the inability to meet desired spending levels. Irish Life believe having a well-defined and articulated investment policy is vital in today's challenging investment landscape.

A formal, written investment policy can provide ongoing guidance on a number of critical subjects such as investment objectives and risk versus reward. By understanding how investment policies work—and how they can go askew – nonprofits can be better prepared to make prudent financial decisions for the long-term management of their assets.

Many institutional investors have long used formal, written investment policies to set guidelines and define their decision making process. While not specifically mandated in the Irish nonprofit sector, a carefully crafted and well maintained investment policy is one of the best ways to document a prudent investment process. While the importance of investment policies is rarely questioned, some nonprofit organisations continue to operate without this governing document. Unfortunately, only 47% the organisations surveyed for this report were operating with a formal investment policy.

What is an investment policy?

An investment policy is a specific document designed to address the objectives, constraints, special circumstances, and overall policies that govern investment related activities of the organisation. The document should identify all parties involved in the investment programme – the board, the investment committee, investment manager and financial advisor.

A well-constructed investment policy will present the portfolio's financial objectives within the context of how much risk the trustees are willing to take on. The long-term strategic asset allocation of the portfolio should be detailed in order to help ensure that the portfolio is invested in accordance with the organisation's long-term goals.

The investment policy should also set operational guidelines for constructing a portfolio which meets the objectives of the investment strategy. Lastly, the investment policy should state the rules for monitoring and reviewing all facets of the investment programme.

Drafting an investment policy should be an educational process for the board or sub-committee involved. Working through issues in the design process can help identify weaknesses in the current risk management structure and refine the objectives, potential investment strategies, and budgets. The result should be a robust document that is easily understood by all interested parties.

Why is an investment policy important?

A clear, well-defined investment policy plays a key role in the overall governance structure of a nonprofit. Well-defined objectives are important to ensure the mission of the nonprofit can be achieved. Clearly defined objectives in the investment policy can help in the determination of appropriate spending rates and help ensure that future government or other funding is not impaired due to a fall in assets. In addition, by identifying potential risks the board or investment committee will hopefully be in a better position to manage them as they arise.

This will allow the organisation to spend more time on other more productive activities such as fundraising.

Setting the target asset allocation, along with appropriate range of returns, is vitally important in the investment policy. Doing so will help ensure that the portfolio is invested in accordance with the organisation's long-term objectives even during times of market uncertainty. The investment policy will help to remove emotions from the investment process in times of market stress, when individuals are more likely to act irrationally.

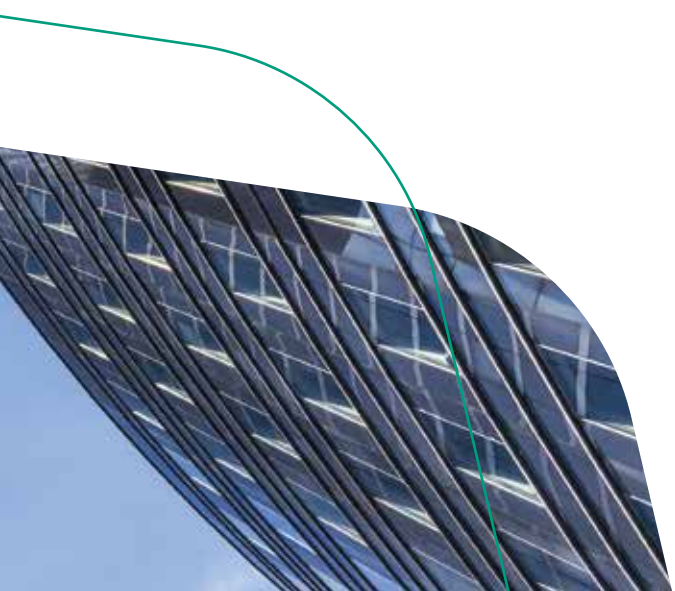
An investment policy can:

- Demonstrate procedural prudence
- Define strategic and tactical asset allocation parameters
- Guide the evaluation and selection of investment managers and advisors
- Discourage random or emotional investment decisions inconsistent with prudent management principles
- Promote long-term investment decision-making; and
- Provide written documentation against allegations of fiduciary imprudence.

Written investment policies can also provide committees and board members with the structure necessary to conduct regular discussions about investment oversight.

Vital elements of an investment policy

Investment policies can range in length from a few pages to much longer documents, depending on the level of detail in the document. The contents of effective investment policies will differ depending on the specific needs of each organisation. However, all good investment policies should contain certain elements including purpose and scope; roles and responsibilities; objectives; investment strategy; budget and reserves policy; special circumstances; monitoring and review process.



53%

operate without an investment policy

SECTION 1:
Purpose and scope

This section is a broad overview of the material in the investment policy. It should include the general objectives of the organisation, state the scope of the document and what role the investment policy plays in achieving those objectives. This section should also include some language on investment governance. There will also usually be a statement that committee members should exercise prudent and appropriate care in accordance with the Prudent Management of Finances as per the Revenue Commissioners.

SECTION 2:
Roles and responsibilities

It is important for the investment policy to clearly state the duties of all involved parties, so that each party may fulfil their duties effectively.

