

Glebe Administration Board Governance and Investment Management

(A report from the Standing Committee.)

Introduction

Summary

1. The purpose of this report is to update the Synod about the progress of Glebe Administration Board (“GAB”) in revising its governance principles (particularly in relation to the implementation of the recommendations from the review undertaken by an external consultant, Cameron Ralph Pty Limited), and the steps taken by GAB since the last session of the Synod in relation to the investment management of the property for which GAB is responsible.

2. This report supplements the report provided to members of the Synod in May 2010 about the progress of the implementation of the recommendations of Cameron Ralph Pty Limited and is provided in response to the request in Synod Resolution 17/09.

3. This report is divided into the following sections –

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Governance and performance

Functions of GAB

4. GAB is constituted by the *Glebe Administration Ordinance 1930*, and is incorporated under the *Anglican Church of Australia (Bodies Corporate) Act 1938*. It is the trustee and manager of the following property –

- (a) the property held on the trusts set out in the *Diocesan Endowment Ordinance 1984* (known as the Diocesan Endowment), and
- (b) the property held on the trusts set out in the *St James' Sydney Phillip Street Property Ordinance 1962* (known as St James' Hall).

5. As trustee and manager, GAB must invest this property in accordance with the general objective specified in clause 2 of the *Glebe Administration Ordinance 1930*, namely, to preserve the real value of the property and provide a reasonable income there from.

6. GAB is also the trustee of the property held on the trusts set out in the *St Andrew's House Ordinance 1975* (known as St Andrew's House). The management and control of St Andrew's House is vested in St Andrew's House Corporation under clause 1 of that ordinance, and GAB has been appointed as attorney of the Corporation to perform those functions on its behalf. However, GAB now only exercises its powers as attorney of the Corporation at the express request of the Corporation.

7. The members of GAB are the members for the time being of Sydney Diocesan Secretariat ("SDS"). SDS is a separate body corporate, constituted under its own ordinance, with the functions set out in that ordinance.

Governance principles adopted by GAB

8. Since the 2009 session of the Synod, GAB reviewed its approach to governance, and settled a governance statement which outlines its governance framework, policies and procedures. A copy of the governance statement can be found at – <http://www.sds.asn.au/Site/104303.asp?ph=cb>.

9. The governance statement states that GAB's approach to governance is based on a set of values and behaviours which underpin everyday activities, ensure transparency and fair dealing, and protect the interests of the Synod and the Standing Committee. It indicates GAB's commitment to the highest standards of governance which it believes are fundamental to the sustainability of the organization. In preparing its governance statement, GAB was guided by the Corporate Governance Principles and Recommendations published in August 2007 by the Australian Stock Exchange Corporate Governance Council.

10. The governance statement addresses 7 principles –

- 1 – Clear roles and responsibilities for the board, its committees and management
- 2 – Structure the Board appropriately
- 3 – Promote ethical and responsible conduct
- 4 – Integrity in financial reporting
- 5 – Effective communications with the Archbishop, Synod and Standing Committee
- 6 – Identify and manage risk
- 7 – Remunerate fairly and responsibly

11. It is beyond the scope of this report to explain in detail how GAB addressed these principles. Such an explanation is made in the governance statement. However, it is helpful to explain some of the key ways in which GAB's review of governance has impacted its operations during 2010.

12. First, GAB has reviewed its meeting procedures to better enable its members to focus on the key functions of GAB. Previously, on the basis of their common membership, meetings of GAB were held concurrently with meetings of SDS. Now, meetings of GAB are held separately from meetings of SDS and separate agendas and minutes are prepared.

13. Secondly, GAB has reviewed the charters and structures of its committees (the Asset and Liability Committee and the Audit and Risk Committee) to enhance the contribution of those committees to the work of GAB. Generally, the role of the committees is to monitor and review, and make recommendations to GAB.

14. Thirdly, GAB has moved to enhance the accountability of management. All board agendas include a report identifying the matters outstanding, the executive responsibility for attending to those matters and the timetable within which such matters are to be addressed. This report is reviewed as a matter of priority at each meeting. GAB has an annual work plan to ensure that all key issues relating to its functions are reviewed at least annually.

15. The enhancement of its governance practices will continue to be a priority for GAB.

Progress of the implementation of the recommendations of Cameron Ralph

Introduction

16. In 2009, GAB appointed Cameron Ralph Pty Limited (“Cameron Ralph”) to undertake a review of the governance practices of GAB. While this review was prompted by the investment losses of the Diocesan Endowment in 2008 (and which were fully reported to the Synod in 2009 in the Annual Report of GAB for 2008), the scope of the review was not intended to address or explain the causes of the losses, nor propose specific actions in the area of investment management.

