Investment Practices of the General Conference

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Many years ago Ellen G. White wrote about the handling of money: "You need to learn the art of using your talents to the glory of Him who has lent them to you. This requires study, and prayer, and consecration. You should learn the science of handling money aright. Then you will not allow it to pass through your hands without producing anything for God."[1] In view of this counsel, it is appropriate to take a good, long look at the use of not only personal funds but also those belonging to the church.

Comments as to the propriety of church investment in this or that vehicle of investment, or of even investing at all, usually go as follows:

> Do you mean to say that the Adventist church is playing the stock market?
>
> Is it true that an institution has put its funds in a shopping center which is open on Sabbaths and that some of the shops sell things we would never buy for ourselves?
>
> Why does the General Conference invest money that people give with the expectation that it is going directly into mission work?
>
> Wasn't it terrible that the conference association lost its whole investment because a bad decision was made to invest in a project that it should never have gotten involved with at all?
>
> The church should sell all its stocks and bonds and put the proceeds into mission work — where so much good can be done right now.
>
> The vast sums held in reserve in the General Conference could be used to bring a lot of people into the church.

Misinformation and fallacious reasoning are obvious in these queries and statements, and it is certain that not everything can be answered to the complete satisfaction of the critics. However, the persons responsible for administering church financial affairs have an obligation to be certain that the rationale for and approach to investing church funds are correct and logical and that what is done can stand on its merit.

I

Before discussing the specifics of the investment of church funds, I will give some brief background matter on investment philosophy, money markets, and financial objectives.

The word *investment* has different meanings for different groups of people — consumer investment, business or economic investment, and financial or securities investment. All of these vehicles are used at times by church investment personnel, and the effectiveness is determined somewhat by *how* these vehicles are utilized.

Consumer investment refers to the purchase of durable goods by the consumer, with the expectation not only that these goods will be used but also that they may even increase in value over the years. Generally one thinks of this as individual investing, such as the purchase of home, automobile, or other large durable item; but the term has relevance for church organizations and institutions also.

Business or economic investment refers to the use of money to purchase business assets that will produce income or other results. This category would include the investment by a person or a company in productive assets of almost any kind designed to earn a profit — a lease on a building, the purchase of furniture and fixtures, the securing of an inventory of supplies and raw materials, etc. These are examples of business that church organizations and institutions are continually involved in, whether in a conference project, an industry at an educational institution, or a large manufacturing concern.

Financial or securities investment usually refers to the purchase of assets in the form of securities that will produce a profit for the investor, even though he does not have direct control of the assets and must rely on the management talent of others. No new productive assets are created as a result if the investment of the investor purchases existing securities from another owner. In exchange for money, the investor looks forward to future income and profit, and he hopes the security purchased will maintain its attractiveness for others when he desires or needs to part with it.

Defined for the purposes of this presentation, the term *investment* means the purchase of a security that upon an appropriate analysis offers safety of principal and a yield commensurate with the risks assumed. Through a rational process of investment analysis, the investor determines whether a specific investment provides safety of principal, satisfactory yield (rate of return), and minimum risk. All of these, of course, are subject to personal and collective judgment.

Diversification. In the investment of a sum of money, the choice must be made between the *safety* of investment and the *profit* that may be earned. One must never be in the position of having all capital invested in one type of security. A balance should be carefully maintained between (*a*) secure investments that offer less in the form of future income and (*b*) those that are less secure but offer the opportunity of future gains in the form of income or capital gain. *Risk* must always be balanced with *reward.*

No investment vehicle, admittedly, is free from all risk; but spreading insures minimizing of risk. The pull toward greater reward and growth is countered by the pull toward greater security. Administrators responsible for investing church funds must attempt to strike a proper balance by the process of diversification. In essence, common stock investing must be balanced to some degree by fixed income (bond) investing. Too much capital should not be placed in one enterprise, business entity, or industry to the exclusion of others. Geographic diversification may also be considered at times.

SECURITIES MARKETS

Three basic forms of securities — bonds, preferred stocks, and common stocks — (plus convertibles) are used in investing, and the following is a rather simplified explanation of them. (U. S. governmental securities are not included in this discussion, but they also should be understood by investors.)