- **Board of Trustees:** The board is responsible for ensuring that appropriate policies governing the management of the portfolio are in place and that they are implemented. Typically, the board sets and approves the investment policy, and delegates responsibilities to the investment committee for implementation and ongoing monitoring
- **Investment committee:** The investment committee is responsible for implementing the investment policy. Typically, the investment committee is responsible for approving investment strategy; engaging investment managers and financial advisors; and monitoring portfolio performance on a regular basis to ensure compliance with investment policy
- **Investment manager:** The duty of the investment manager is to implement the strategy for which they are retained. It is the responsibility of the investment committee to ensure that the investment manager remain in compliance with the investment policy
- **Financial advisor:** The financial advisor is responsible for assisting the investment committee in all aspects of managing and overseeing the nonprofits investment portfolio. Financial advisors would provide asset allocation advice, provide portfolio level performance reports, monitor the overall health of the portfolio and provide investment committee education.

SECTION 3:
Objectives

All investment policies should clearly state the investment objectives of the portfolio. Clearly defined objectives will help set the investment strategy and strategic asset allocation. One of the key elements in these objectives is a statement of the rate of return the nonprofit would like to achieve. When determining the rate of return the nonprofit will need to consider their attitude to risk, capacity for loss, liquidity requirements, inflation, time horizon and investment expenses.

SECTION 4:
Investment strategy and asset allocation

Once the overall objectives of the organisation are clearly defined, the broad investment strategy can be broken down to more specific detail and the long-term strategic asset allocation can be defined.

This is usually accompanied with a requirement for a comprehensive review of current and projected financial requirements to be undertaken before investment strategy is set. It is important in this section of the investment policy to acknowledge that although investment risk is involved, the committee will create a strategic asset allocation that attempts to manage risk through asset class selection, diversification and rebalancing.

Once the strategy is detailed, it is important to define which asset classes will be used in the strategic asset allocation. These could include cash, equities, bonds, property, other alternatives, etc. In making asset allocation decisions, best practice is to include a declaration that while asset allocation should be monitored regularly, frequent changes in response to subtle changes in the financial markets are not expected.

The investment committee is tasked with developing and adopting guidelines for broad allocation on a long-term basis. In setting the asset allocation, it is appropriate to develop ranges around asset classes so that minor tactical shifts can be made in response to market conditions.

Within the asset allocation section, it is appropriate to list all asset classes the organisation finds appropriate for investment. Equally important is to include investments that are prohibited from use within the portfolio. Typically, the last item that is presented in the asset allocation section is the rebalancing policy. While the asset allocation ranges specified in the investment policy can be very large, most nonprofits find it appropriate to rebalance when asset classes deviate from the target policy by more than 2% to 5%. Usually this is done on a specific date, such as month or quarter-end.

The Investment Committee should have an explicit understanding of a portfolio's purpose and a clear definition of success in determining whether the portfolio fulfils that purpose.

Figure 6: Strategic asset allocation: Potential Portfolio Mix

Source: Irish Life

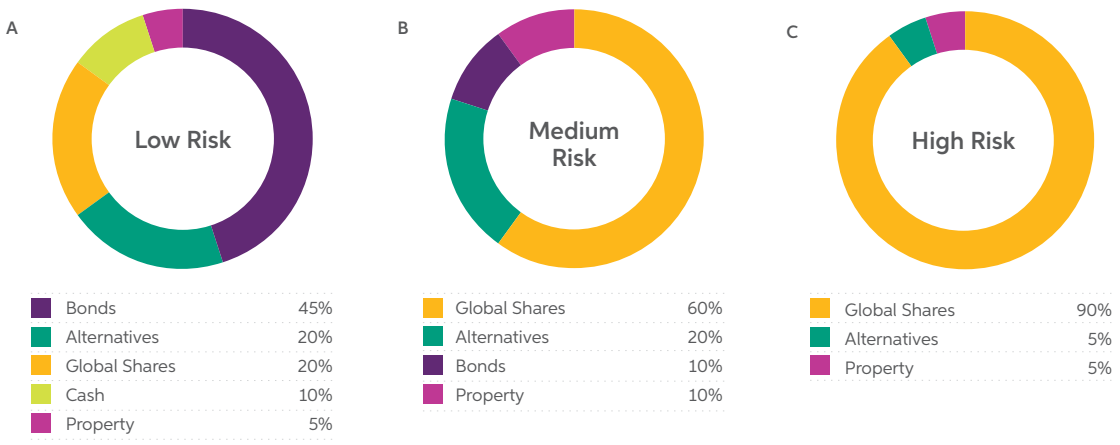
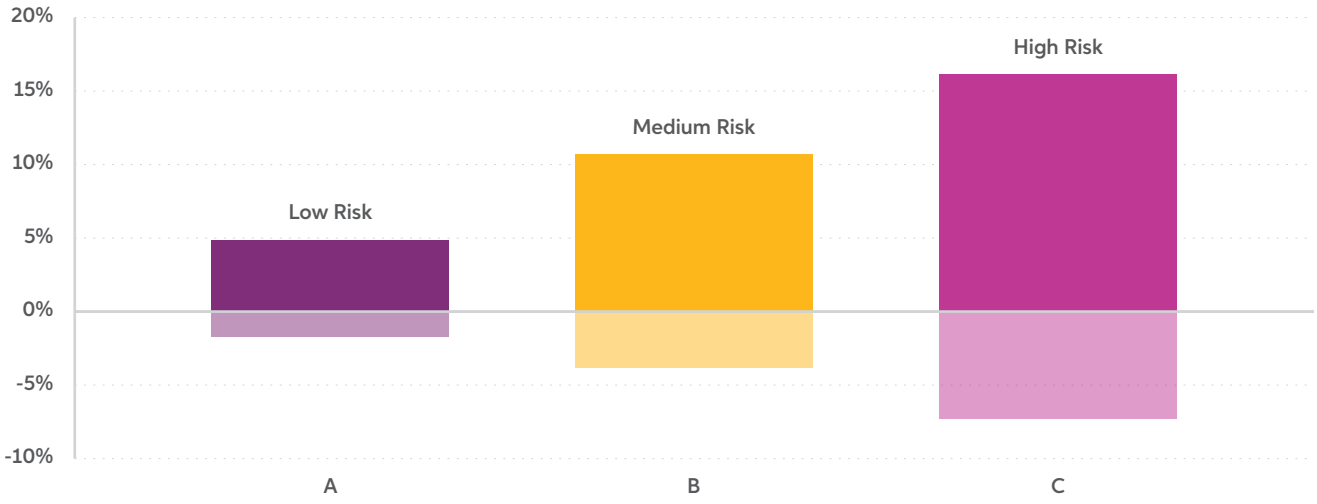