17. Following its review, Cameron Ralph made recommendations about the following matters –

- (a) Developing a plan for board renewal
- (b) Clarifying the respective roles of the board and management
- (c) Addressing board culture
- (d) Reviewing the format and content of board papers
- (e) Strengthening the board’s decision making by addressing meeting processes
- (f) Revisiting the committee structure
- (g) Driving accountability.

18. In March 2010 GAB provided a progress report to the Standing Committee about the implementation of the recommendations of Cameron Ralph.

19. The following paragraphs summarise the recommendations of Cameron Ralph, and the action taken by GAB in relation thereto, including the action taken since the progress report provided in March 2010.

Recommendation 1 – Developing a plan for Board renewal

20. Cameron Ralph recommended that a plan for renewal of the board of GAB be driven by the needs of the board and its strategy for

the next 5 to 10 years. It was suggested that the renewal strategy must avoid loyalty and interest in serving on the board being the sole determinants of whether a person remains a member of GAB.

21. Cameron Ralph recommended the implementation of the following steps –

- (a) Identifying at least 4 members for retirement within 3-6 months, and developing a plan for the sensible rotation of membership of GAB thereafter.
- (b) Establishing tenure limits (Cameron Ralph noted that a well accepted practice is fixed terms with eligibility for reappointment up to a maximum period – perhaps 3 terms of 3 years, with a possible extension if a member is appointed Chairman).
- (c) Reducing the size of the board to no more than 9 members.
- (d) Establishing a comprehensive induction program for new members.
- (e) Implementing regular board reviews and performance reviews of each member.

22. The action taken to implement these recommendations is as follows –

- (a) The Standing Committee reduced the size of the membership of GAB on 31 August 2009 when it reduced the number of members of SDS. (The members of SDS are ex-officio members of GAB). The number of members of SDS is now at least 8 members and no more than 10 members. Previously, the number of members of SDS (and hence the number of members of GAB) was 12. Currently, there are 8 members.
- (b) The election of members by the Standing Committee in December 2009 led to a significant turnover in membership of GAB. At that meeting 8 members of SDS were elected, comprising 4 persons who had previously been members of SDS (and hence GAB) and 4 persons who were new members. Members serve for a term of 3 years from the date of their appointment.
- (c) SDS has established which members will retire at the first meeting of the Standing Committee after the session of the Synod in 2010 (although such members are eligible for re-election). The members to retire after the Synod sessions in 2011 and 2012 will be determined early in 2011. At that stage, the process for the rotation of membership will have been settled.

- (d) A proposed tenure policy was submitted to the Standing Committee for its approval on 28 September 2009. The proposed tenure policy was that the maximum tenure of a board member be 9 years (up to 3 terms of 3 years each), and the chairman 12 years. The Standing Committee asked that the proposed policy be reconsidered with a view to increasing the maximum tenure of a member beyond 9 years. SDS has deferred further consideration of the tenure policy until the Synod has considered the recommendations of the Governance Policy Committee appointed by the Standing Committee. SDS understands that Committee will review generally the question of tenure of members of Diocesan boards.
- (e) An induction program for newly appointed members was approved on 15 October 2009.
- (f) A review of the performance of GAB and individual members of the board is to be implemented early in 2011, after the current members of the board have served for 12 months.

23. In summary, GAB considers that the recommendations of Cameron Ralph for developing a plan for renewal of board membership have been substantially implemented. The recommendation concerning a tenure policy will be addressed after the Synod has considered the recommendations of the Governance Policy Committee, and a process for the periodic review of the performance of the board and each member will be implemented in 2011.

Recommendation 2 – Clarifying the respective roles of the Board and management

24. Cameron Ralph recommended that the annual strategic planning day of GAB revisit what GAB should be spending its time on, and how it can maximise its “value add” to the business of GAB.

25. The action taken to implement these recommendations is as follows –

- (a) An annual work plan enabling the review and reconsideration of the key strategic issues for GAB been agreed. This will ensure key strategic issues to be reviewed by GAB on an ongoing basis.
- (b) A board strategic review “offsite” meeting was held on 2 June 2010. On that day, several key issues relating to the business of GAB were considered, and a timetable for the implementation of decisions agreed. It is intended that such meetings be held, at least annually.

