December 2012

DISTRIBUTION & SPENDING POLICIES

CONSIDERATIONS FOR IWI

"Ma te huruhuru te manu ka rere"

"Distribution policy" in this report refers to the allocation of commercial and investment returns between iwi spending and investment.

bnz

E rua tau ruru
E rua tau wehe
E rua tau mutu
E rua tau kai

Two years of wind and storm
Two years when food is scarce
Two years when crops fail
Two years of abundant food

There have been lean years for Māori, and as we enter into a time of prosperity for Māori we need to look at how we can protect current assets for use by future generations yet still meet the needs of today, and part of that is to understand the best way to allocate Māori and iwi income between spending today and investment for tomorrow.

BNZ recognises the importance Māori place on an intergenerational perspective. The goal of this report is to assist iwi, Māori land trusts, and other long term intergenerationally focused organisations in forming sound policies to govern the decision on how much to spend today and how much to invest for tomorrow.

The approach taken can have a critical impact on intergenerational fairness, spending stability and overall wealth generation. A small misalignment now can have a very large impact when compounded over the very-long term focus of many iwi. But, despite often being topical, there does not appear to be a lot of framework development or formal publication on the issue amongst the wider Māori community.

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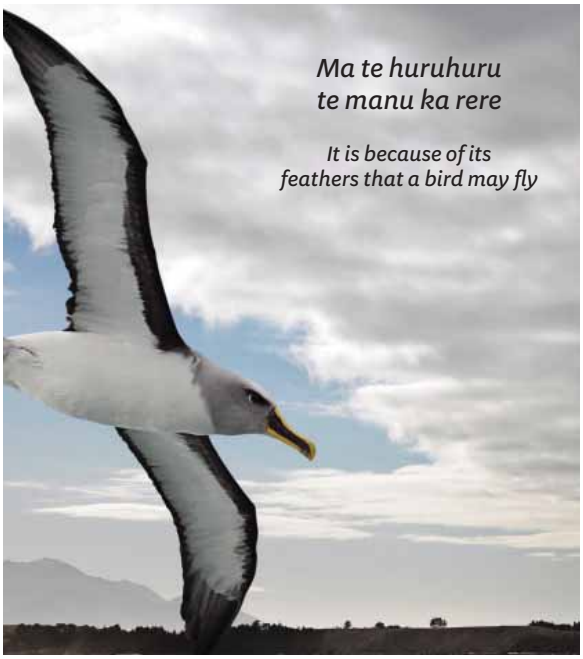


EXECUTIVE SUMMARY

Introduction

In Part 1 of this report we discuss important issues relating to the allocation of iwi[1] income between annual spending and investment, including the challenges of balancing the sometimes competing objectives of intergenerational fairness, stable income to fund spending and strong wealth creation. We close this part with iwi Q&A on distribution policies, with a generous contribution from Mike Sang of Ngāi Tahu.

In Part 2 we turn our attention to iwi spending policies, with a special focus on universal cash payments to iwi members. This is an issue that may attract more attention as iwi wealth and incomes continue to grow.

PART 1: DISTRIBUTION POLICIES

How to best allocate income between spending and investment?

Each year iwi commercial assets and investments generate returns. In deciding how to allocate those returns between spending today and investment for tomorrow, iwi make a number of important tradeoffs.

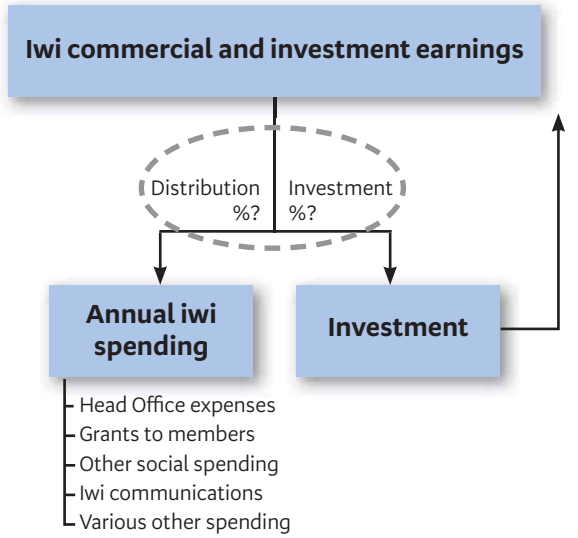
A desire to achieve intergenerational fairness, for example, means that over time the annual split between spending and investment needs to be fair to both current and future generations. A high investment rate today, at the expense of spending, might not be fair to the current generation. Likewise, a low investment rate today might limit the funds available for spending in the future and disadvantage future generations.

The decision on how much to invest versus how much to spend each year can also be complicated by the volatility of returns. Iwi may want distributions from commercial assets and investments to be stable from year to year, so they can plan and budget their spending effectively. But returns can be volatile from year to year, and there can be a risk of spending too much in the good times and not having enough when times are hard. The right disciplines are needed in order to achieve a strong and stable income flow for annual iwi spending and a satisfactory intergenerational fairness outcome, whilst maintaining an asset base that is sustainable in perpetuity.

1 For the sake of brevity references to iwi also include Māori land trusts and other long term intergenerationally focused organisations.

*Achieving the best balance of iwi financial outcomes requires an appropriate investment policy governing commercial assets and other investments. It also requires an appropriate policy for balancing the level of iwi spending and investment each year. We refer to this as the "**distribution policy**", and it is the main focus of Part 1 of our report.*

The distribution decision: What's the best split?



For clarity, please note that in Part 1 of this report we have referred to iwi grants to members as 'spending' rather than 'distributions'. We have endeavoured in Part 1 to reserve the term 'distribution' to refer to how much of an iwi's income is spent rather than invested.

Current iwi distribution policies

Different distribution strategies are used by iwi. Examples include:

- Ngāi Tahu's Investment Policy Framework includes a policy rule for determining the level of distribution from the commercial and investment activities to be used for iwi spending. The annual distribution is partly linked to the value of equity invested. The Q&A with Mike Sang, CEO of Te Rūnanga o Ngāi Tahu, in section 1-11 of our report discusses Ngāi Tahu's approach in more detail.
- Waikato-Tainui's commercial and investment operations have, in recent years, focused on providing a consistent dividend each year.

Many iwi do not publish their policy relating to annual distributions. We expect that some of these iwi may use a discretionary approach. They might decide how to allocate income on a case-by-case basis, taking each year as it comes.

Such an approach may have been put in place deliberately, or have come about by default.

The adoption of a discretionary approach might reflect an iwi being at an early stage of commercial development, still awaiting progress on treaty settlement; or an iwi with otherwise insufficient income to warrant a formal distribution policy.

Ngāti Whātua o Ōrākei will provide an interesting new reference point as its income levels increase significantly. The commercial and investment activities will generate high levels of income relative to the number of iwi members. The governing entity is moving away from a charitable structure - partly to provide greater flexibility around distributions.

Distribution rules used by overseas permanent funds

We have examined the distribution policies used by permanent investment funds overseas for allocating their annual earnings between: (i) investment and (ii) distributions to their parent organisation for annual spending.