Figure 7: Possible average annual range of returns over a 7-year period

Source: Irish Life



Example Option B

If €200,000 was invested in option B and market conditions are unfavourable, the return could average around minus 4% each year over the 7 years. In this scenario you would only return €152,000, a loss of €48,000 or 24% of your initial investment.

If things go well and market conditions are favourable, option B could average as much as 10% each year over the 7 years. Earning this average return, €200,000 would grow to €420,000 over 7 years.

While these examples show possible returns if things go badly or very well, it is more likely that your investment will see a return each year closer to the mean, which suggests 3% to 4% would be a more likely outcome.

The figures used in this example are estimates for illustration purposes only and are not a reliable guide to the future performance of an investment. Always seek professional advice in the development of an investment strategy.

Warning: These figures are estimates only. They are not a reliable guide to the future performance of your investment.

SECTION 5: Budget and reserves policy

All nonprofits should specifically state their expected spend on a yearly basis. Usually, it is the goal of the nonprofit to distribute in excess of the spending rate if it has the ability to do so. It should be specified in the investment policy if a nonprofit has certain rules that it must follow in its budget. The reserves policy is something that many nonprofits use to ensure the long term viability of the organisation.

While nonprofits differ in their asset allocation and cash needs, it is advisable to clearly state the cash requirements needed on a monthly, quarterly, or annual basis. This should allow greater flexibility to meet their cash needs during times of market distress.

SECTION 6: Special circumstances

All investment policies should contain a section detailing any circumstances unique to the organisation such as a preference for ethical funds, green investing, or items in the nonprofit's charter. The special circumstances section is an opportunity to include items which the nonprofit would like to highlight that are not covered elsewhere in the investment policy.

SECTION 7: Monitoring and review process

Once the asset allocation and investment strategy has been established, it is important to create a well-defined monitoring and review process to ensure that the objectives of the nonprofit are achieved.

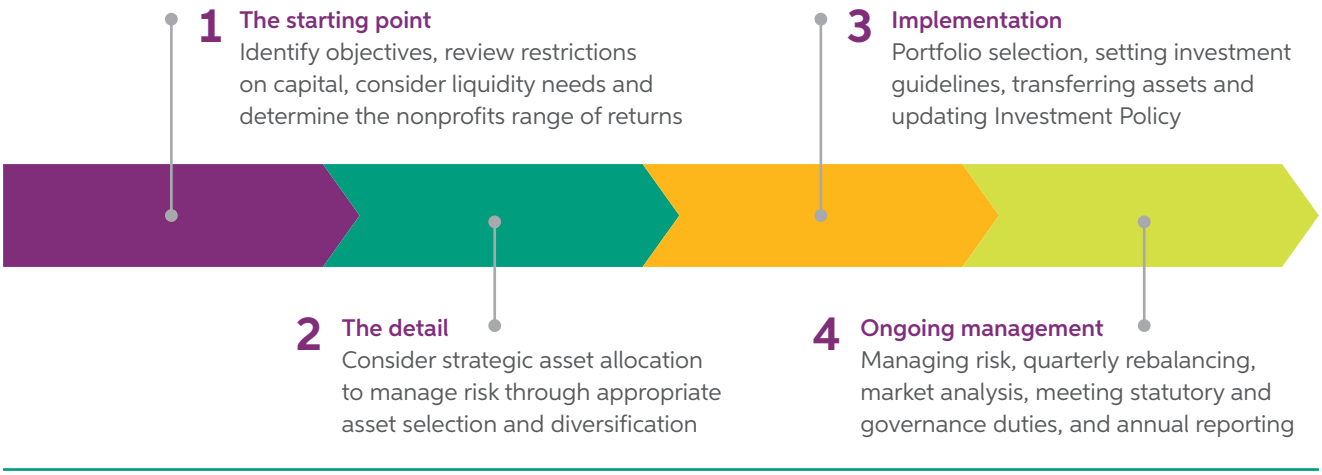
The review mechanisms should be centred on the investment objectives of the portfolio. Client-specific, common elements that might be found in this section include:

- The investment committee seeks to achieve or outperform the target return objective as defined in the asset allocation section over a full market cycle (five years or longer)
- The investment committee does not expect that this objective will be attained every year and recognises that during various time periods, investment managers may produce significant underperformance and/or outperformance relative to the markets
- The overall health of the portfolio will be monitored by comparing the value of the nonprofit's assets against the forecasted budget and tracking the changes of each to determine whether the spending rate requires adjustment
- Portfolio returns should be monitored quarterly to assist in evaluating the effectiveness of the investment strategy
- Individual investment managers' guidelines will be reviewed as stated in each asset class strategy statement
- The investment committee and/or board of trustees will undertake a detailed review and assessment of the programme's overall strategy and investment structure at least every three years. Any changes to the policy should be communicated in writing to all appropriate parties.