26. In summary, GAB believes that the recommendations of Cameron Ralph for clarifying the respective roles of GAB and management have been implemented.

Recommendation 3 – Addressing Board culture

27. Cameron Ralph recommended that GAB take time to discuss how its own culture may impact on its effectiveness and what mechanisms or processes may improve its capacity to deal with future challenges. The development of a set of operating protocols was suggested.

28. GAB was also encouraged to think of new ways of operating that might help develop a more robust culture, including closed meetings where only members were present, creating opportunities for members to meet outside of meetings for social occasions, adding a dinner to the annual strategic planning day and considering the appropriate number of staff present during meetings of GAB.

29. The action taken to implement these recommendations is as follows –

- (a) Operating protocols for meetings of GAB have been adopted. These include protocols which address the presence of staff members at the meetings of GAB.
- (b) Members only sessions occur at the conclusion of all meetings of GAB. Staff are absent from these sessions.
- (c) An informal dinner for GAB members was held after the “offsite” meeting on 2 June 2010. The opportunity will be taken at other times to enable members to meet informally outside of meetings.

30. In summary, GAB considers that the recommendations of Cameron Ralph about board culture have been implemented.

Recommendation 4 – Review the format and content of Board papers

31. Cameron Ralph recommended that a systematic approach be taken to progressively review the nature and format of the information provided to GAB, with a particular focus on value added analysis and non-financial key performance indicators. A short term small working group was suggested to address the issue.

32. The Chairman, Acting Chief Executive Officer and Secretary have spent a great deal of time in reviewing the format and content of board papers as a small working group. As a consequence of that review –

- (a) GAB meetings are no longer held concurrently with meetings of SDS. A separate agenda is prepared for meetings of GAB, and separate minutes are prepared and maintained.

- (b) Agendas are reviewed by the Chairman before being issued to members.
- (c) The agendas are structured to give priority to significant issues.
- (d) Each agenda includes a report about the matters outstanding, the executive responsible for attending to such matters, and the timeframe for attending to those matters. This report is reviewed at each meeting as a matter of priority.
- (e) Reports for the meeting highlight the key issue or issues for GAB's determination. Feedback is sought from members about whether papers contain enough (but not too much) information to enable members to make effective decisions; whether they are written in plain English; and care is taken to ensure they do not contain technical jargon or acronyms, and
- (f) Minutes of meetings of GAB clearly state the action arising from decisions made, the time within which such action to be undertaken, and the responsibility for undertaking such action.

33. Members of GAB have the opportunity to comment at the end of each meeting about the format and content of the papers for the meeting.

34. In summary, GAB considers that the recommendations of Cameron Ralph about the format and content of Board papers have been implemented.

Recommendation 5 – Strengthen decision making by addressing various meeting processes

35. Cameron Ralph recommended that the following meeting processes be addressed to strengthen decision making by GAB –

- (a) extending the length of meetings of GAB to allow for substantive debate, and more comprehensive reporting, and
- (b) limiting the agenda of alternate meetings to one strategic area, and
- (c) revisiting the agenda structure, and
- (d) agreeing clear criteria and key performance indicators for each decision, and
- (e) undertaking a short critique after each meeting about how the meeting was conducted, how the members dealt with matters, and the quality of the debate during the meeting.

36. The action taken to implement these recommendations is as follows –

- (a) GAB meetings now start earlier to allow more time for the meeting, and
- (b) the chairman of each of GAB's committees reports on the affairs of the committee at the following meeting of GAB, and
- (c) key strategic matters are timetabled for consideration by GAB during the year, and
- (d) attention is given to ensuring that there are clear criteria and key performance indicators for each decision of GAB, and
- (e) time to enable members to critique each meeting of GAB is included at the end of each meeting.

37. There is overlap between the actions taken to address this recommendation, and the actions taken to address recommendation 4. GAB considers that the recommendations of Cameron Ralph in relation to the processes for the meetings of GAB have been implemented.

Recommendation 6 – Revisiting the Committee Structures

38. Cameron Ralph made the following recommendations about the structure of the committees of GAB –

- (a) the charter of each committee should be reviewed to put more responsibility back in the hands of GAB, and
- (b) the focus of each committee should be on policy, risk level, triggers for actions and delegations, and the committee should not try to make all decisions for themselves, and
- (c) clear criteria for assessing the performance of committees is required, as is monitoring such performance against such criteria, and
- (d) the chairman of GAB should not chair any committee of GAB, and
- (e) all members should attend the Asset and Liability Committee for a period of time, until they are satisfied that they have sufficient grasp and control over the key issues and the way the investments of GAB are handled.