Like iwi, many permanent funds overseas need to ensure they maintain their asset base in perpetuity, while generating a regular income flow to finance the not-for-profit activities of the organisation they support.

Key observations include:

- The approach permanent funds take to managing their portfolios has refined and developed over the last hundred years, and distribution polices have needed to evolve accordingly.
    - Early funds concentrated on "fixed income" types of investment and it was fairly straightforward to determine annual distribution payments using the value of income generated.
    - Since the 1950s there has been more emphasis placed on portfolio diversification and a shift from a pure income focus to a total return focus (i.e. income plus capital gains). This shift brought about a change in distribution policies. Permanent funds started using the market value of their investment fund, rather than the fund's annual income flow, to determine annual distribution payments. They needed to do this because a significant portion of their returns was now in the form of capital gains.
    - Using the value of an investment fund to calculate yearly distributions can lead to distributions being volatile from year to year. Rules have been developed to smooth this volatility and provide more stable funds for annual spending.
- Today a variety of rules are used by overseas permanent funds to determine the annual level of distribution. These include:
    - Simple discretionary or income-only approaches;
    - Rules linked to a moving average of the market value of the portfolio;
    - Rules which determine an appropriate starting level of distribution and then grow it each year; and
    - Hybrid rules which combine a formula linked to the market value of the portfolio with formulae to provide distribution stability (Ngāi Tahu use this type of approach).

The "Yale Rule" is often cited as an example of best practice in the US. It is designed to provide stability in annual distributions and to be responsive to changes in the value of the investment portfolio.

The rules adopted by permanent funds seek to provide sustainable distributions and the settings they use will typically account for the effects of inflation. An overview is provided in the following table.

Summary of the main methods for allocating income between investment and spending

Rule Category	Method of calculating distributions	Features	Examples of possible relevance to iwi *
Discretionary	• Decide an appropriate level of distribution each year.	• Flexible, but long term sustainability could be an issue and distributions may not be stable.	• Might suit some iwi who want maximum flexibility and who have the ability to adjust spending as required. • Requires careful governance. Achieving intergenerational fairness and growth in the asset base could be very challenging.
Income Only	• Spend current income but leave the principal intact. May invest some income to protect the principal against inflation.	• Encourages conservative investing that emphasises income, which may limit long term growth. • Protection against inflation only if sufficient income re-invested.	• May suit some iwi with extremely limited funds who require very stable income to meet a tight annual spending budget.
Inflation-based	• Determine an appropriate starting annual distribution level and then grow it each year at the rate of inflation. • May use cap and floor levels, expressed as a percentage of the value of the investments.	• The chosen starting level of spending has a critical impact. • Without cap and floor levels it is de-linked from moves in the value of investments, which creates a risk that future distributions might not be sustainable.	• Might suit some iwi that wish to focus on running a low level of spending for a period of time while they build up their investments.
Market Value	• Each year distribute a specified percent of the market value of investments. • May use the market value at the start of the year or a moving average of recent years. • The distribution rate is set at a level which leaves sufficient returns invested to allow for the effects of inflation.	• Allows total return investing, which should, over time produce higher returns than a conservative income-focused fund. • Distributions lack predictability and can be prone to volatility. • Moving average approach is widely used in the US and provides more stable distributions than rules using the market value at a single point in time.	• Iwi seeking to maximise long term growth in their asset base are likely to focus on total return investing rather than investing just for income. • The Market Value approach provides a method for determining distributions when some investment returns are coming from capital gains.
Yale/ Stanford	• Current year distribution is a weighted average of (i) last year's distribution, adjusted for inflation, and (ii) the policy target distribution rate (e.g. 5%) multiplied by the market value of the fund.	• Combination of stable year-to-year spending and linkage to changes in market value of portfolio, with moderation. • The weightings provide an organisation with the means to customise a policy that balances its needs.	• May be suitable for iwi who are investing on a total return basis, but who want greater stability in annual distributions than that provided under a Market Value approach.
Stabilisation Fund: Alpha/Beta	• Returns from the investment portfolio that are in excess of the target distribution rate are placed in a separate fund (the "stabilisation fund") and invested alongside the main portfolio. • The stabilisation fund can be drawn down when the performance of the main portfolio is below the target distribution rate.	• Can be effective in achieving intergenerational fairness objectives and maximising total benefits (total distributions + portfolio growth) over time. • Distributions are sensitive to market volatility. • Can be combined with a Yale approach to trade off some of the value generated in return for the greater distribution stability.	• Versions of the stabilisation fund approach, such as the Alpha/Beta method, may appeal to iwi who wish to run a liquidity buffer alongside their main portfolio of commercial and investment assets. • Some versions of this approach allow the stabilisation fund to run negative balances at times. This particular aspect may not suit iwi who prefer not to use borrowings to support distributions.
Milevsky Brown	• Parameters set in order to achieve a high probability (e.g. 95%) of achieving the desired outcome.	• Can be effective in preserving the real value of capital, but is complex to calculate and reliant on assumptions. • Higher volatility in distributions.	• The administrative complexity and distribution volatility is unlikely to suit many iwi.

** This column does not provide an exhaustive list. It is not meant to be prescriptive in any way and the intent is only to provide examples for consideration.*

Appendix 1 of the report outlines the distribution policies used by a selection of overseas institutions operating permanent funds. The distribution rules outlined here are a starting point only. Multiple variations are possible and each organisation needs to do their individual analysis, and adopt or customise rules to suit their situation and objectives. Strategic spending for example, such as spending on large infrastructure assets, can benefit multiple generations. However, the cost might not be met proportionately by current and future beneficiaries. This needs to be taken account of when assessing appropriate distribution rates.

Some iwi may not feel the need for a distribution rule at all and may be comfortable with a discretionary approach. But at the very least, it is prudent to monitor aspects such as intergenerational fairness and the purchasing power of income generated by assets held, and to ensure appropriate governance is in place.

What distribution rate is sustainable in perpetuity?

- The "distribution rate" typically refers to the ratio of the annual distribution amount[2] to the total equity value of the investment portfolio. In the case of iwi, investments might include commercial businesses, property and fishing quota, in addition to market securities such as shares and bonds.

In considering what distribution rate is sustainable, several US studies suggest that paying out an amount equivalent to 5% of a portfolio's market value each year would be too high for many US permanent funds, and wouldn't leave enough in the fund to fully compensate for inflation.

- The sustainable distribution rate for New Zealand iwi will vary on a case-by-case basis. It depends on factors such as the composition of commercial assets being included in the distribution calculation. For example, some iwi may hold large amounts of commercial land not yet developed and not producing income, that might be excluded from the distribution calculation.
- An iwi would need strong justification to support an underlying annual distribution rate equivalent to 5% or more of the value of equity they have invested in commercial assets and other investments. To generate sufficient returns they would need to consistently outperform many US endowment funds (assuming a similar risk profile). Otherwise there is a risk that their distribution rate might not be sustainable over the long term, and that the value of their investment base might not keep pace with inflation.
- Generally, the US endowment fund material we reviewed did not consider intergenerational fairness from a per-person perspective. Most US university endowment funds are not established with the intent of sustaining a growing number of beneficiaries. However, iwi may wish to take population growth into account, in accordance with their intergenerational fairness objectives.
- As an example, let's say an iwi wants the ratio of the amount they spend each year divided by the number of iwi members to be consistent over time (adjusted for inflation). Let's also assume that the iwi's population is expected to grow at 1.3% per year and their portfolio or balance sheet is split 35% into income assets (e.g. bonds and term deposits) and 65% into growth assets (e.g. shares in companies). The table below provides indicative sustainable distribution rates, showing how the rate varies under different assumptions for tax and population growth.