A *bond* is a long-term senior debt of the issuing corporation in the form of a note given to the bondholder who has lent his money to the bond-issuer. The corporation (debtor) promises to pay to the bondholder (creditor) the face value of the bond on a published maturity date usually at least five years away. A fixed rate of interest is also paid at stated times. Therefore, bonds are correctly called fixed income securities. Since bonds are debts, they are senior to all other securities issued by a corporation, and interest on bonds must be paid before any dividends are available for distribution to shareholders of preferred or common stocks. They are secured in various ways.

Bonds are rated as to quality, depending on the security involved; and the higher the quality, the lower the interest rate. Changes in the financial status of the bond-issuer (thus changes in the rating of the bonds) can affect bond values materially. The safety of a bond is dependent on the ability of the issuing corporation to pay the interest when due and the principal at maturity.

Bond prices are affected directly by the general level and trend of interest rates. If the cost of borrowing money rises, bond prices decline; if interest rates ease, market prices of bonds firm up, thereby providing capital gain opportunities. Yields on most bonds tend to rise as maturity dates lengthen.

The advantage of owning bonds is that they provide a steady source of income and the preservation of capital.

Preferred stocks lie somewhere between bonds and common stocks. Some consider them as neither full debt nor full ownership. They represent limited equity; generally owners have no voting rights. They carry a fixed rate of dividend, but without maturity date or maturity value.

Convertibles, although they are not in the basic three forms of securities, are a most important group to be considered. There are convertible bonds, and there are convertible preferred stocks. They are hybrids in that they are neither complete debt nor complete ownership per se. Under certain stated conditions, convertible items may be converted into the common stock of a company; but until then they are not fully considered as equities, although they have the capacity to become such. They are an excellent investment vehicle when properly understood and carefully followed.

Common stocks (representing basic ownership of a company) are what the average person thinks of when he considers investing in securities. A stockholder buys a part of the ownership of the company — part of the plant, inventory, production, all its properties. Since common stocks represent ownership, they carry no fixed rates of return (dividends), and the amount and regularity of payment depend on the fortune of the company.

When a company first offers its stock for sale, a specific price is set on that stock. But once this stock has been sold to the public — once it is freely traded in the market — its price is determined by what the buyer is willing to pay and what the seller is willing to accept. The price of the stock fluctuates with supply and demand. This is so whether the stock is traded on a regular exchange or in the over-the-counter market, where prices are determined by private negotiation among dealers.

Holders of common stocks cannot be paid dividends until all interest is paid on bonds and until dividends are paid on preferred stocks. However, common stockholders are not limited in the possible rate of return, since they receive no fixed rate of return. If the company does well, the common stockholders may be paid dividends in excess of the return paid on bonds or preferred stocks. Also, as the attractiveness of the company is enhanced, the share value may increase (giving a capital gain), or vice versa (giving a capital loss).

Investing in equities has long been considered a means of providing a hedge against inflation; theoretically, the value of stocks will increase as inflation develops or its rate increases. However, the market at times does not reflect any real reasons for fluctuation, since the tendency is for psychological factors to enter the picture. Over the long term, though, common stocks have indeed provided a good investment vehicle and must be considered by those having funds available to invest.

Investment Companies. Open-end investment companies (mutual funds) are not discussed in detail in this presentation, although they are an important vehicle used by millions of investors. Likewise, closed-end investment companies are omitted here.

BASIC INVESTMENT OBJECTIVES

The three common forms of investment discussed here can be rated in a simplified manner against three basic investment objectives — safety of principal, income, and growth of capital:

	Safety	*Income*	*Growth*
Bonds	most	very steady	usually none
Preferred stocks	good	steady	variable
Common stocks	least	variable	best

Investors who want safety of principal above all else should consider investing heavily in high-grade bonds and quality preferred stocks. Those who want high current income would also choose bonds and preferred stocks. If growth is the investment objective, carefully chosen common stocks would be indicated.

II

An organization the size of the Seventh-day Adventist church, handling the large sums of money entrusted to it, must have definite policies and procedures pertaining to investment philosophy and strategy. Because such policies and practices are related to the times, they must be subject to constant scrutiny, review, and revision. The policies currently in effect have been developed over many years by various administrations in the light of prevailing economic conditions and trends, and they have been considered and modified at the annual councils of the world church organization through the years.