39. The action taken to implement these recommendations is as follows –

- (a) GAB has amalgamated its Audit Committee and Risk Committee to form the Audit and Risk Committee. The

other committee of GAB is the Asset and Liability Committee.

- (b) Members have been appointed to the committees on the basis of skills and experience. The membership of the Asset and Liability Committee includes people with specialist skills who are not members of GAB.
- (c) The charter of each committee has been reviewed to more expressly incorporate GAB's expectations of the committee and its performance criteria, and to reflect that the role of each committee is generally to monitor, review and make recommendations to GAB, rather than exercise executive authority.
- (d) The Chairman of GAB does not chair either committee of GAB.
- (e) All members of GAB are invited to each meeting of the Asset and Liability Committee, and receive the agenda for each meeting.
- (f) The minutes of meetings of each committee are formally received at the following meeting of GAB, and the chairman of each committee has the opportunity to report about the work of the committee.
- (g) Each committee has or is developing an annual work plan to ensure that all key issues relating to its functions are reviewed at least annually.

40. GAB considers that the recommendations of Cameron Ralph about committee structures have been implemented.

Recommendation 7 – Driving Accountability

41. Cameron Ralph recommended that GAB consider initiatives to create an environment of greater accountability including –

- (a) developing more comprehensive GAB policies, and
- (b) ensuring that all management proposals have clear key performance indicators and objective criteria by which they can be assessed and monitored, and
- (c) establishing a regular process for post implementation reviews, and
- (d) strengthening follow up requests and implementation/ action with management, and
- (e) ensuring regular and robust review of performance of GAB and the performance of individual members.

42. The action taken to implement these recommendations is as follows –

- (a) a governance policy has been adopted by GAB setting out the governance principles adopted by GAB, and
- (b) management establishes clear key performance indicators for major proposals and a timetable for post implementation reviews, and
- (c) the agenda for meetings of GAB contains a detailed report about matters outstanding, the executive responsibility for attending to those matters, and the timeframe for dealing with those matters, and
- (d) GAB will commence conducting annual reviews of its performance and the performance of individual members in 2011.

43. GAB considers that the recommendations of Cameron Ralph about driving accountability have been implemented.

Governance and performance – summary

44. Since the 2009 session of the Synod, GAB has spent a significant amount of time reviewing and improving its governance processes, particularly in light of the recommendations of Cameron Ralph. GAB considers that those recommendations have largely been implemented, noting that the specific recommendations regarding the tenure policy for members and the review of the performance of the board and its members (Recommendation 1) are expected to be implemented in the near future. GAB considers that substantial progress has been made in improving governance within the organisation, and intends an ongoing review of its processes to identify opportunities to further enhance governance.

Investment Management – Diocesan Endowment

Introduction

45. At the end of 2009, GAB reconsidered the way in which investment management of the Diocesan Endowment should be undertaken. In undertaking this reconsideration, GAB sought investment management proposals from 4 of the main asset consultants to other endowments and foundations in Australia and obtained proposals from 3 of those consultants. Subsequently, GAB determined to appoint Mercer Australia Pty Limited (“Mercer”) as its asset consultant under an implemented consulting arrangement. Under this arrangement the role of Mercer is –

- (a) to provide advice on high level strategic issues concerning the investment of the property of the Diocesan Endowment, including its investment objective, risk tolerance, strategic asset allocation, asset class investments and distribution policy of the Diocesan Endowment, and

- (b) to provide advice on and assist with the implementation of the investment arrangements approved by GAB, and
- (c) to monitor and report on all aspects of investment performance.

46. Under clause 2 of the *Glebe Administration Ordinance 1930*, the principal objective of GAB in relation to the investment of the Diocesan Endowment is to maintain the real value of the Endowment and provide a reasonable income there from. Having regard to that principal objective, and with the assistance of Mercer, in early 2010 GAB reviewed the investment objective for the Diocesan Endowment, the risk tolerance, the nature of the asset classes in which the Diocesan Endowment should invest, and the strategic asset allocations and ranges for those asset classes.

47. The framework adopted by GAB for the investment of the property of the Diocesan Endowment is set out in an Investment Policy Statement adopted in July 2010. A copy of that Statement can be found at <http://www.sds.asn.au/Site/104303.asp?ph=cb>. The following sections of this report address the key elements of the Investment Policy Statement.