Indicative sustainable distribution rates for an example portfolio

		Effective tax rate	
		0%	**28%**
Population growth	**0%**	5.0%	3.4%
	1.3% p.a.	3.7%	2.1%

Source: BNZ Private Bank

Because each iwi's portfolio of commercial and investment assets requires unique analysis, we stress that these figures are a starting point only, and not a substitute for the expert investment advice that is ultimately required.

PART 2: SPENDING POLICIES

In this Part of the report we look at some of the issues and current practices relating to iwi spending policies.

- The starting point for establishing appropriate spending polices (and for that matter distribution

2 ie. the amount available for annual iwi operating expenses, grants and other spending.

and investment policies as well) is an iwi's core values and objectives (desired outcomes). These need to be clearly articulated, and for many iwi this will already be the case.

- Historically, many iwi have structured their organisation as a charitable trust, which can operate with favourable tax status (tax rate of 0%), but is subject to limitations on how funds may be used. Newer iwi structures are tending to take a different approach.
- Ngāti Whātua o Ōrākei will provide a useful new reference point for a non-charity, as their income ramps up.
- Operating separate business units for achieving commercial and social objectives provides clarity of focus and accountability. Many iwi organisations are now structured this way.
- Some iwi spend on a wide range of tribal development and support activities. With less wealthy iwi, spending tends to be predominantly directed towards tribal operational expenses and discretionary grants.

Focus topic: Universal cash payments to individual iwi members

In this focus topic we touch on some of the issues and overseas experience in relation to universal, direct cash payments to individuals (often referred to as "per capita payments"). In New Zealand, direct payments by iwi to individual members have typically been targeted and in the form of small grant schemes to assist in areas such as education, sporting development and health. However, as iwi wealth grows, so does the capacity to increase returns to tribal members and the political pressure to do so.

- Regardless of philosophical position, an overriding constraint on making per capita payments is the availability of cash. For some iwi the capacity to pay universal cash distributions is very limited.
- We note that amongst American Indian tribes the decision on whether or not to make per capita payments is very tribe-specific. Having a large amount of tribal revenue available does not necessarily mean that a tribe will choose to make per capita payments.
- Some American Indian tribes attach conditions to per capita payments to promote desirable behaviours. For example, deductions from family entitlements when children show a poor attendance at school.

Cash (and tax) constraints aside, the choice of whether it's better to make universal cash payments to individuals or not comes down to the objectives and values of individual iwi. This is a crucial point, and it's a judgement call.

While not the same as universal per capita cash payments, Ngāi Tahu's Whai Rawa savings programme does provide the opportunity for iwi members to receive direct payments. Under the programme Ngāi Tahu match members' savings contributions, subject to a specified annual limit and certain other conditions. Unlike universal cash payments, recipients need to contribute their own capital and expose it to investment risk; and face a delay before they can access the benefits. Importantly, the programme encourages desired behavioural outcomes (e.g. saving habits).

Appendix 2 of the report provides a case study of the Alaska Permanent Fund - an interesting example of a fund with an intergenerational focus that makes universal cash payments to individuals.

Summary comments

- **Policies governing the allocation of income between spending and investment can have a profound impact on long term iwi outcomes and need careful consideration. There does not appear to be a lot of formal framework development across the wider iwi community, but we expect greater focus on this area as iwi incomes grow and settlements progress.**
- **A range of approaches for determining the best spending/investment allocation have been adopted by permanent funds overseas. No one size fits all, and different approaches - or combinations of approaches - may suit different iwi.**
- **The proportion of income being spent each year needs to be sustainable over the very long-term if intergenerational fairness is important. If the spending rate is too high, then the value of the underlying assets won't be able to grow sufficiently to keep pace with inflation. US evidence suggests that the sustainable annual amount of spending is probably less than 5% of the value of equity invested.**
- **If an iwi is seeking to sustain their real (inflation adjusted) level of spending on a per-person basis, then they need to allow for population growth.**
- **Given the potential for the world to enter a low-growth, low-inflation environment, the ability to distribute at past levels may be severely restricted for some time.**
- **Structural separation of iwi commercial and social operations enhances clarity and accountability.**
- **As iwi wealth grows we may see more debate around the issue of universal cash payments to members. Ultimately the approach taken is a judgement call, which may vary across iwi. If adopted, universal cash payments can be structured in ways which promote desirable social outcomes.**

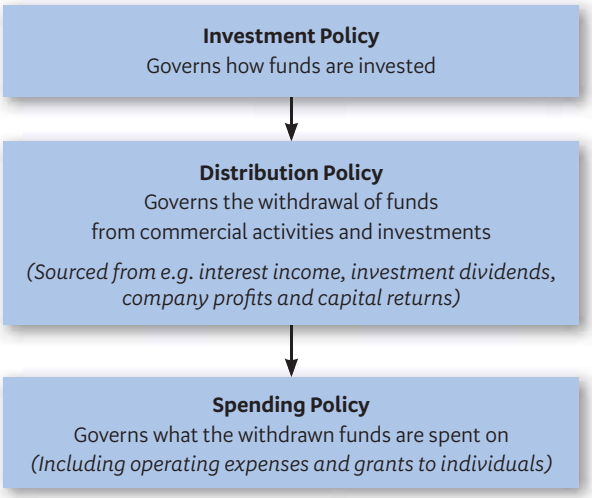
PART 1:

Distribution Policies

How to best allocate income between spending and investment?

1.1 Introduction

Managing iwi[1] investments (including investments in commercial activities) and the returns they generate can be viewed in three parts:



The primary focus of Part 1 of this report is on key issues relating to iwi distribution policy. The approach taken can have a critical impact on achieving iwi objectives and we hope this report will assist iwi in forming sound policies.

We look at the different approaches to distribution policy taken by some iwi so far and some of the approaches taken by charitable organisations in other countries as they seek to balance current spending demands with other objectives such as intergenerational fairness ("intergenerational equity").

As iwi wealth and income continue to grow, wider avenues for investing and distributing funds can be considered, and we believe there will be increased focus on distribution policy in the coming years. Several larger iwi have already developed and refined their approach in this area.

Please note: Our report is intended to be an aid to discussion, rather than a complete guide.

1 For the sake of brevity references to iwi also include Māori land trusts and other long term intergenerationally focused organisations.

Throughout the report we often use the term "investments" to capture both:

i. Commercial enterprises owned by iwi (such as fishing interests, dairy farms, forestry assets, commercial properties, tourism ventures and other businesses); and

ii. Portfolio investments (such as shares in listed companies and bonds).

For clarity, please note that in Part 1 of this report we have referred to iwi grants to members as 'spending' rather than 'distributions'. We have endeavoured in Part 1 to reserve the term 'distribution' to refer to how much of an iwi's income is spent rather than invested.

