# NEGOTIABLE SECURITIES INVESTMENT POLICY

## Fargo Moorhead Area Foundation

### Negotiable Securities Investment Policy Statement



Policy # 6.5 Reviewed by the Investment Committee
*Amended by the FMAF Board of Directors: 12-19-2023*

# I. Definitions

**Introduction**

The Fargo-Moorhead Area Foundation (the Foundation) is a tax-exempt, Internal Revenue Code Section 501(c) (3), not-for-profit, autonomous, publicly supported, philanthropic organization formed and operated primarily as a permanent collection of endowed funds for the long-term benefit of Cass and Clay Counties in North Dakota and Minnesota. As such, it is intended that the Foundation must meet the public support test required for community foundations under Section 170(b)(1)(A)(vi) as modified by Treas. Reg. 1. 170A-9(c)(10). The IRS classifies the Fargo-Moorhead Area Foundation as an Internal Revenue Code Section 501(c)(3) organization.

**Purpose**

This Investment Policy Statement was adopted by the Board of Directors of the Fargo-Moorhead Area Foundation (the Board) to direct the prudent investment of its negotiable securities investment portfolio in a manner consistent with the investment objectives stated herein. The Board has delegated financial oversight of the negotiable securities portfolio to the Investment Committee (the Committee). A separate committee has been established for the purpose of overseeing the Foundations local impact investment portfolio.

The Investment Policy Statement shall be used by the Committee in performing its duty to oversee the negotiable securities investment portfolio (in managing, monitoring and reporting on the investment portfolio) and by the Fund Managers.

It is expected that the Committee will review this document at least annually. Any revisions will be recommended to the Board for approval.

**Scope**

This Policy applies to all assets that are included in the Foundation's negotiable securities investment portfolio for which the Committee has been given discretionary investment authority. Local impact investments, as well as endowed funds created with specific restrictions that would be at odds with the Foundation's investment policy shall have a separate investment policy created to govern those assets which will be segregated from pooled investment assets.

**Fiduciary Duty**

All assets shall be managed consistent with sound and prudent fiduciary practices and comply with all applicable laws including the Uniform Prudent Management of Institutional Funds Act as adopted in North Dakota and Minnesota. In seeking to attain the investment objectives set forth in the policy, the Committee and its members must act with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person in like capacity and familiar with such matters would use in the conduct of an enterprise of the like character and with like aims. All investment actions and decisions must be based solely on the interests of the Foundation. Fund Managers must provide full and fair disclosure to the Committee of all material facts regarding any potential conflicts of interest.

**Definition of Duties:**

*Board of Directors*
The Board or in some cases, the Trustee, has the ultimate fiduciary responsibility for the portfolio. The Board must ensure that appropriate policies governing the management of the Portfolio are in place and that these policies are being effectively implemented. To implement these responsibilities, the Board sets and approves the Investment Policy Statement and delegates responsibility to the Investment Committee for implementation and ongoing monitoring. At least annually the Board will review the Investment Policy Statement and receive a performance report from the Committee in a format deemed acceptable by the Board.

*Investment Committee*
The Committee is responsible for implementing the Investment Policy as directed by the Board of Directors. This responsibility includes recommending investment strategy, monitoring performance of investment portfolios on a regular basis and maintaining sufficient knowledge about portfolios and their Fund Managers to be assured of their compliance with the Investment Policy. Annually, the Committee will make a recommendation to the Board of Directors on the spending rate to be applied consistent with the goals of the Foundation's Spending Policy.

*Fund Manager*
The Fund Managers are responsible for prudently investing in the assets the Foundation entrusts to them in accordance with the objectives and guidelines included in this policy.

## II. Objectives

Investment related objectives for the Fargo-Moorhead Area Foundation are:

*Return Expectation*
Over the longer term (5-year horizon) the assets are expected to yield an annual return at a rate equal to, and preferably greater than, the benchmark. Assets are expected to generate a reasonable risk-adjusted total return, given normalized capital markets. Emphasis is on investments which assure the return of invested principal over the return on money invested, i.e., safety of principal is primary.

*Risk Tolerance*

Fiduciary standards of prudence apply to investments of the Foundation. Given a range of risk from very low to very high, endowment investments should carry a moderate level of risk.

*Asset Mix*
All investments in Foundation assets will be made in accordance with the guidelines set forth below. Diversification of assets should be employed.
*Strategy*
Because the Portfolio is expected to endure into perpetuity, and because inflation can have an impact on its Performance Objective, the long-term risk of not investing in growth securities outweighs the short-term volatility risk.