SECTION 8: Approval

Typically, the last section in an investment policy is the approval section, which is signed by the nonprofit before copies are distributed to all parties. An example of an approval statement is as follows: "We recognise the importance of adhering to the strategies detailed in this policy and agree to work to fulfil the objectives stated herein, within the guidelines and restrictions, to the best of our ability."

Figure 8: Investment strategy process



Common challenges when drafting an investment policy

A poorly written investment policy may often do more harm than good. Some common complications of a poorly crafted policy include:

1. Lack of consensus

The investment committee and board of directors, whether they are one and the same, should possess a level of agreement about the nonprofit's investment objectives and goals.

2. Unrealistic goals

The investment committee and governing board understand historical market performance and investment results. Obviously, while it would be well received, it would be unrealistic to expect a 25% annual rate of return over an applicable market benchmark.

3. Unclear language

Investment policies should be specific and clearly state their guidelines. Avoid vague and misleading statements. For example, few investors would state that their "tolerance for investment risk is a standard deviation of 8.5%." A statement like this would be more useful when translated into something more easily understood such as ''tolerance for investment risk is moderate with typical annual range of returns of -6% to +10%''.

4. Overly restrictive guidelines

Investment policies can often be overly restrictive. Minimise restrictive language as much as possible – especially when delegating investment authority to professional managers. For example, the investment manager should be allowed to invest in specific sectors depending on their individual investment philosophy and process.

5. Failure to set risk and liquidity requirements

Establishing a process to re-evaluate risk tolerance and setting liquidity guidelines directly within the investment policy can help your nonprofit stay on track during times of market stress.

6. Lack of communication

A copy of the investment policy should be sent to the investment manager and financial advisor involved with the organisation. You should ask each individual or firm to acknowledge, in writing, their understanding of the policy and their responsibilities under the policy.

7. Failure to review

The investment policy should be regularly reviewed to ensure the continued relevance of its objectives and strategy.

CASE STUDY

Maintaining Order: The Salesians of Don Bosco Ireland

Fr Paddy Hennessy, Provincial Economer of the Salesians of Don Bosco speaks to Barry McCall about the congregation's continuing mission in Ireland and the financial issues created by a challenging investment environment.

The Salesians of Don Bosco Ireland face the twin challenges of continuing to fulfil their purpose and mission while providing for a growing number of retired members. In common with most religious orders the Salesians have to contend with an ageing congregation and an increasing proportion of pensioners in its ranks.

"Ours is an aging community like other orders", says Father Paddy Hennessy. "We have an average age of around 67 or 68. We are one of the smaller orders in Ireland with just 54 members. The majority are old age pensioners; just three of us are earning a salary while a further ten of us are on a stipend."

The Salesians have been in Ireland since 1919 and works for young people in a number of centres and services throughout the country. The order is involved in schools, care homes, university hostels, parishes, agricultural education, chaplaincy, spirituality centres, retreats and prayer, social media, drug rehabilitation, and non-formal education.

In addition, Don Bosco Care Services provides safe, secure and healing homes to young people who can't live in their own homes. These young people come from the most challenging backgrounds and grow up in homes where violence, addiction, physical and emotional abuses and neglect are commonplace. Don Bosco Care provides them with the support and care that they need.

The main focus and reason for any Salesian mission or centre is young people and their needs, Fr Paddy explains. "We try to respond in a pastoral and educative way to the holistic development of the young person and their families."

Education, family and faith, are at the core of the order's interventions for young people and at the heart of the Salesian ethos. This is underpinned by what is known as the "preventive system" which is built on three principles: an educative relationship built on trust and reasonableness; an encounter with the young that invites meaning and hope; and a relational approach that is seen in terms of kindness and partnership.

Funding this work and order itself is increasingly challenging. "Our principal sources of funds are income from investments and rent from our agricultural educational campus" says Fr Paddy. "Legacies to the Salesians is another source of income but this tends to be destined for international missions and cannot be used for other purposes unless specifically allowed for in the donation or legacy."

"Securing adequate income from investments is particularly difficult at present. "We are governed by charities regulations as well as our own rules", he points out. "We have to adopt a low to medium risk attitude and our investments must have an ethical dimension. A third important rule is that we cannot make money for the sake of making money."

This last rule can have quite onerous implications. For example, the order once owned a farm which was quite profitable but wasn't actually contributing to the fulfilment of its mission. It had to be sold off with some of the money going to the head house in Rome, some to investments, and some to other charitable purposes.

The order has an ethical and liquid investment portfolio that provides vital income to the Order at a time when our liabilities and costs are ever increasing. In the current low interest environment, portfolio income has declined in recent time but this has been somewhat offset by healthy capital returns. However the Order continues to experience challenges in meeting its funding needs.

The Order runs a deficit on total income across its presences in Ireland as it endeavours to meet the need of care of its own members and seeks to honour the mission of the Order to meet the needs of vulnerable young adults and young people. This deficit has been gradually reduced in recent years. This is largely the result of belt tightening and other measures.