1.2 Distribution policy: Managing important trade-offs

Each year iwi commercial assets and investments generate returns. In deciding how to allocate those returns between spending today and investment for tomorrow, iwi make a number of important tradeoffs. For example:

- A desire to achieve intergenerational fairness means that over time the annual split between spending and investment needs to be fair to both current and future generations.
    - A high investment rate today, at the expense of spending, might not be fair to the current generation. Likewise, a low investment rate today might limit the funds available for spending in the future and disadvantage future generations.
- There might also be a desire to maximise the total benefits to iwi members, over the very long term.
    - It is possible that a high investment rate today might lead to higher iwi wealth and income overall. But it might benefit future generations disproportionately.

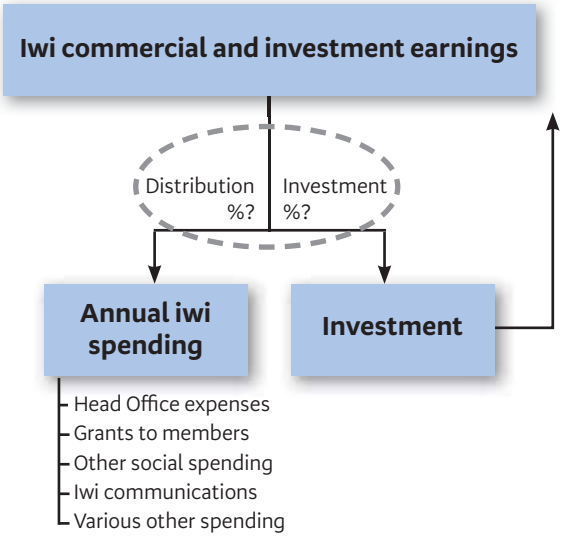
Iwi may also want distributions from commercial assets and investments to be stable from year to year, so they can plan and budget their spending effectively. Achieving stability also involves trade-offs. For example:

- Investing in a portfolio of government bonds and using the interest income each year to finance iwi spending might produce a stable income flow. But it might not be very effective at maximising iwi wealth and income over the long term. And it might not be fair to future generations if it isn't managed in a way that compensates for inflation or allows for population changes.

- Investing in other asset classes, such as equities, might give higher long term returns. But those returns can be very volatile from one year to the next. This can complicate the decision regarding what proportion of returns to allocate for iwi spending each year, especially if iwi are to avoid distributing too much in the boom years and having too little in the future or when times are tough.

*Achieving the best balance of iwi financial outcomes requires an appropriate investment policy governing commercial assets and other investments. It also requires an appropriate policy for balancing the level of iwi spending and investment each year. We refer to this as the "**distribution policy**".*

The distribution decision: What's the best split?



1.3 How do iwi currently allocate income between spending and investment?

Examples of current distribution policies

While specific details on distribution and spending policies are not publicised by many iwi, it appears that iwi with a relatively small amount of annual income either make discretionary allocations each year, or follow straightforward distribution and spending policies (e.g. a budgeted allowance for educational grants).

In some such cases a more comprehensive policy might not be needed and might be administratively expensive and time consuming.

For more wealthy iwi a key focus is on achieving a reliable income stream to fund tribal expenditures. (e.g. Ngāi Tahu and Waikato-Tainui). For many iwi, intergenerational fairness is an important influence on the decision of how much to spend today and how much to invest for the future.

In the following sections we show approaches to distributions taken by a sample of iwi.

Ngāi Tahu

- Ngāi Tahu Holdings Corporation (NTHC) is responsible for commercial and investment operations and Te Rūnanga o Ngāi Tahu (TRONT) is responsible for social operations and distributions.
- Ngāi Tahu adopted a Group Investment Policy Framework (IPF) in 2010, which governs both investments and distributions.
- The IPF includes a rule that means approximately 4% of the value of assets was returned to iwi (TRONT) for spending in 2012[2].
- Ngāi Tahu is structured with charitable status, but does operate some non-charitable entities.

NTHC (commercial arm) has delivered consistent dividends to TRONT.

Ngāi Tahu distributions

	Dividend from NTHC to TRONT ($m)	Dividend as % Net Operating Surplus	Dividend as % NTHC Average Equity
2006	21.4	149%	n/a
2007	20.9	97%	n/a
2008	22.9	72%	n/a
2009	22.0	118%	4.7%
2010	22.0	62%	4.6%
2011	22.6	61%	4.5%
2012	26.3	48%	4.7%

Notes: "Equity" is the average of opening and closing accounting values for the year. When calculating distributions Ngāi Tahu actually uses market values rather than accounting values. Net Operating surplus is prior to property revaluations and other adjustments. It is unclear whether "equity" excludes the interests of minorities. Figures are sourced from annual reports.

2 Ngāi Tahu Annual Report, 2011, page 12. Note that "assets" in this instance actually refers to the market value of equity invested.

Waikato-Tainui

- The commercial arm – Tainui Group Holdings (TGH) - works to provide a consistent dividend in perpetuity.
- In 2006 TGH undertook to guarantee an annual dividend of $10 million for 5 years.
    - This decision followed formal discussions between TGH and the tribe around the trade off between (i) consistency in dividend income so the tribe could plan its activities with certainty; and (ii) the level of investment in the business to enable capital growth.
- The dividend in 2012 was $11.0m (from TGH and Waikato-Tainui Fisheries Ltd combined). We understand that the intention is to increase this by approximately $0.5m per year.
- Waikato-Tainui is structured with charitable status but does operate some non-charitable entities (e.g. some investments where Waikato-Tainui are only a part owner of an asset).

TGH has been successful in delivering consistent dividends over the past 6 years

Tainui Group Holdings (TGH)

	Dividend $m	Dividend as % Net Operating Profit	Dividend as % Average Equity
2007	10.7	68%	n/a
2008	10.5	57%	3.9
2009	10.0	84%	3.4
2010	10.0	63%	3.3
2011	10.5	72%	3.3
2012*	11.0	53%	3.1

Note: "Equity" excludes the interests of minorities and is the average of opening and closing values for the year. Net Operating Profit is prior to asset revaluation adjustments. Figures are sourced from annual reports.

** Figures for 2012 combine TGH and Waikato-Tainui Fisheries Ltd.*

Ngāti Whātua o Ōrākei

Ngāti Whātua o Ōrākei are continuing to develop their distribution strategy in anticipation of a strong revenue stream from land rentals.

- Ngāti Whātua o Ōrākei expects to distribute up to 50% of net cash profit from July 2012. Retained funds will be used for further investment and to pay down debt.

Ngāti Awa

Ngāti Awa received settlement of approximately $42m in 2005, including assets and cash. The asset base has grown since then and Rūnanga equity is now valued at $94m. Of this amount, $83m resides with the iwi's commercial arm, Ngāti Awa Group Holdings Ltd ("NAGHL").

Publicly available information does not provide details on the distribution strategy of Ngāti Awa. However, we do note that the stated objectives of NAGL include:

- To grow the underlying real capital value of the NAGHL's assets over the long term.
- To provide funds to Te Rūnanga o Ngāti Awa sufficient for its purposes without compromising the wealth available for future generations.