## Fargo-Moorhead Area Foundation

**Asset Allocation Guidelines for Marketable Securities**

| ASSET CLASS | Acceptable % of total assets |
|---|---|
| Large Cap Equities | 15-50% |
| Mid Cap Equities | 0-20% |
| Small Cap Equities | 0-20% |
| International Equities | 0-40% |
| Real Estate | 0-15% |
| Alternative Investments | 0-10% |
| Total Equities | 40-80% |
| Fixed Income | 20-60% |
| Cash/Cash Equivalents | 0-10% |

***Benchmark comparison for entire portfolio is 60% S&P and 40% Barclays Aggregate**

## III. Implementation

It is the intent of the Foundation, through the Committee, to select and retain competent Fund Managers. It is believed that over time, Fund Managers who understand the Foundation's long-term goals will be better able to contribute to overall performance.

*Credentials for Fund Managers*
State or federally regulated Investment Firms and Trust Companies

*Fund Manager Performance Objectives*
All investment returns shall be measured net of fees. Each Fund Manager will be reviewed on an ongoing basis and evaluated upon the following criteria:
a) Ability to meet or beat the return of appropriate benchmark indices;
b) Percent performance above or below the appropriate benchmarks as compared to other Fund Managers;
c) Adherence to the guidelines and objectives of this Investment Policy Statement;
d) Avoidance of regulatory actions against the firm, its principals or employees.

*Fund Manager Designation*
The Foundation recognizes the importance of the partnership we have with the Fund Managers. Donors will be presented with a current list of qualifying fund managers. If they choose to nominate a financial institution that is not represented on our list, we accept that institution manager subject to a due diligence review.

Performance will be reviewed over a rolling twelve-quarter period and evaluated at the end of each quarter. Rate of Return will be calculated using a time-weighted comparison, net of fees.

When a new Fund Manager establishes a partnership with the Foundation, such Fund Manager is eligible to manage additional funds, if they maintain compliance with current investment policies.

## IV. Guidelines and Restrictions

### General

Each Fund Manager shall:

- Have a minimum of $100,000 to become a Fund Manager.
- For accounts which remain at or below the threshold level after a period of 5 years, the Foundation will consider moving the assets in order to foster the Foundation working with Fund Managers who actively promote the Foundation.
- Have full investment discretion regarding security selection consistent with this Investment Policy Statement and is expected to maintain a fully invested portfolio (defined as no more than 10% in cash equivalents without express permission from the Board);
- Immediately notify the Committee in writing of any material changes in the investment outlook, strategy, portfolio structure, firm ownership, or senior personnel;
- Make every effort to control the investment cost of investing the assets of the Foundation.

### Equity

Equities include common stock (both domestic and foreign), convertible securities and managed or index funds made up of these securities. Real Estate and Alternative Investments are viewed as equities for the purpose of this policy.

Each Fund Manager shall:

- Assure that no position of any one company exceeds 10% of the Fund Manager's total portfolio as measured at market;
- Maintain a minimum of 20 positions for individual securities in the portfolio to provide adequate diversification. The diversification requirement may also be met through investment in diversified mutual funds or ETFs without regard to the number of positions.
- Maintain adequate diversification among economic sectors.

### Real Estate

This portion of the portfolio will be allocated to publicly held investments in public investment funds, including REIT's and timber through managed funds. Direct investment in real estate, farmland, minerals, or oil/gas is **not allowed** without prior Committee approval.

### Alternative Investments

This portion of the portfolio will be allocated to public investments gaining exposure to hedged equity, hedged fixed income, managed futures, and commodities with a goal of dampening overall portfolio volatility. Other options and private investments not allowed without prior Committee approval.

**Fixed Income**
Fixed income instruments include any marketable public securities (both domestic and foreign) that provide contractual payments and/or have specific maturity dates, or managed funds made up of these securities, including municipal securities - both taxable and tax-exempt; US (United States) treasury and agency bills, notes and bond; corporate debentures – senior or secured, including those issued by Reits; structured securities rated at a minimum of AAA and/or agency collateral at the time of purchase including asset backed securities (ABS), commercial mortgage backed securities (CMBS), and residential mortgage backed securities (RMBS); obligations of supranational organizations, such as the IMF and World Bank, provided the US Government guarantees the principal; Yankees or foreign debt issued in the US market by a sovereign entity or company; individual preferred stocks; mutual funds; or fixed income ETFs.