"We had to carry out a major restructuring of Don Bosco Care Services. We continue to support this work. Working with Don Bosco Care, the Order has supported the putting in place of new governance structures and got in some extremely good people on the board. It is now a company with charitable status with a board of directors with a lot of expertise on it. We brought in professional advice four years ago and they came up with a set of recommendations which we have implemented."

The agricultural educational campus also came in for attention. "We brought in Deloitte to do a major piece of work", says Fr Paddy. "As a result we have now put in an advisory board of governors. The trustees are ultimately responsible for the running of the college and they delegate authority to the advisory board. We have also put in a very strong management team. There are now monthly meetings between the advisory board and the principal and quarterly meetings with the trustees. This has resulted in a significantly improved management support mechanism and financial reporting."

"A change in mindset as much as anything else has been responsible for this improvement. We now recognise that a charity is a business that is nonprofit and has to be run professionally. We were afraid of being a business, now we recognise that it is a business. We have to balance this with the care of our members and our purpose."

Long term financial planning has also played a key role and the order works closely with AIB's Customer Financial Planning advisor team in this regard. The team combines detailed knowledge of the sector with the reach of an extensive branch network to serve nonprofit customers throughout Ireland. Qualified AIB advisors collaborate with organisations to gain a solid understanding of, and appreciation for the challenges they face in balancing public interest activities with the preservation and distribution of assets and management of cashflow.

The team also recognises that nonprofit organisations have more complex financial needs and requirements now than ever before and can therefore offer a customised service with advice, support and guidance to develop the optimal solution for each individual set of circumstances.

Fr Paddy has a determinedly optimistic outlook for the future. "If some of our work is no longer needed we will look for new work that is needed. We recognise that our purposes of the past may not be what's needed in the future. A lot of orders are moving towards completion but we are not. You have to ask if what the order was founded for is still needed and if not, is there something else that's needed that it could do. It's like what Pope Francis has said. It's a change of era, not an era of change."

Investing in a Low Yield Environment

Investors from all backgrounds, whether profit or nonprofit, face a significant challenge when it comes to constructing a portfolio to meet not only their return requirements but to do so within their risk tolerance parameters, according to David Haslam from Irish Life Investment Managers (ILIM).

At one time a combination of cash deposits, capital guaranteed products and investment grade bonds provided the backbone of the return in investment portfolios, many of those options now have much lower levels of return than in the past and in some cases, are even negative.

Historically, portfolios that were considered quite low risk were still able to generate reasonable returns. This is not necessarily the case today and investors are increasingly being asked to take on more risk to match the rates of return achieved in former times.

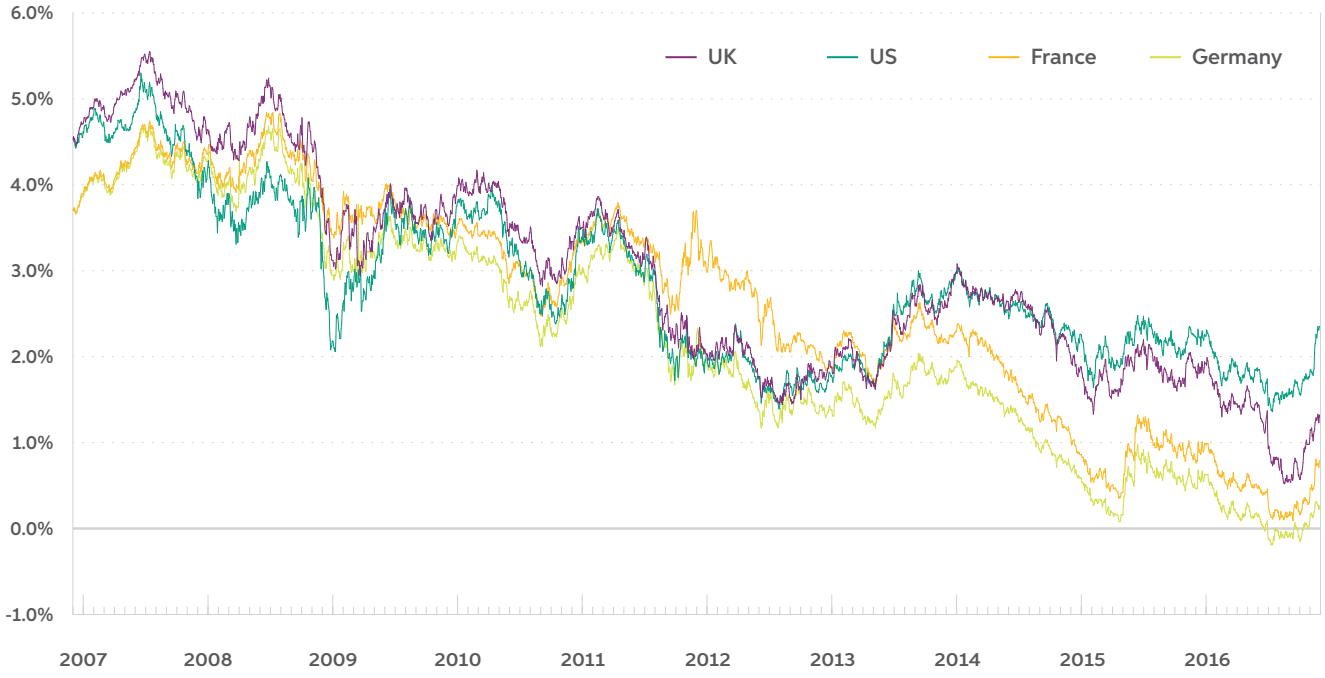
Following a sustained period of positive performance for the traditional asset classes, valuations rose and bond yields fell and by 2015 more than half of the returns were in negative territory. Of those with positive returns, none were greater than 2.8%.*[1]

Global and European sovereign bond yields generally hit new all-time lows immediately after the Brexit referendum in July this year. Since then global bond yields have drifted higher on the back of improving global growth in the second half of 2016 and a rise in inflation due to the base effects of higher oil prices in 2016 compared to 2015. This trend towards higher yields was exacerbated by Donald Trump's election as US President. The expectation of a boost to US and global growth through fiscal stimulus has contributed to a further rise in inflation expectations and hence higher yields.