The dividend paid by NAGHL to the Rūnanga out of 2008/2009 earnings was $1.5m, which was unchanged from the prior year, despite a marked fall in profitability. In the group's 2009 Annual Report, NAGHL comments that:

"Economic conditions will continue to have an effect on our commercial activities for the next two to three years. The Rūnanga needs to ensure it maintains a conservative approach to seeking extra funding from Ngāti Awa Group Holdings during that period so that medium to long term returns are not jeopardised."

A similar sentiment was expressed in the 2008 Annual Report, which notes that the level of dividend is likely to constrain Rūnanga activities for a further 3-5 years while NAGL's investment strategy is implemented and the economy tightens.

Points of note

Payout Ratios

Using the tabled data in the previous section, dividend payments from commercial operations have been, on average:

- 87% of net operating surplus (before property revaluations) for Ngāi Tahu and 66% for Waikato-Tainui.
- 4.6% of accounting equity for Ngāi Tahu and 3.4% of accounting equity for Waikato-Tainui.

These figures provide useful reference points. However, please note that the limited timeframe means we can't draw conclusions about what

payout levels are sustainable over the long term. Furthermore, assessing sustainable payout levels requires thorough analysis of the mix of assets in the investment portfolio, and would consider market values rather than the accounting values we have used in the tables.

Distributions with a link to asset value

A particularly salient aspect of Ngāi Tahu's policy is that distributions by the commercial arm are linked to a percentage of assets[3]. This is in contrast to approaches that link distributions purely to investment income or are driven by predetermined spending formulae. Linking distributions to the value of the asset base is a practice prevalent overseas and we discuss this kind of approach in more detail later in this Part of our report.

1.4 How are the distribution policy and the investment policy interrelated?

The commentary in this section provides background context for the discussion in sections 1.5 and 1.6 on policies for distributing income between investment and spending. In the interest of clarity, please note that distribution policy and the methods we discuss are relevant to iwi regardless of whether they operate separate social and investment arms or a single integrated entity.

Potential uses of commercial and investment returns

The potential uses of returns from an iwi's commercial and investment operations can be summarised as follows:

Use of Funds		Categories
Investment		• Investment into the existing businesses for maintenance and growth. • Investment into new commercial and investment opportunities.
Spending	**Tribal**	• Spending on ongoing tribal services and social objectives – such as administration, governance, education grants and marae upkeep. • Strategic spending - in areas such as advocacy, long term community infrastructure, or the purchase of assets for social or cultural purposes (as opposed to investment).
	Individual	• Targeted payments to members – such as education grants. • Universal payments to members - if deemed appropriate.

3 "Assets" in this context effectively refers to the market value of equity invested.

Factors influencing the spending / investment split

The decision on how to split each year's returns between investment and spending ("distribution policy") involves balancing multiple factors, some of which have competing objectives. The amount of funds available is a clear constraint, but other factors influencing the allocation decision include:

(i) Capital requirements of existing commercial businesses

To some extent the capital requirements of existing businesses are commercial decisions determined at the operating business level. For example, the decision on how much capital to retain to keep the business running in good order. Decisions regarding surplus funds beyond this amount are governed by the corporate level dividend policy and/or over-arching portfolio investment policy.

Interestingly, there is no global consensus on the best approach to corporate dividend policy, despite a huge amount of academic research. The situation is summed up well in a recent review of this area: "No general consensus has yet emerged after several decades of investigation, and scholars can often disagree even about the same empirical evidence."[4] For many iwi-run businesses, their appropriate dividend policy may vary on a case-by-case basis.

(ii) Preservation of assets and growth aspirations

Ongoing investment is required in order to preserve the value of the asset base from the effects of inflation. This applies to both iwi owned businesses and iwi "portfolio holding" investments in assets such as bonds and shares in listed funds or companies. Furthermore, some iwi may have a bias towards growing their asset base rather than running it down.

Deeper considerations around the issue of preservation of the asset base go beyond inflation-adjusting and look more closely at the capacity to sustain income generation. For a detailed discussion in this area we refer readers to a 2005 report by James Garland called "Long-Duration Trusts and Endowments"[5]. Garland focuses on "fecundity", which he describes as "a measure of the spendable cash that a fund can provide today without unduly threatening its ability to provide similar amounts – adjusted for inflation – in the future."

4 Dividend Policy: A Review of Theories and Empirical Evidence", Al-Malkawi, Rafferty, Pillai, International Bulletin of Business Administration, Issue 9 (2010).
5 Long-Duration Trusts and Endowments", James P Garland, The Journal of Portfolio Management 2005.31.3, pages 44-54.

(iii) Intergenerational fairness

Individuals vary in their preferences for consumption spending versus savings over the course of their life and there are several economic theories that try to model and explain this (theories of "intertemporal consumption"). A pension plan is typically designed to provide a person with a certain amount of income in retirement. How much they want to have in retirement determines how much they need to save beforehand. The asset mix changes as the person ages and their requirements change.

However, an iwi is a mix of individuals and collectively has a much longer time perspective for spending than an individual does. The iwi investment horizon stretches into the ultra long term, well beyond that of the average pension plan or kiwisaver account. It's perpetual. With a perpetual horizon, there is no "retirement" point – no binary switch from saving to spending. Saving and spending continually need to happen at the same time.

Achieving intergenerational fairness is an important driver of how an iwi's commercial asset base is managed. The debate around intergenerational fairness can get very philosophical – as many discussions around fairness do. However, our focus is primarily on economic and financial aspects, such as the need to compensate for the corrosive effects of inflation and the need to allow for population growth. We acknowledge that there are wider considerations, outside of the scope of our report, and in many cases best left to the judgement of individual iwi.

(iv) The requirement for stable cashflows to fund a base level of tribal expenditures

For many iwi, a base level of expenditure has been established. Regardless of whether the commercial operations have a good year or bad year, certain tribal expenses still need to be paid. The requirement for a base level of tribal funding is well demonstrated by Ngāi Tahu's and Waikato-Tainui's emphasis on stable dividends.

(v) Discretionary tribal spending and disbursements to members

Many iwi have the desire and the financial capacity to spend beyond the base level of spending that keeps the organisation ticking along. Some of this spending is targeted towards tribal development and advocacy. Some of it is spent in ways where iwi members can benefit directly from the fruits of the investments - such as a new community centre, or individual education or social grants.

Some types of tribal expenses may be non-essential, but a strong history of regular payments can lead to expectancy and political pressures for them to continue, regardless of tough economic times.

Key points

Broadly speaking, the investment / distribution policy mix is attempting to balance 3 things:

- **Preserve and grow the asset base**
- **Provide stable distributions for tribal spending**
- **Achieve intergenerational fairness**

Interdependence of investment, distribution and spending policies

The investment, distribution and spending policies are interdependent.

- The returns generated by investments determine how much income is available each year. The distribution policy allocates it between spending and further investment.
- Future spending requirements, which are influenced by intergenerational fairness objectives, affect the amount of new investment needed each year and the investment portfolio mix.

This interdependence means that all three policies need to considered and analysed together, and not viewed in isolation.