Investment Objective for the Diocesan Endowment

48. In February 2010 GAB, with the assistance of Mercer, reviewed the investment objective of the Diocesan Endowment. As a consequence of that review the following investment objective was adopted –

“To achieve a real rate of return over rolling 5 year periods of 5% per annum net of external investment management fees and adjusted for tax effects, subject to –

- (A) preserving the real value of the Diocesan Endowment over rolling 10 year periods with a 70% probability, and
- (B) the sum of the distributions from the Diocesan Endowment plus administrative and other costs (not including external investment management expenses) not exceeding, on average over rolling 5 years periods, 5% from 2013.”

49. The investment objective includes not only a return objective, but also a statement as to risk tolerance and a distribution and costs policy. While each of these components is related, it is not necessarily appropriate to measure them over the same time periods.

50. The return objective is stated in the introductory paragraph of the investment objective, namely, to achieve a real rate of return over rolling 5 year periods of 5% per annum, after external management

fees and adjusted for tax effects. For this purpose, the real rate of return is the excess of the nominal return above the corresponding movement in the consumer price index (CPI). The reference to “tax effects” recognises that there are some particular tax characteristics of the Endowment which need to be taken into account in calculating the return (such as recognising that imputation credits can be obtained on dividends paid by Australian companies, but withholding or other similar taxes on overseas investments cannot be reclaimed). Stated simply, the return objective for the Endowment is CPI plus 5% per annum over rolling 5 year periods.

51. Paragraph (a) of the investment objective sets out the statement as to risk tolerance, namely, that the real value of the investments be maintained over a rolling 10 year period with a 70% probability. This statement reflects that the achievement of the principal objective, namely the maintenance of the real value of the Endowment and the provision of a reasonable income there from, requires risk to be incurred. For example, this objective could not be achieved if the property of the Diocesan Endowment was held only in capital guaranteed investments since the return on those investments would be insufficient to enable the real value of that property to be maintained, and provide a reasonable income to pay administration costs and make distributions. The statement of risk tolerance recognises that there is a 30% probability that the real value of the Endowment will not be achieved over a rolling 10 year period. After taking advice from the asset consultant, GAB considers that this level of risk tolerance is appropriate for the Endowment. However, the risk tolerance for the investment of the Endowment will be reviewed by GAB annually with the assistance of the asset consultant.

52. The distribution and costs policy is stated in paragraph (b) of the investment objective, namely, that the sum of the distributions from the Endowment and the administration costs (other than external investment management expenses) is not to exceed 5% per annum, on average, over rolling 5 year periods from 2013. This policy limits distributions and costs to no more than 5% per annum, so as to ensure that the real value of the Endowment can be maintained. 2013 is stated as the commencement for this policy since, under the *Diocesan Endowment (Special Distributions) Ordinance 2009*, distributions to the Synod for appropriation in 2010 (for spending in 2011) and 2011 (for spending in 2012) have been prescribed. Further comment about the distribution and costs policy is made later in this paper.

Asset Classes and Strategic Asset Allocation

53. Having regard to the return objective, the statement of risk tolerance and the distribution and costs policy, and after taking advice from its asset consultant, GAB has adopted the following asset classes, strategic asset allocations (SAA), asset class and rebalancing ranges for the investments of the Diocesan Endowment –

Asset Class	Min %	Rebalancing Min %	SAA %	Medium Term Tilt %	Rebalancing Max %	Max %
Australian Shares	15	20	25		30	35
Overseas Shares – Developed	0	13	18		23	28
Overseas Shares – Emerging (unhedged)	0	1	2		3	5
Direct Property (SAHC)	20	n/a	25		n/a	30
Legacy Assets	0	n/a	0		n/a	3
Total Growth Assets	50	65	70		75	80
Australian Sovereign Bonds	0	7	10		13	20
Global Sovereign Bonds (hedged)	0	3	7	- 3	10	20
'Banking' Operations (net capital)	10	n/a	13		n/a	20
Other cash (not included in the banking operations)	0	n/a	0	+ 3	n/a	30
Total Defensive Assets	20	25	30		35	50

54. Asset classes regarded as “growth” assets comprise 70% of the SAA of the portfolio, and asset classes regarded as “defensive” assets comprise the balance of 30%. There are minimum and maximum limits

for investments in each asset class and, within each such limits, is a rebalancing range.