We have also seen a further unwelcome development for all investors of late, increased volatility. Although volatility is perfectly normal and current levels are still below long term averages, the growing size and frequency of market movements can be unsettling for investors given the artificially low levels they have experienced in recent years.

Figure 9: Top Tier Sovereign 10 Year Bond Yields

Source: FactSet as of 30/09/2016



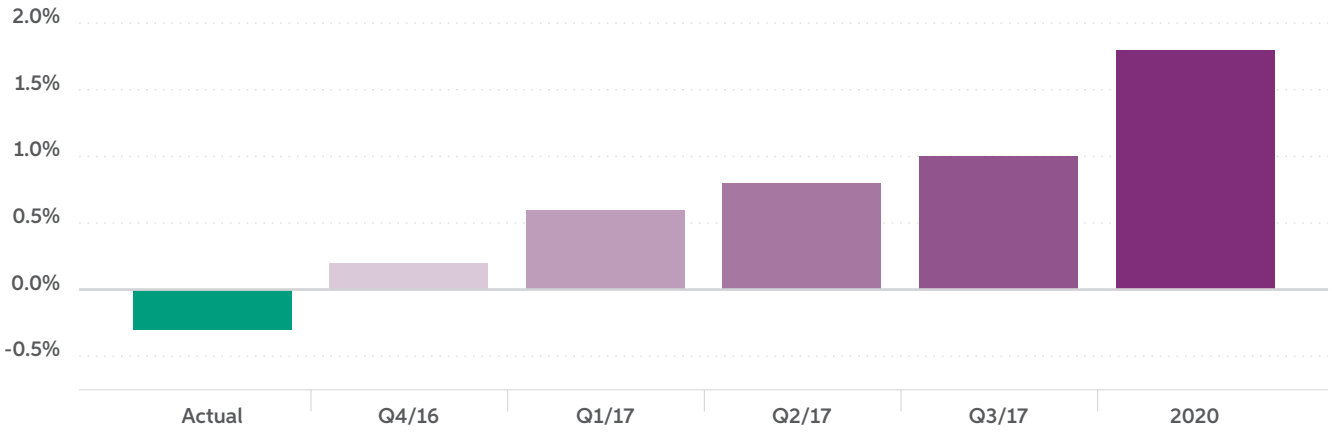
*[1] See 'Novel Investor' as of 30/12/2016

We believe returns are likely to remain lower in the coming years because:

- Cash rates are close to zero in the retail market and in some instances have gone negative in the corporate market
- Bond yields have benefitted from significant support through central bank actions in the US and more recently in Europe. Significant bond buying programmes have supported prices and depressed yields and will continue to do so
- Property has recovered in line with the broader economic recovery and, as with equities, the opportunity for outsized returns in the shorter term has reduced
- Equities have had a sustained run over a period and valuations are now back in line with historic norms. In other words, the premium for buying a recovering asset, like equities, following the crisis in 2008 is gone.

Figure 10: Irish inflation outlook 2016 to 2020

Source: www.tradingeconomics.com as of 30/12/2016



While there are obviously risks to investing, there are also risks to not investing. For example, many investors in the nonprofit sector have historically relied on the interest from deposit accounts to meet known annual income requirements.

While those deposits once earned upwards of 5% per annum, they are now at or close to 0%. The risk is clearly that either increased income requirements or rising inflation will reduce the value of funds over time.

In other words, leaving investment funds on deposit no longer represents a medium or long term investment strategy. Worse still, deposit rates are likely to fall further before we see any recovery.

That is clearly not a very appealing scenario. Other capital guaranteed options, like tracker bonds, have more or less disappeared as they were either too expensive to manufacture or offered poor prospective returns to investors.