1.5 How do permanent investment funds in the US allocate their annual returns between investment and distributions to their parent organisation?

If intergenerational fairness is an objective, a portfolio of commercial/investment assets needs to be maintained in perpetuity. There needs to be a permanent capital base. The size and composition of that base may change over time, but an underlying permanency must prevail.

In considering how to best manage a permanent fund, including the balance between investment and distribution policies, there is a wealth of overseas experience that we can draw on. A particular area we are going to focus on is permanent funds in the United States.

US permanent funds - background and similarities with iwi wealth management

Many not-for-profit institutions in the US - such as universities, colleges and museums - source a significant part of their funding from endowments (donations such as money or property). With some institutions the capital built up over time from successive endowments has amassed into substantial investment funds ("endowment funds") – some worth several billion US dollars.

Like iwi, many endowment funds have a need to balance an intergenerational time horizon with a need to make regular distributions to fund operating expenditure. They also need to take account of inflation. University endowment funds, for example, may focus on inflation specific to the education sector and its implications for how they manage withdrawals from their funds.

Another similarity with iwi is a heavy reliance on the income earned from the invested funds. For example, some US universities may source 30-40% of the income they need each year from earnings generated by endowment funds. This is a substantial component of a university's income, and needs very careful management.

While 30-40% reliance is not exactly the same as some iwi's 100% reliance on commercial and investment earnings to fund tribal operations, many of the considerations on how to manage investments and distributions are similar. For example, stable, consistent distributions are important, because volatility in funding can be very disruptive to operations. Smoothing the volatility of distributions has been a key focus of US endowment funds and a range of developments have been made in this area. We review these in the following sections.

Before we do though, we wish to draw attention to a particular difference between the situation of iwi and that of US endowment funds. The portfolio of a typical US endowment fund might include a diversified mix of asset classes such as domestic equities, global equities, fixed income securities, real assets (e.g. property), hedge funds and private equity. However, the mix of assets invested in by most iwi is quite different. For example:

- The investment preferences of iwi may include regional concentrations (e.g. preference for NZ and/or local region) and/or sector concentrations (e.g. property, farming, fishing, tourism); whereas US endowment funds may be more globally and sector diversified.
- Many US funds invest a large portion of their portfolio in highly liquid assets (easily sold), such as listed shares and bonds which can be bought and sold daily. In contrast, some iwi may have a higher weighting to less liquid assets, such as direct property holdings.
- The asset portfolios of some iwi are small and may consist of a limited number of investments.

It is important to keep these differences in mind when translating the US experience into what might be most appropriate for iwi in NZ. The lessons may be the same, but the application different. Often it's the rationale behind the US approach that's most relevant to take note of, rather than the final approach they adopt.

Evolution of distribution rules used by US permanent funds[6, 7]

A useful starting point is to review the evolution of US endowment distribution policies, to understand why certain features have come about.

The 12th century (and possibly earlier)

- Rental income from land holdings was used to support religious organisations.
    - Both land values and rents tended to rise over time, providing increased distributions.

Early 1900s

- By the early 1900s the predominant assets of endowment funds had shifted to fixed interest investments. Portfolios might also include dividend paying blue-chip equities.
    - The trustees of the funds would simply distribute income generated by investments – such as dividends from blue chip stocks and interest from investment quality bonds - and keep the principal capital invested.
    - It was important to maintain the historic value of the source capital.
    - Capital gains were invested and not distributed.

1950s-60s

- Stock market booms in the 1950s and 1960s caused a greater focus on capital gains and saw a shift in endowment funds from a pure income focus to a total return focus (investing for both income and capital gains).
- However, receiving a much greater share of a fund's investment returns in the form of capital gains can cause problems if these capital gains cannot be realised or distributed under a fund's distribution policy.
- A new distribution method was developed in the late 1960s and is the origin of the distribution policies of most non-profit endowment funds in the US today.
    - The new method linked distributions to the value of the fund's investments. It involved using a moving average of the value of the fund over a specified historic period (e.g. 3-5 years), and applying a pre-determined spending rate (typically 4.0-5.5% of the fund's average value).

1970s-80s

- High inflation in the 1970s and 1980s, declining dividend yields, and further developments in investment and portfolio strategies all contributed to shift preferences away from fixed income securities and towards other types of investments.
    - Inflation can be very corrosive. For example, funds invested in a 5 year bond paying 5% interest per year will suffer an erosion in purchasing power if inflation averages, say, 7% over the life of the bond. Inflation in New Zealand is now held in check by the Reserve Bank, but the peak rate of New Zealand inflation in the 1970s and 1980s approached 20%.
- Introduction of the Uniform Management of Institutional Funds Act (UMIFA) in 1972 meant US charities could distribute capital gains (but a fund still could not go below the original value of the principal capital). Previously charities generally relied on trust law for guidance, which was conservative and did not allow total-return investing.

2000s

- Major falls in fund values due to the GFC (Global Financial Crisis) and other major market declines this century have seen some large cuts to distributions by US endowment funds.
    - In some cases these cuts have been very painful, as the organisations (such as universities) benefiting from the income flowing from the fund are heavily reliant on this source of income.
    - Some organisations made special appropriations, outside of the level determined by their spending rule, to soften the blow.
- Market declines saw many funds "underwater", a situation where the value of the fund was lower than the value of the original capital invested. Under UMIFA, underwater funds were restricted from spending.
- The Uniform Prudent Management of Institutional Funds Act (UPMIFA) was approved in 2006 and replaced the 1972 UMIFA. The new Act removed the requirement of the UMIFA that endowment funds could not distribute out of principal capital. The new Act also placed an emphasis on preserving the purchasing power of the fund, not just the value of the original capital contributed. (Further commentary on UPMIFA is provided in Appendix 3.)

6 "Evolution of Endowment Spending Policies and Today's Best Practices", Callan Associates, November 2004.
7 "Sustainable Spending for Endowments and Public Foundations: Achieving Better Long-Term Results", Bernstein Global Wealth Management, January 2011.

Key Points

1. **Portfolio emphasis shifted away from "fixed income" types of investments in response to stock market booms, the effects of inflation and developments in portfolio theory. More emphasis on diversification and more emphasis on capital gains as a source of total returns.**
2. **This necessitated distribution rules linked to the value of the investment fund rather than its income flow.**
3. **Volatility in the value of the investment fund causes volatility in distributions. Rules to smooth this volatility can help.**
4. **But some funds have needed to step outside their distribution rule to avoid excessively painful spending cuts.**

1.6 What are the main types of distribution policies used by US permanent funds?

We now turn to consideration of the main distribution rules used by US endowment funds.

Note beforehand: When we express distribution rates as percentages of market values, the market values generally refer to the market value of the *equity* invested. Any borrowings by an iwi or investment fund would be deducted from the value of their assets. Many investment funds are not geared, in which case their asset value is similar to (or the same as) their equity value.

Distribution rules

The distribution rules used by US endowment funds can be grouped into several main categories, which we summarise in the table below. Further variations are also possible.