55. The asset allocation for direct property reflects the Endowment's interest in the St Andrew's House fund, as a proportion of the net assets of the total portfolio. GAB, as trustee of the Endowment, is a holder of a 50% interest in St Andrew's House (the other 50% stakeholder is Anglican Church Property Trust Diocese of Sydney as trustee of the Endowment of the See). GAB considers that the investment in St Andrew's House represents an unacceptable concentration risk given the size of that investment compared with the total net assets of the Endowment. However, it accepts that there is little likelihood of realising the asset in the short term.

56. The strategic asset allocation for the "banking operations" reflects the amount of capital of the Endowment allocated to the banking operations undertaken by the Endowment. Further comment about the banking operations is made later in this paper.

57. The legacy assets comprise a range of illiquid assets currently held by GAB. It is intended that such assets be liquidated in a commercially prudent manner, and the proceeds invested in the other approved asset classes.

58. The "medium term" tilt for the Global Sovereign bonds asset class reflects the asset consultant's view that investments within this asset class are currently overvalued. Accordingly, in the medium term, cash will be retained rather than invested in that asset class.

59. GAB has rules for the rebalancing of investments between asset classes where the holding in an asset class falls outside the rebalancing range, or outside the maximum and minimum limits. Where the holding falls outside the minimum or maximum limits, the Asset and Liability Committee of GAB is to be advised and the breach rectified within 10 working days, subject to available liquidity.

Invested Funds

60. Investments in the Australian shares, Overseas shares, Australian sovereign bonds and Global Sovereign bonds asset classes are undertaken through multi-managed funds operated by Mercer Investment Nominees Limited and approved by GAB. Before the investments in these funds were approved due diligence was undertaken having regard to the investment policies of GAB referred to later in this paper.

61. The transition of investment to those funds in accordance with the strategic asset allocation was completed on 4 June 2010.

62. GAB considers that undertaking such investments by way of such multi-managed funds benefits the Endowment in several respects –

- (a) the multi-managed funds give the Endowment exposure to a range of investment managers, thus reducing the risks associated with over-exposure to any one manager, and
- (b) Mercer, rather than GAB, is responsible for monitoring and assessing the performance of each investment manager, and
- (c) the use of such funds will enable the simplification of the investment processes of GAB and reduce the overall costs of administering the Diocesan Endowment (for example, the use of such funds will enable the winding up of the Glebe Equities Trust which was an internal structure through which investments in Australian shares were formerly undertaken).

Investment policies

63. GAB has reviewed the policies which apply in relation to the investment of the property of the Diocesan Endowment.

Gearing Policy

64. GAB will not borrow or gear the Endowment for investment purposes, except by way of overdraft for short term cash flow needs.

65. The prohibition on borrowing does not apply to the operation of the Glebe Income Accounts, which are conducted as part of the banking operations undertaken by the Endowment. The banking operations are referred to later in this paper.

66. GAB will not invest in any fund that uses gearing to increase the gross value of the assets of the fund. However, this restriction does not apply where the fund consists of real property or infrastructure assets which are partly funded by debt.

Derivatives Policy

67. GAB will not invest in a fund, or an underlying fund, if derivative instruments (such as forwards, future, options, warrants, swaps or other derivative instruments) are used to gear the portfolio or create net short positions.

Currency hedging policy

68. GAB applies the following principles in relation to hedging foreign currency exposure back to Australian dollars –

- (a) The exposure to the overseas shares developed markets asset class is to be 50% hedged unless, on the advice of the asset consultant, a different ratio is agreed.
- (b) All other exposures to overseas asset classes as to be fully hedged, wherever practicable.

69. In May 2010, on the advice of its asset consultant, GAB agreed that a currency hedging position of 40% be adopted for the overseas shares developed markets asset class, as a medium term adjustment to the policy.

70. GAB also recognizes that it is impracticable to hedge the currency exposure to the overseas shares emerging markets asset class and has agreed that the allocation to that asset class may be unhedged. But the currency exposure is taken into account as part of the decision about the level of hedging to apply to the overseas shares developed markets asset class.

Ethical Policy

71. Consistent with the Standing Committee's determination, a fund in which the property of the Endowment is invested, or an underlying fund, must not conduct as its main business, or one of its main businesses, a "disapproved" business, and such fund must not invest mainly in the securities of a corporation of fund which conducts a "disapproved" business" as its main business or one of its main businesses. For the purposes of this policy, a "disapproved business" is one or more of the following businesses –

- The manufacture, promotion, distribution or sale of armaments,
- A business which is illegal or immoral,
- The manufacture, promotion, distribution or sale of tobacco
- The business of gambling or betting or a business directly connected therewith
- The manufacture, promotion, distribution or sale of liquor,
- The production, sale or distribution of "X" or "R" rated video or digital images, videos or films.