Each fixed income investment manager shall:

- Maintain an overall weighted average credit rating of "A-" by Standards and Poor's, Moody or another nationally recognized rating agency service;
- Hold no more than 40% of the fixed income portfolio in investments rated BBB+/BBB/BBB-;
- Hold only securities that are US dollar denominated;
- Hold only cash bonds; synthetic, and other convoluted securities such as collateralized bond (CBO), debt (CDO) or loan obligations (CLO) are not allowed;
- Hold no more than 15% of the fixed income portfolio in investments rated below investment grade, and/or not rated. Investments in below investment grade fixed income securities must be limited to diversified funds;
- Maintain duration of 3.5 – 6.5 years.
- With respect to the corporate sector of the portfolio, maintain adequate diversification amongst economic sectors, investing no more than 15% in any one sector per Barclays Level 4 classification.
- Assure that no position of any one issuer shall exceed 5% of the Fund Manager's total portfolio as measured at market value except for securities issued by the U.S. government or its agencies;
- Invest no more than 30% of the portfolio in residential mortgage-backed securities (RMBS), with no more than 10% being non-agency RMBS;
- Invest no more than 20% of the portfolio in commercial mortgage-backed securities (CMBS) and/or 20% in asset backed securities (ABS);
- Provide for adequate call protection, with 50% of the fixed income portfolio being non-callable or callable at a "make-whole";
- Not include 144A securities unless the issue is suitable for "accredited investor", or the FM Foundation qualifies as a "qualified institutional buyer (QIB)".

### Unacceptable Securities

Investments should be consistent with this policy, but certain types of investments are not considered prudent for this Foundation including, but not limited to, securities purchased on margin, options, futures or short sales except through a managed funds in a Complementary Strategy as defined above.

## V. Reporting and Monitoring

### Reporting

Open communication between the Fund Managers and the Foundation is critical to the success of the Foundation. The Fund Manager shall provide the following at least annually.

- A verbal or written review of key investment decisions, investment performance and portfolio structure including asset allocation;
- An annual written declaration of target asset allocation mix;
- An organizational update;
- A review of the Fund Managers' understanding of investment guidelines and expectations and any suggestions to improve the policy or guidelines;

In addition, the following is required of each Fund Manager:

- Quarterly performance summary report provided to the Foundation no later than 30 days following the end of the quarter;
- An annual detailed breakdown of all fees charged to the Foundation including management fees, transaction fees and mutual fund fees;
- Immediate notification to the Foundation of any exceptions to this investment policy statement with a recommended plan of action to correct the violation.

A detailed listing of the Annual/Quarterly Fund Mgr. Reporting Format is included. See Attachment #1.

### Monitoring

The Foundation allows its Fund Managers a great deal of latitude in the management of their portfolio. However, in the event a Fund Manager does not adhere to those policies the following measures will be taken.

*Asset Allocation*
If a Fund Manager is out of compliance with the general asset mix, upon discovery, a Foundation staff member will notify the Fund Manager that compliance is mandatory. If Fund Manager is not in compliance after another three months, one-half of the assets under their management may be removed, and if the Fund Manager is not in compliance after another 6 months (out of compliance one year), all assets remaining may be removed.

*Costs*

The Foundation monitors the Fund Manager return net of fees. This analysis is one method of monitoring and controlling Fund Manager fees.

*Endowment Fund Manager Discipline*

Discipline/termination of a Fund Manager for failure to achieve certain levels of investment performance will be as follows:

1. Donor Initiated. When a donor has nominated a Fund Manager and the Fund Manager is brought to the Foundation, the management of the Fund Manager becomes the sole responsibility of the Foundation.

2. Foundation Initiated/Investment Performance.
   a) Investment performance that is less than one half of the pro-rated benchmark return against which the endowment pool as a whole is measured is not a reasonable return. When a Fund Manager produces less than one-half of the pro-rated benchmark return over a calendar one-year period, the Fund Manager will be put on the watch list and appear before the Investment Committee to discuss how they will improve their performance. The Fund Manager will be taken off the watch list when their performance for a calendar one-year period exceeds one-half of the prorated benchmark return.
   b) When a Fund Manager produces less than one-half of the pro-rated benchmark returns over a three-year period, 50% of the assets that the Fund Manager received in rotation up to a maximum of 25% of their total assets under management will be removed by the Foundation. Assets under management because of donor choice will remain with the Fund Manager.
   c) One year later, if the Fund Manager's return in that year does not exceed one-half of the pro-rated benchmark return, all remaining assets that the Fund Manager received in rotation up to a maximum of 50% of their total assets under management will be removed by the Foundation. Assets under management because of donor choice will remain with the Fund Manager.
   d) One year later, if the Fund Manager's return in that year does not exceed one-half of the pro-rated benchmark return, the Fund Manager will be terminated and all assets under management will be removed.