Two articles by Wilfred M. Hillock, of Loma Linda University, appeared in issues of the *Review and Herald,* the church paper, in 1972. Hillock warned against "speculation" as contrasted with "investment." An editorial followed in a third issue.[2] Much of the material in these three presentations, which dealt with how a Christian should look at investing in the securities market, is applicable to church investment policies and practices. It provides background for understanding the sensible and rational approach to investment that might be appropriately engaged in by the church.

Because the General Conference is responsible for a large pool of capital, the controlling investment and securities committee decided in 1967 to retain professional investment counsel. (This took place at the time the "unitized funds" program, described later in this article, began operation.) Lionel D. Edie & Company, Inc., of New York City, was chosen to do the research, analysis, and selection of securities for the General Conference portfolio. Members of the investment section of the Treasurer's Office work very closely with Edie & Company and keep in communication by telephone and in-person conferences for detailed review of current and projected trends in the economic and money markets.

Various funds of the Seventh-day Adventist church are available for short-term and long-term investing, including working capital as defined by policy, certain reserve funds, pension funds, funds appropriated but not yet called for, etc. Since all but the pension funds must be available in fairly liquid form, the policy is that these funds be invested in banks, savings and loan associations, governmental obligations, high-grade commercial paper, corporate bonds, and equities (stocks). A high degree of safety, it is believed, is built into all of these investment vehicles.

The investable funds of a church organization come from two basic sources: (*a*) funds actually *owned* by the church and (*b*) funds held in *trustee* capacity, in either revocable or irrevocable form.

OWNED FUNDS

Investments of *owned funds* are limited by policy to the following:[3]

Commercial banks.

Savings banks.

Savings and loan associations or building societies.

Short-term obligations of the federal government.

Federal agency issues.

Commercial paper (rated "prime" or "A" only).

Bankers' acceptances.

Church unitized funds.

Building sites for conference and church projects and church-owned employee housing (subject to availability of excess operating capital of a nontithe source).

All of the items except the last have a high degree of liquidity, which is essential in this area of owned funds; only a very limited amount of capital, if any, would be invested in the last item.

These policy provisions and restrictions are applicable to all entities of the church organization — the General Conference, division conferences, union conferences, local conferences, and institutions. Administrators and controlling committees and boards do not have express or tacit license to go beyond the foregoing forms of investment. By policy, only unitized funds of the church organization may invest owned funds in bonds and stocks.

53 TRUSTEE FUNDS

An increasing number of deferred-giving vehicles are being used in church organizations and institutions, and this practice has resulted in a large increase in the assets for which the church organization is responsible. Since the corpus of these trusts many times is in the form of cash, definite stipulations have been included in the overall investment policy. Basically, funds held in *trustee capacity* are to be invested in the same investment media as owned funds are, with the following exceptions and limitations (and with additional types permitted):

1. There is a 75 percent limitation on the investment of trustee funds in unitized funds.
2. The final item listed under the owned-funds policy is not allowed for trustee funds.
3. Provision is made that up to 25 percent of the total of trustee funds may be loaned to approved church projects under certain conditions.
4. Up to 50 percent of annuities and irrevocable trust agreements involving cash may be invested in first mortgages on real property under certain limitations. Included in this 50 percent is a special provision for investing in U. S. Post Office facilities.

UNITIZED FUNDS

In order to serve not only the General Conference proper and its organizations and institutions, but also to assist the worldwide component organizations, the General Conference has established special "unitized" funds which are operated in a manner similar to mutual funds. All unit-holders (conferences, unions, divisions, the General Conference, and church-owned institutions) own a proportionate share of the unitized funds, on the basis of the amount invested; and unit-holders share in the investment income and capital appreciation.

The General Conference operates these funds to provide the organizations and institutions of the church with a place to invest funds. This is especially important, since church policy does not permit organizations and institutions to invest in bonds and stocks except as particular union conferences by choice operate unitized funds. (Only one union conference has chosen to do this.)

The two main unitized funds operated by the General Conference are (*a*) the Investment Fund and (*b*) the Income Fund. The Investment Fund is a balanced growth fund with moderate current income and reasonable growth as objectives. The Income Fund has a high current-income objective, with less emphasis on growth. Full disclosure is made to the unit-holders of all equity positions (preferred and common stocks) held by the funds, with indication given as to purchases and sales made during the quarter.