Summary table: Types of distribution rules

Rule Category	Methods	Description
Discretionary	Discretionary	• Decide an appropriate level each year.
Income only	Simple	• Spend all current income, leave principal intact. • One alternative is to invest some current income to inflation-protect the principal.
Market value	Simple	• Specified % of starting market value.
	Moving average	• A set percentage of the average market value of the fund (commonly the average market value taken over a 3 to 5 year period).
Inflation based	Inflation protected distributions	• Grow distributions at the rate of inflation.
	Banded inflation	• Grow distributions each year at the rate of inflation, with the amount subject to cap and floor levels, expressed as a percentage of the value of the fund at the start of the year.
Hybrid rules	Yale / Stanford	• Current year distribution is a weighted average of last year's distribution, adjusted for inflation, and the policy target distribution rate (e.g. 5%) multiplied by the market value of the fund.
	Stabilisation Fund: Alpha/ Beta	• Returns from the fund that are in excess of the target distribution rate are placed in a separate fund and invested alongside the main fund. The stabilisation fund can be drawn down when the performance of the main fund is below the target distribution rate.
	Milevsky Brown	• Parameters set in order to achieve a high probability (e.g. 95%) of achieving the desired outcome.

The following sections look at each type of rule in more detail. We draw on a range of reference papers and a summary of the main sources is in Appendix 4.

1. Discretionary approach

The starting point is no rule – distributions are decided on a discretionary basis each year. Despite developments made in relation to distribution rules, many funds choose to retain a relatively simple approach.

Distribution = A discretionary amount each year

Although simple, this rule can still be appropriate in certain circumstances. For example:

- An organisation that's not very dependent on the endowment fund for their income might not be concerned about volatility in payments from the fund, and prefer a straightforward approach to distributions.
- A small organisation with a limited number of assets (e.g. a few property holdings rather than a diversified portfolio of equities and bonds) might find a discretionary approach with a few basic guidelines more appropriate than a rigid or complex rule. Particularly if the income from their limited asset set is reliably consistent and inflation is low, stable and easy to adjust for.

In the US, this method of deciding an appropriate distribution rate is used by a range of endowment funds, but it is most prevalent amongst the funds with investments below US$50m. For a discretionary approach like this to be sustainable for an iwi over the ultra long term, we believe strong governance and budgeting systems are essential.

2. Income-only rules

Another relatively simple approach is to spend only the income generated by the fund each year (from dividends and interest payments) and leave the principal intact.

Distribution = Income generated by the fund over the year

Example: A fund receives $2m in dividends from companies they have invested in, receives $3m in interest income from a bond portfolio and the market value of their investments increases by $1m due to share price rises. The amount distributed by the fund would only be the $5m of dividend and interest income.

This approach can be used in a variety of circumstances. For example, some funds adopt this type of approach following large falls in the fund's value, to allow the capital base to rebuild over a period of time (presumably via capital gains and new funds from fresh donations). One variation is to re-invest some of the fund's income each year to inflation protect the principal.

A downside of rules that distribute only a fund's income flows (and ignore capital gains) is that they can lead to an investment bias towards assets with attractive yields, at the expense of growth assets.

3. Market Value rules

Market value approaches link distributions to the market value of the portfolio. They are used in conjunction with an investment policy that focuses on total returns (as opposed to just income returns).

Simple Market Value Based Rule

A simple approach is to distribute an amount based on a predetermined proportion of the fund's value at the start of the year. This proportion, or "distribution rate", is set at a level expected to be sustainable over the long term. The level set typically aims to ensure that the value of the fund grows sufficiently to keep pace with inflation.

Distribution = R x V_{t-1}

R = Distribution Rate (%)
V_{t-1} = Value of invested funds at the end of last year

Example: A fund has determined that an annual distribution rate of 4.5% is sustainable over time and will leave enough funds invested to grow the asset base sufficiently to compensate for the effects of inflation. If the value of the fund at the end of last year was $100m, the distribution this year will be $4.5m, regardless of how the fund performs this year and regardless of the composition of returns between interest, dividends and capital gains.

This rule can result in volatility in the amount distributed from the fund each year, so a fund adopting this approach would need to be comfortable with that volatility. The volatility stems from changes in the market value of the investment portfolio, which occur due to changes in asset values such as share and bond prices.

Moving Average Rules

A partial solution to distribution volatility is to use a moving average of market value, rather than a single point in time. Moving average rules are the most popular distribution method used by US endowment funds.

The approach typically takes the moving average of the fund's value at the start of the last few years or quarters and applies a set distribution rate to it.

- The period used for the moving average is commonly the previous 3 years or 12 quarters, although 5 years or 20 quarters is also used.
- The distribution rate applied to the average fund value is typically 4.0% to 5.5%.

The formula below assumes a 12 quarter moving average. The example following it illustrates a 3 year moving average.

Distribution = R x $[V_{t-1} + V_{t-2} + V_{t-3} + ... + V_{t-12}]$ / 12

R = Distribution Rate (%)
V = Value of invested funds at the end of each of the previous 12 quarters

Example: A fund has determined that an annual distribution rate of 4.5% is sustainable over time and will leave enough funds invested to grow the asset base sufficiently to compensate for the effects of inflation. The fund uses a 3 year moving average and the values of the fund at the end of the 3 previous years were $120m, $110m and $130m. The average value is therefore [120m+110m+130m]/3 = $120m. The distribution this year will be 4.5% x $120m = $5.4m, regardless of how the fund performs this year and regardless of the composition of returns between interest, dividends and capital gains. Note that a further adjustment could potentially be made to increase the distribution to adjust for inflation.

The method can work well at smoothing out some of the distribution volatility, when the fluctuations in markets are moderate. It doesn't work so well with prolonged upswings and downswings, or when markets move sharply. For example, the increases in distributions dictated by the rule might not be sustainable; or required cuts in distributions might be abrupt and difficult to implement (not to mention painful).

4. Inflation-based rules

In the context of current practice by US endowment funds, "inflation based rules" refer to inflation-adjusting the fund's *distributions*, rather than the fund's investment *assets*.

Inflation protected distribution rule

An appropriate dollar amount of annual distribution is determined by the organisation (e.g. based on its view of what is sustainable). The setting of this initial level of distribution is very important, as too high an amount might not be sustainable over the very long term.

The distribution amount is then adjusted each year in accordance with the rate of inflation.

Distribution = D_{t-1} x (1 + δ)

D_{t-1} = Distribution $m last year
δ = The rate of inflation in the last year

Example: Last year a fund paid a distribution of $10m to its parent organisation. The relevant inflation rate for the last year was 3.0%. This year the fund will pay a distribution of $10.3m ($10m x 1.03) to its parent, regardless of the fund's performance.

The inflation index used might be the Consumer Price Index, or a measure more specific to the organisation, such as an index that tracks costs in the education sector. Some organisations just use a predetermined inflation rate.

On the positive side, this method provides stable and predictable income to the organisation. Income is steady, even when investment markets go through a downturn.

On the negative side, it disconnects the distributions from the underlying asset base of the fund. Over the long term this can mean the rule leads to much lower spending than rules linked to investment values, because market investment returns should outstrip inflation. In the shorter term, it's possible that a large fall in the market value of the fund, coupled with a period of high inflation, could result in withdrawals from the fund consuming a disproportionate amount of the capital base.