If a Fund Manager has been terminated, they may rejoin as a Fund Manager if a donor asks for them to be added as a Fund Manager. When they rejoin, they will be on the watch list until their performance for a calendar one-year period exceeds one-half of the pro-rated benchmark return.

## Annual Fund Manager Reporting Format

1. Evidence of compliance with the IPS via attached reporting checklist.
2. All numbers reported should be annualized as of the end of the current calendar year.
3. Performance and attribution reported should be calculated on an annualized basis for one, three and five years.
4. All representations of performance must be net of fees.
5. Provide book yield and dividend yield based on cost not market.
6. Report portfolio performance and attribution on the entire portfolio, both fixed income and equity on a combined basis, in comparison to the blended benchmark of 60% S & P and 40% Barclays Aggregate.
7. Please include a comprehensive breakdown of all fees charged including management fees, transaction fees and mutual fund fees, represented as both a dollar amount and as a percentage of assets managed.
8. Please include a detailed description of any "funds" used, be they internally managed or commercial mutual funds.
9. Please provide biographical information on the individual or individuals charged with performing investment of funds locally. If you are utilizing commercial funds, it would be helpful to have information on the individual or individuals managing each fund.
10. Please provide some background information on your institution and any outside organizations or firms that may be managing Foundation funds. Additional information such as recent changes in fund management, pending litigation, compliance violations/sanctions and system changes would also be appreciated.
11. For the purpose of being able to reference specific information, please number the pages on handouts.
12. Statistical measurements for 12, 36, and 60 months to be included for each portfolio should include:
    a. **Alpha rating**: alpha is the difference between an investment's expected return based on its beta and its actual return. Alpha is interpreted as the value added by an investment manager. A positive alpha of 1.0 means the investment has outperformed its benchmark by 1%. A similar negative alpha would indicate underperformance of 1%
    **b.** **Beta rating: beta** shows the volatility in returns on a portfolio relative to a benchmark. A beta of 1.2 states that the return can be expected to be 20% more variable than the return on the benchmark, all else being equal. While the return with a beta of 0.8 can be expected to be 20% less volatile than the return on the benchmark.
    **c.** **Sharpe ratio**: a measure of risk adjusted performance, which measures the excess return per unit of risk. The greater the Sharpe Ratio, the more attractive an investment's return relative to the risk assumed. A negative Sharpe Ratio indicates a risk-less asset would perform better than the investment analyzed.
    **d.** **Standard Deviation**: a measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Standard deviation is calculated as the square root of variance. In finance, it is applied to the annual rate of return of an investment to measure the investment's volatility and is a basic measure of risk.

## Quarterly Fund Manager Reporting Format

1. Evidence of compliance with the IPS via attached reporting checklist.
2. All numbers reported should be annualized as of the end of the current quarter, year to date, last 12 months, last 36 months, and last 60 months.
3. Report portfolio performance and attribution on the entire portfolio, both fixed income and equity on a combined basis, in comparison to the blended benchmark of 60% S & P and 40% Barclays Aggregate.
4. Provide book yield and dividend yield based on cost not market.
5. All representations of performance must be net of fees.
6. Statistical measurements for 12, 36, and 60 months to be included for each portfolio should include:
    a. **Alpha rating**: alpha is the difference between an investment's expected return based on its beta and its actual return. Alpha is interpreted as the value added by an investment manager. A positive alpha of 1.0 means the investment has outperformed its benchmark by 1%. A similar negative alpha would indicate underperformance of 1%
    b. **Beta rating: beta** shows the volatility in returns on a portfolio relative to a benchmark. A beta of 1.2 states that the return can be expected to be 20% more variable than the return on the benchmark, all else being equal. While the return with a beta of 0.8 can be expected to be 20% less volatile than the return on the benchmark.
    c. **Sharpe ratio**: a measure of risk adjusted performance, which measures the excess return per unit of risk. The greater the Sharpe Ratio, the more attractive an investment's return relative to the risk assumed. A negative Sharpe Ratio indicates a risk-less asset would perform better than the investment analyzed.
    d. **Standard Deviation**: a measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Standard deviation is calculated as the square root of variance. In finance, it is applied to the annual rate of return of an investment to measure the investment's volatility and is a basic measure of risk.