The Investment Fund did well in 1972, with a total performance of 14.17 percent for the year. This compared favorably with the mutual fund industry as a whole and with the well-known popular indices. The Income Fund did not do too well in 1972, as was the case with other similar funds, but it did pay out 6.24 percent in current income (which is in excess of the minimum yield objective of 6 percent per annum). (By Internal Revenue Service regulations, the Income Fund can be used for the investing of the corpus of life income agreements, and certain legal limitations relating thereto some-

CASH MANAGEMENT AND SHORT-TERM INVESTMENTS

The investment section of the General Conference Treasurer's Office also has the responsibility for the overall cash management activities of the General Conference Office itself. This entails a daily review of the domestic bank balances of the General Conference, the corporation, the unitized funds, and the pension funds. Minimum operating balances are maintained in the various banks; and projections are continually reviewed and revised, so that funds not immediately needed can be placed in short-term investments (such as U. S. Treasury bills and prime quality commercial paper). This close attention to bank balances and to the investing of short-term funds results in a sizeable amount of earnings each year.

In order to have expeditious use of funds, the General Conference has arranged for union conferences to remit funds to the General Conference by bank wire transfers; and this same procedure is used for the settlement of securities sales.

The use of the "float" (checks issued but not yet cleared at the bank) is also a source of interest income, since these funds are kept invested until the projected time of the arrival of the checks at the banks for payment.

III

Through the years, the General Conference administrators have given careful attention to the selection of companies in which the church will invest funds. Basically, investment is made only in companies whose major products and services are compatible with church standards and values. Obviously this practice eliminates investments in companies dealing in liquor, tobacco, entertainment, meatpacking, etc. Most investments are in companies listed on the New York Stock Exchange or in high-quality over-the-counter issues.

CORPORATE RESPONSIBILITY

Near the end of 1971 and on into early 1972, a great amount of interest developed in the matter of church investments and corporate responsibility. One of the first major articles in a national news magazine appeared in the September 20, 1971, issue of *U. S. News and World Report.*[4] The Seventh-day Adventist church was represented in this article as a "prosperous denomination" and as "still aloof" toward corporate responsibility. Both of these interesting observations are not entirely inaccurate.

The Adventist church has never taken an official position in regard to restricting investments to those companies that are "socially responsible" in respect to fair employment, military contracting, pollution control, product safety, race relations, and similar policies. Some universities and religious bodies in recent years have taken a growing interest in these matters and appear to be exerting at least limited influence on the activities of some companies.

At the time of the annual shareholders' meetings in 1972 a great amount of publicity was given to the campaign of five of the major Protestant denominations for information and disclosure on the involvement of six corporations having major activities in racially separated South Africa. A report released earlier had indicated the amount invested by churches in military contractors, and the figures given were significant.

In 1972 Yale University decided to become active in corporate responsibility, and the 500-million-dollar Yale endowment stock portfolio is being invested according to guidelines laid down in the 208-page treatise entitled *The Ethical Investor* jointly written by two Yale professors and a former Yale seminarian.[5] This book has become almost a nationwide guide for universities as they have taken some steps in the direction of selecting companies that are more socially responsible than others.

A few mutual funds (including one by the giant Dreyfus group) invest only in companies that are "benefiting society," such as in the areas of equal and nondiscriminatory employment practices, occupational health and safety, product safety and purity, impact on the ecological environment, military contracting, etc. From the monetary and economic viewpoints, however, their performance has not been too satisfactory, and this fact has dampened the enthusiasm of potential private and institutional investors.

According to a report prepared and released under the auspices of the Ford Foundation, awareness of the social ramifications of business activities is growing among banks, mutual funds, insurance companies, foundations, universities, and churches. This report was prepared by Bevis Lonstreth and H. David Rosenbloom, two lawyers who served as consultants to the Ford Foundation during its examination of its own investment policy.[6] The report particularly pointed out that some religious groups and insurance companies are devoting portions of their portfolios to socially oriented investments where economic factors are not controlling.

During the past few years the General Conference has involved itself in a limited way by the holding of certificates of deposit in United States banks that are minority-owned, minority-operated, and serving blacks and other racially oriented minorities.

The idea of a corporate social audit has captured the imagination of social critics, businessmen, consultants, and professional accountants alike. Such groups as the Council on Economic Priorities, the National Council of Churches' Corporate Information Center, and the student-led Committee for Corporate Responsibility have all had a try at auditing individual companies' social performance in the areas of minority hiring, defense contracting, or pollution. Even the American Institute of Certified Public Accountants has appointed an eight-man committee to develop some guidelines and standards for measuring social performance, a task which, admittedly, will be difficult if not impossible.