Banking Operations

Introduction

72. The banking operations of GAB comprise its lending activities, its borrowing activities (through the Glebe Income Accounts), and its treasury activities (being investments in cash and short term deposits). The banking operations are treated as an asset class, to which a proportion of the net assets of the Endowment is allocated for prudential purposes.

73. The banking operations are a valuable component of the portfolio because of the consistency of the returns from those operations, and because those operations bring greater diversification to the investments of the Endowment. The banking operations also

provide valued services to parishes and diocesan organisations, through the availability of loans and the Glebe Income Accounts.

Allocation of capital

74. GAB allocates a portion of the net assets of the Endowment towards the banking operations for prudential purposes. Having regard to the prudential standards which apply to authorised deposit taking institutions, GAB allocates from the net assets of the Endowment an amount equal to 12.5% of the value of loans made as capital for the banking operations (GAB is not an authorised deposit taking institution). As at 30 June 2010, the value of loans made was about \$110 million. This equates to about 13% of the net assets of the Endowment as at that date.

Loans made by GAB

75. Of the total value of loans of \$110 million made as at 30 June 2010 about \$6 million was lent to parishes, \$59 million to Diocesan organisations, \$28 million to affiliated Christian organisations, and \$17 million to external bodies.

Lending Policies

76. GAB has recently reviewed its lending policies, and determined not to continue lending to external bodies. Existing external loans will be required to be repaid when due. GAB will continue to support Christian ministry by lending to parishes, Diocesan organisations and affiliated Christian organisations when it is appropriate to do so in accordance with its lending policies. GAB's lending policies require that all applications for loans be assessed on commercial terms.

77. One of GAB's lending policies is that the exposure to any one borrower must not exceed 10% of the value of the net assets of the Endowment. There are currently 4 loans which exceed this credit exposure limit – each loan had been made when the total value of the net assets of the Endowment was significantly greater than is presently the case. GAB undertakes a periodic review of the loans and will seek to ensure that exposures are reduced at the earliest possible opportunity. Each of the loans is being appropriately serviced in accordance with the relevant loan terms.

Glebe Income Accounts

78. The Glebe Income Accounts are at call and term deposit accounts with GAB. These accounts are offered to parishes, diocesan organisations, and supporters of the Church. They are operated on the basis of regulatory exemptions granted by the Australian Securities & Investments Commission and the Australian Prudential Regulatory Authority.

79. As at 30 June 2010, the total value of deposits in the Glebe Income Accounts was \$151 million. Of this amount, a total of \$25

million was from parishes, a total of \$27 million was from supporters of the Church, a total of \$22 million was from Church organisations, and the balance was from Diocesan organisations based in St Andrew's House (of which the Property Trust is the largest depositor).

80. About 70% deposits are made on an at call basis. The total amount of deposits has remained very stable in recent years.

Cash and short term deposit policy

81. The cash and short term deposits earn a return for the Endowment and provide liquidity for the Glebe Income Accounts. As at 30 June 2010, GAB had \$57 million invested in cash and short term deposits with authorised deposit taking institutions. A significant proportion of those deposits can be redeemed on 2 days notice should they be required for liquidity management purposes. GAB intends reviewing the cash and short term deposit policy to increase returns, within prudent risk limits.

Standby facility

82. GAB continues to have a bank standby facility, to provide further liquidity support for the Glebe Income Accounts. The amount of the facility was recently reduced from \$50 million to \$15 million on the basis that GAB considered that the larger facility limit (for which there was a substantial fee to maintain) was no longer required.

Ongoing monitoring of risk

83. GAB is reviewing the way in which risk associated with the investment of the Endowment is monitored on an ongoing basis.

84. GAB manages the investment of the Endowment so that under adverse market conditions the expected loss (whether realized or unrealized) from investments and loans over rolling one year periods is not more than 20% of net assets with a 95% probability. This is monitored by GAB using a value at risk (VaR) methodology. Reports about Value at Risk are provided each month to the Asset and Liability Committee of GAB.

85. In addition, stress testing of the portfolio is now undertaken on a quarterly basis. This involves modelling the impact of extreme market conditions (such as those associated with the 1987 share market crash and the 2007 – 2009 Global Financial Crisis) to understand the impact on the Endowment if similar events were to occur in future. The range of adverse scenarios which are modelled is to be widened to enable GAB to better monitor risk associated with the portfolio.