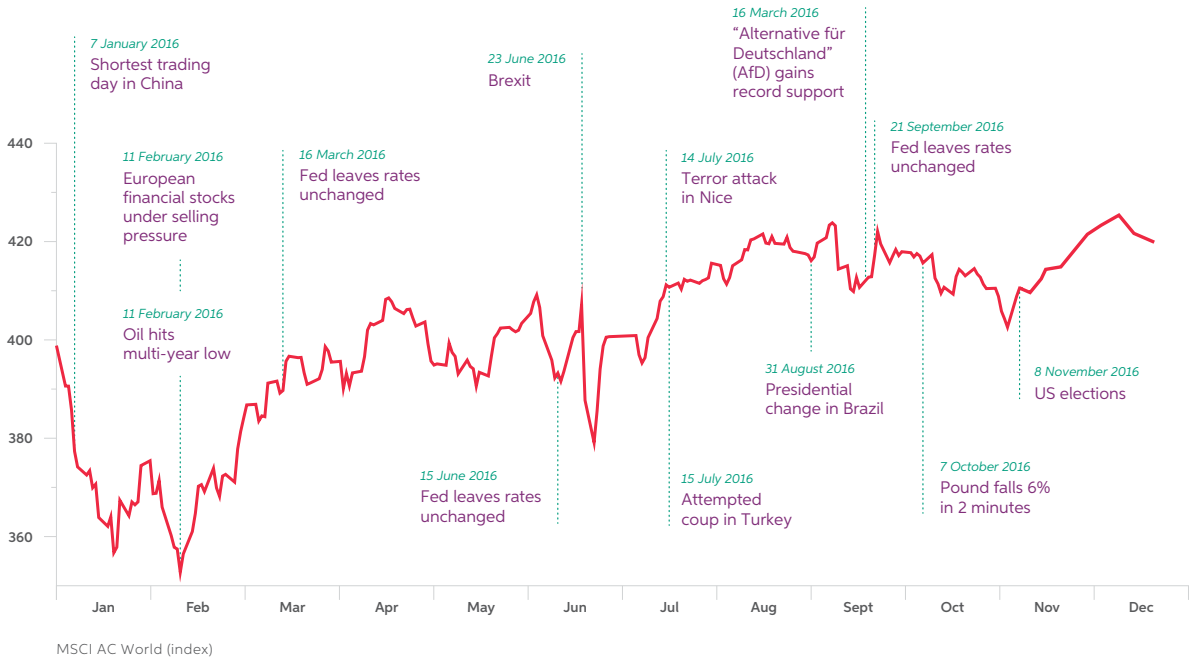
Historically, to generate "deposit plus" type returns investors sometimes looked to safe haven assets like government bonds where there was minimal risk and the prospect of improved returns. Today, however, nearly 65% of all investment grade 1-5 year government bonds globally have negative yields.*[2] In other words, you are paying governments to look after your money and this is certainly not a medium or long term investment strategy.

Real assets, such as equities and property, have historically delivered the best returns over time. However, they have also shown themselves to be the most risky and volatile over shorter periods – characteristics that have generally not appealed to more cautious investors.

*[2] See 'JP Morgan' as of 30/09/2016

Figure 11: 2016 Political volatility – resilient markets

Source: Credit Suisse as of 30/12/2016



MSCI AC World (index)

With Trump's success in 2016 greater clarity is required on his mandate to confidently predict the outlook for global equities in 2017. With positive growth implications from whatever final fiscal package is introduced in the US and with less extreme trade restrictions likely compared to those that were suggested during the campaign, downside risks to equity markets have been reduced. However other issues continue to overhang equity markets such as valuations being full in absolute terms, the expected reduction in monetary policy support from global central banks in 2017, potential political risks in Europe over the course of the year, ongoing uncertainty over the impact of Brexit and potentially slower growth in China in 2017 all potentially limiting the extent of upside in equity markets over the next twelve months. Given the above issues, volatility is likely to remain a feature in markets through 2017.

However, it is worth noting that while it is not possible to eliminate risk, it is possible to manage it. So, in order for these or any other investors to consider the risk required to meet more challenging return objectives in a low yield environment, strategies are required that can identify and manage risk.

The investment question then changes from "What should we invest in?" to one of "How should we invest in them?"

There are two main types of risk when investing – day to day risk and big event risk. The best way to mitigate the short term movements in stock markets is through diversification. This means spreading investments over different assets, managers, strategies, geographies, currencies, sectors, economic cycles etc. A properly diversified portfolio should have as many different return streams as possible, the mix of which determines the risk and likely return a fund will deliver over time.

The higher the exposure to 'real' or growth assets like equities or property, the greater the returns are likely to be but higher too is the risk of losing money. More cautious funds tend to invest a greater proportion in lower risk or 'defensive' assets like bonds and cash. A 'medium risk' or balanced fund would typically invest around 70% in a diversified blend of growth assets and 30% is a diversified blend of defensive assets.

The benefit of investing in a diversified a portfolio is that it is less likely to be impacted by individual market

movements. In other words, when one part of your investment may fall, there will be many other parts that can offset the impact of that fall. Broad portfolio diversification can be further supported by specific strategies. Many investors want to keep their investment journey as smooth as possible and target strategies that aim to reduce volatility in equities, for example.

Instead of being worried by volatility, be prepared. A well defined investment policy can help prepare you for the normal ups and downs of the market, and take advantage of opportunities as they arise.

For big risk events, like 2008, there should also be a strategy to reduce exposure to stock markets altogether – one that needs to be driven by a robust and objective process the aim of which is not capital protection but capital preservation. Capital protection strategies typically mean none of the money invested is at risk of falling in value. A common example would be a cash deposit with a bank. Capital preservation strategies do not guarantee the value of your initial investment but aim to deliver superior returns and reduce the impact of significant market falls using risk management strategies. Today capital protection is expensive and typically delivers lower returns as a result.

Investors may still want to put a portion of their funds on deposit for short term access. However, if they need an option to grow their funds over the medium to long term, the best way is with a well-diversified portfolio of real assets. It is essential that these assets are underpinned by effective and proven risk management strategies and processes. Significant expertise is required not only to identify the right risk assets to invest in to help meet your financial objectives but crucially in the development and execution of the strategies to manage the risk along the journey.

Glossary of Terms

Irish Life has prepared the following glossary to help explain some of the terms used in this report.

Alternatives are investments in asset classes other than shares, bonds or cash. Because alternatives tend to behave differently to traditional assets, adding them to a portfolio may provide broader diversification, reduce risk, and enhance returns.