The concept of a corporate social audit implemented by certain groups involves an attempt to determine how well a particular corporation is doing in meeting its social responsibilities. This concept has been studied very carefully by two professors at Harvard Business School, Raymond A. Bauer and Dan H. Fenn, Jr., who coauthored a book entitled *The Corporate Social Audit.*[7] Their findings indicate that during the time they were conducting their research (1971 and 1972) a notable change took place in the way companies assessed their social contributions. These writers contend that the community at large is not so much interested in the *results* of various social programs as in the answer to one key question: Is the company really trying?

A Seventh-day Adventist student in the Graduate School of Journalism at Columbia University, Tom Dybdahl, wrote his master's thesis in 1972 on the subject of the investment policies of the churches that are members of the National Council of Churches. Subsequently he prepared a forthright and well-documented paper on the subject as it relates to the Adventist church. This paper was sent to the twenty-five members of the investment and securities committee of the General Conference and is under consideration by them.

One rather difficult aspect that has not yet been legally resolved has to do with the investment of trust funds. It has been a well-established rule that funds held for others must be invested by a trustee in a manner which will bring the maximum economic benefit to the trustor. Obviously, the introduction of other criteria complicates investment practices.

Just how far social and corporate responsibility will go is still very much a matter of conjecture. Most certainly the question should be followed rather closely on a continuing basis by religious, educational, and charitable organizations.

CORPORATE MANAGEMENT

At a seminar I attended in April 1972 in New York City, Roger Murray, the well-known Columbia University Business School professor, spent considerable time on the question of investors' attempting to influence management. He presented what he termed two creeds for discussion by the group.

> *Creed One.* I am an investor in equity securities and seek to maximize my total return by picking stocks that outperform a random selection of issues. This is a difficult enough task so that I ought not dissipate my time, energy, and analytical skills trying to substitute my judgment for that of corporate managers in specific business decisions. I intend to hold a stock just as long as I think it will afford my portfolio a superior return. If I think management is making inferior decisions, my job is to liquidate my investment promptly, not to try to change those decisions. I must remember at all times that I am an investor, not an owner or a manager of the business.
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> *Creed Two.* When I become a stockholder, inevitably I become a part owner, and I cannot escape my responsibilities. In the first place, I believe corporate managements need to have informed and experienced stockholders who continually review their

performance. The system will not work well if self-perpetuating managements are accountable to no one. In the second place, moreover, I know that I cannot always see trouble ahead and get out of a stock position before the price is affected. This means that on occasion I will improve my performance by staying with a situation, acting as an owner, and bringing about change in a portfolio company. If I perform my critical function well, I can even hope to prevent some problems. In the process of acting like an owner, in any event, I shall improve my chances of obtaining an early warning signal of impending problems.

Thus far, the General Conference has followed Creed One, regardless of pressure at times from dissident shareholders who have solicited the church's proxies at annual corporation shareholder meetings. In rare instances, the church representatives have remained neutral in proxy battles, but as yet they have not resorted to an antimanagement stance.

A tremendous amount of time and effort must be expended just to service the rather large pools of capital entrusted to the church. Hence, the responsible persons have not felt it worth while to maintain an enlarged staff such as would be required to investigate carefully the issues involved in proxy fights and other disputable areas. The attitude of the General Conference has been to liquidate its position in any company when confidence in its management is lost.

CONCLUSION

The responsibility of properly investing church funds is most important to the progress of the worldwide Adventist program, and the General Conference investment section takes this responsibility most seriously. In late 1969 a series of seven articles on the general subject of financial procedures was written by the treasurer of the General Conference, Kenneth H. Emmerson.[8] These appeared in the *Review and Herald* first and were subsequently combined to form a booklet entitled *Financing a World Church.* Copies are available on request to the Treasurer's Office.

The conservative and progressive policies that the General Conference has tried to formulate through the years are always under review and refinement, as I have mentioned earlier. Also, attempt has been made to secure the best counsel available to guide in the selection of investments.

It is impossible to operate an investment program counter to the prevailing economic and market trends. But the intention is to have proper safeguards to cushion against severe declines when they occur. The expectation also is to participate at least moderately in rising markets. In other words, the objectives are to insure protection in down markets, some of the action in up markets, but prudence and caution in all markets!

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