86. The terms of engagement of the asset consultant require it to undertake an annual "health" check of the investment policy and investments of the Diocesan Endowment. This check will include an annual review of the risk associated with the investment of the property of the Endowment.

Distribution Policy

87. The distribution and costs policy stated in paragraph (b) of the investment objective is that the sum of the distributions from the Endowment and the costs of administering the Endowment (excluding external investment management expenses) is not to exceed 5% per annum, on average, over rolling 5 year periods from 2013. This policy limits distributions and costs to no more than 5% per annum, so as to ensure that the real value of the Endowment can be maintained.

88. As noted earlier, 2013 is stated as the commencement for this policy since, under the *Diocesan Endowment (Special Distributions) Ordinance 2009*, distributions to the Synod for appropriation in 2010 (for spending in 2011) and 2011 (for spending in 2012) have been prescribed.

89. GAB considers that the level of distributions proposed by the 2009 Ordinance, together with the costs of administering the Endowment, are too high to enable the real value of the Endowment to be maintained on a rolling 5 year basis. GAB proposes recommending to the Standing Committee by the end of 2010 a new formula to be applied in 2011 and in the years thereafter for determining the level of distributions from the Endowment having regard to the need to maintain the real value of the Endowment to apply in future years. In addition, GAB is taking steps to reduce the costs of administering the Endowment (such as by investing through the Mercer multi-manager funds) although the full extent of the cost reductions will not be evident until 2011.

90. GAB has invited the Standing Committee to consider reducing the amount of the distribution for 2010 (for spending in 2011) prescribed by the *Diocesan Endowment (Special Distributions) Ordinance 2009*, having regard to projections undertaken in July 2010 which indicate that the return of the Diocesan Endowment in 2010 is likely to be significantly below budget by reason of continuing uncertainty in global markets and, in particular, the significant falls in those markets during May and June 2010.

Investment Management – St James’ Hall

91. The St James’ Hall fund (the “Fund”) comprises the property held on the trusts set out in the *St James’ Sydney Phillip Street Property Ordinance 1962* (the “1962 Ordinance”). The main asset of the Fund is the commercial office building known as St James’ Hall situated at 169 Phillip Street, Sydney (the “Property”).

92. The 1962 Ordinance gives the GAB extensive powers of mortgaging and leasing the property.

93. The interest of the parish of St James (the “Parish”) in the Fund is reflected in the following specific provisions of the 1962 Ordinance –

- (a) The power to mortgage the Property cannot be exercised unless and until GAB gives the wardens of the Parish notice of the maximum amount proposed to be borrowed, or any increase in such amount above the amount for which such notice has previously been given.
- (b) GAB may only exercise the power to lease in respect of the "Parish Area" (being levels 1, 2 and 3 of the building, and 4 parking spaces) with the prior written consent of the parish council of the Parish.
- (c) The wardens are entitled to exclusive possession of the Parish Area. The income from the Parish Area, after the deduction of the relevant portion of building expenses, is to be paid to the wardens for the purposes of the Parish.
- (d) A specified portion of the distributable income from the remainder of the Property is to be distributed to the wardens for the benefit of the Parish. (The portion remaining of the distributable income is to be paid to the Synod.)

94. With the agreement of the Parish, an external property manager has been engaged to undertake the property management of the building. GAB consults regularly with the property manager and the Parish about the management of the property.

95. GAB is presently negotiating with a number of tenants in the building for the renewal of their leases which are due to expire within the next 18 months.

96. The Parish is in the course of preparing a further proposal for an ordinance for the Standing Committee's consideration about the distribution of the income from the remainder of the Property (that is, the non-Parish Area) earned in 2010 and in the following years. Such income is being retained by GAB until such time as an ordinance authorising distribution is passed.

St Andrew's House

97. GAB is the trustee of St Andrew's House but, under clause 1 of the *St Andrew's House Ordinance 1975*, responsibility for the management of St Andrew's House is vested in St Andrew's House Corporation. GAB has a power of attorney from St Andrew's House Corporation to permit it to exercise functions in relation to St Andrew's House, but has determined not to exercise any function under that power of attorney except at the express direction of St Andrew's House Corporation. Accordingly, GAB does not exercise any function in relation to the day to day management of St Andrew's House which is the responsibility of St Andrew's House Corporation.

Recommendation

98. The Synod receive this report.

For and on behalf of the Standing Committee

ROBERT WICKS

Diocesan Secretary

16 September 2010