Articles of Association is a document that contains the purpose of the company as well as the duties and responsibilities of its members defined and recorded clearly.

Asset allocation is the implementation of an investment strategy that attempts to balance risk versus reward by adjusting the percentage of each asset in an investment portfolio according to the investor's risk tolerance, goals and investment time frame.

Bonds are debt investments in which an investor loans money to an entity (typically governmental or corporate) which borrows the funds for a defined period of time at a variable or fixed interest rate.

Cash is a short to medium term investment option typically offering a high degree of security but with lower returns and flexible levels of access.

Charitable Trust is a trust that is established for charitable purposes only and is established under a deed of trust that requires the trustees of the trust to apply all of the property of the trust to further the purposes of the trust except for money used in its management, and where none of the property is payable to the trustees except in specific circumstances.

Charities SORP (Statement of Recommended Practice) provide a structured way for charities to deliver an account of their business in a way that reflects the particular characteristics of charities.

CLG (Company Limited by Guarantee) is a company which does not hold share capital.

DAC (Designated Activity Company) is a private company limited by shares.

Emerging market shares are those shares located in less-developed regions of the world.

External Managers are fund managers outside of the Irish Life Investment Managers with whom we invest to access specialist skill managing non-traditional assets and non-traditional strategies.

Global shares are shares representing companies typically from developed countries around the world.

Investment diversification is a strategy of spreading risk in a portfolio by investing in many different assets, countries, currencies, sectors etc. to reduce the risk of underperformance by any single part of the portfolio.

Investment policy is a specific document designed to address the objectives, constraints, special circumstances, and overall policies that govern investment related activities of the organisation.

Investment strategy is a set of rules, behaviours or procedures, designed to guide an investor's selection of an investment portfolio.

Investment sub-committee has overall responsibility for the operation and administration of the investment portfolio.

Low volatility shares are those shares whose price does not move up and down by as much or as frequently as those of ordinary shares.

Memorandum of Association is the formal, legal constitution governing a company, often simply called the memorandum.

Property refers to commercial buildings or land intended to generate a profit, either from capital gain or rental income. This can also include exposure to quoted property companies or REITS (Real Estate Investment Trusts).

Range of returns is a document used to explain the likely fund returns for different levels of risk over time. It is a statistical estimate which is accurate 95% of the time.

Risk appetite is the amount of investment risk that an organisation is willing to take in order to meet their strategic objectives.

Tracker bonds are fixed-term investments where typically most of your money is invested in a deposit based account and the rest is invested in the stock market, in a stock-market index or mix of indices.

Unit-linked fund is an investment plan, which combines your money with money from other investors and buys units in a fund.

AIB Customer Financial Planning

At AIB, we have been supporting and advising Nonprofit clients for many years. Over 50% of Irish Nonprofits choose to bank with AIB*[1], and in terms of investment advice our team of 25 Financial Planning Specialists have the sectorial experience and expertise to help our Nonprofit clients develop tailored financial plans.

With interest rates at historically low levels and forecast to remain so in the short to medium term, Nonprofits have had to expand their investment approach beyond deposits. This has led to more methods of portfolio diversification, which brings with it increased complexity and sophistication.

AIB have a proven track record in supporting our Nonprofit clients develop a sound approach to investing assets by helping them define objectives for investing and risk tolerance, and assisting them adopt a prudent investment policy.

AIB is ready to support Nonprofits and our team of Financial Planning Specialists is looking forward to supporting our clients in this ever changing and evolving sector.

If you would like to talk to one of our specialists a contact list by geography is on the next page.

Bryan O'Connor
Head of Growth Platforms
Allied Irish Banks, p.l.c.

Warning: The value of your investment may go down as well as up.

Allied Irish Banks, p.l.c. is tied to Irish Life Assurance plc for life and pensions business.

*[1] Source: 2014 research conducted by Ipsos MRBI on behalf of AIB.

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Who are Irish Life Investment Managers?

Irish Life Investment Managers (ILIM) are part of the Great-West Lifeco, and investment manager to the Irish Life Group. The most important part of our business is our clients who comprise retail, corporate and institutional investors both domestically and internationally. Our aim is to meet and exceed our clients' expectations by delivering both innovative and bespoke investment solutions with industry leading service. ILIM have over €64 billion*[1] in assets under management on behalf of clients who trust, believe and invest in our award winning investment capabilities. Amongst our clients, we count 8 of the 10 largest US multinationals in Ireland, the vast majority of large Irish institutional pension funds as well as charities, educational bodies, government and supra national institutions both at home and abroad. They invest with ILIM because they trust us and feel they can:

Access Expertise:

- National and International multi award winning Risk Management strategies
- ILIM are recognised global leaders in indexation.

Take comfort from our Size and Scale:

- ILIM has over €64bn in assets under management
- Irish Life is 'AA'*[2] rated and has over 1,000,000*[3] individual customers in Ireland.

Benefit from our Experience:

- Vastly experienced investment team behind the investment solution for you
- Learning from past experiences enables us to deliver on future expectations.

Share in our Success:

- Invest alongside our world class domestic and international clients
- Benefit from innovative research and bespoke solutions.

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*[1] Correct as of 28/02/2017
*[2] See 'Fitch Rating Agency' as of 28/02/2017
*[3] This figure represents the combined customer count of Irish Life Assurance plc's Retail and Corporate Business as of 28/02/2017

NOTES

Notes

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