Banded Inflation Rules

To mitigate the disconnection effects, some organisations apply upper and lower spending limits, linked to the market value of the fund. For example, using a ceiling of 6% and a floor of 3%.

We illustrate how this might work in the following table. The default distribution is the previous year's distribution adjusted for inflation. However, if that default value exceeds the maximum or falls below the minimum allowable level, then the cap or floor apply. The calculated default, maximum and minimum values are shown in the "Decision Calculations" section of the table. The one that applies in each year is in bold.

Banded Inflation rule example

Year	Fund at start		Inflation	Decision calculations			Result
	Value $m	% chg	%	Last year's distribution plus inflation	Maximum distribution If 6% of fund value	Minimum distribution If 3% of fund value	Distribution $m
Year 1	100	..	..	..	..	..	**4.500**
Year 2	135	35%	3%	**4.635**	8.100	4.050	**4.635**
Year 3	165	22%	2%	4.728	9.900	**4.950**	**4.950**
Year 4	125	-24%	1%	**5.000**	7.500	3.750	**5.000**
Year 5	80	-36%	2%	5.099	**4.800**	2.400	**4.800**

Cap applies — Floor applies

Compared to moving average methods, institutions using a banded inflation approach tend to spend less during rising markets and more during falling markets.

5. Hybrid Rules 1: Yale / Stanford rule

A particular type of distribution rule combines elements that are designed to both generate spending stability and respond to changes in the market value of the investment fund. Variations of these rules are often referred to as the 'Yale Method' or 'Stanford Method' or 'Tobin Method' and they are used by several of the major US universities with large endowment funds.

This approach uses a market-value rule and an inflation-based rule and then assigns weights to each.

One example of this type of rule is:

Distribution = $W \times V_{t-1} \times R + [1 - W] \times D_{t-1} \times [1 + \delta]$

W	= Weight applied to market value of the fund
V_{t-1}	= Value of invested funds at the end of last year (can use earlier values)
R	= Distribution Rate (%)
D_{t-1}	= Distribution last year $m
δ	= The rate of inflation in the last year

- The weight applied to the value of the fund is typically between 0.2 and 0.4, which means that the greatest emphasis is on the previous year's level of spending.
- The distribution rate is typically between 4% and 6% of the market value of assets.
- The measure of the market value of the fund might be taken from the previous year, or earlier.
- The weightings can be altered to shift the emphasis between stability and responsiveness to movements in the market value of the fund.

Yearly distributions are more stable (in dollar terms) than those calculated using moving average methods.

Example:
(i) A fund has determined a target annual distribution rate of 4.5%, which is viewed as sustainable over time and should leave enough funds invested to grow the asset base sufficiently to compensate for the effects of inflation.

(ii) The value of the fund at the end of last year was $100m.

(iii) Last year the distribution paid by the fund was $4m.

(iv) Inflation last year was 2.0%.

(v) The organisation has decided to apply a weight of 0.2 to the value of the fund and a weight of 0.8 to last year's spending.

The distribution this year will be:
(0.2 x $100m x 4.5%) + (0.8 x $4m x 1.02)
= $0.9m + $3.264m = $4.164m, regardless of how the fund performs this year.

Note that further adjustments could potentially be made (e.g. using a different period or combination of periods to calculate the market value used in the formula).

6. Hybrid Rules 2: Stabilisation funds - the Alpha-Beta approach

A further type of rule, proposed by Mehrling in 2004[8], advocates the use of two separate funds, a primary fund and a stabilisation fund, in an attempt to improve the management of intergenerational fairness.

8 "Endowment Spending Policy: An Economist's perspective", 2004, Perry Mehrling, Barnard College http://net.educause.edu/ir/library/pdf/FFP0413S.pdf

1. The primary fund contains the original capital and is grown at inflation each year (by investing earnings).

2. An annual distribution rate is decided, expressed as a percent of the market value of the fund. Let's call this "Alpha". Alpha should be set at a level below or equal to the expected real rate of return of the fund. One suggestion is to have the rate sufficiently low, such that the earnings of the investment fund can cover it most of the time.

3. In times when the primary investment fund earns high returns, surplus earnings are invested in the stabilisation fund.

4. In times when the primary investment fund does not earn enough to pay for the required distribution, funds are drawn out of the stabilisation fund (which can be overdrawn).

5. Over time, the average balance of the stabilisation fund should be zero. In order to ensure this happens (because it won't unless Alpha is set perfectly), a distribution rate is applied to the stabilisation fund. Let's call this "Beta". To achieve a zero balance over time, the Beta rate will need to be higher than the real rate of return, given that Alpha is probably below the real rate of return.

The full formula is then:

Distribution = α x V_{t-1} + β x S_{t-1}

V_{t-1}	= Value of Primary Fund at the end of last year
S_{t-1}	= Balance of Stabilisation Fund at the end of last year

Example:
Assumptions
Value of primary fund at the end of last year = $100m
Value of stabilisation fund at the end of last year = $5m
α = 4.5%. β = 8%
Inflation this year = 2.0%
Fund returns this year = 7% (=$7m)

Calculations
Distribution this year = 4.5% x $100m + 8.0% x $5m
= $4.5m + $0.4m = $4.9m
Increase in primary fund = $100m x 0.02 = $2m
Increase in stabilisation fund = $7m - $4.9m - $2m = $0.1m

High values of Beta help correct misspecifications of Alpha, but can also produce greater volatility in distributions. One possibility for dealing with this is to incorporate the smoothing technique of the Yale rule.

For example:

Distribution = W x [α x V_{t-1} + β x S_{t-1}] + [1 - W] x D_{t-1} x [1 + δ]

W	= Weight applied to the Alpha-Beta calculation
D_{t-1}	= Distribution last year $m
δ	= The rate of inflation in the last year

Another alternative is to allow Beta to vary over time, such as using a higher value when the stabilisation fund is large. But not so high that distribution volatility is excessive.

7. Hybrid Rules 3: Milevsky-Brown rule

Professors Moshe Milevsky and Sid Browne advocate the setting of probabilistic criteria to guide endowments in their policies for asset allocation and distribution payments.

This involves using a tolerance level (e.g. "95% of the time") in conjunction with the financial policy parameters. For example, "a 95% probability of achieving investment returns of 6% pa over 30 years and reaching a target ending portfolio value".

The rule is more complex than the others we have discussed, and for a detailed discussion we refer readers to research papers by Milevsky and Browne. For example: "A New Perspective on Endowments", Moshe A Milevsky, York University, 10 March 2003.

Summary table: Pros and cons of different distribution rules

Rule Category	Methods	Pros	Cons	Examples of possible relevance to iwi*
Discretionary	• Decide an appropriate level each year	• Flexibility to adapt to conditions.	• Long term sustainability could be an issue. • Distributions may not be stable.	• Might suit some iwi who want maximum flexibility and who have the ability to adjust spending as required. • Requires careful governance. Achieving intergenerational fairness and growth in the asset base could be very challenging.
Income Only	• Income based	• Capital can be preserved (if principal is protected from inflation e.g. through investment of some of the year's income).	• Encourages conservative investing that emphasises income, rather than total return investing. This may limit the growth of the fund and reduce the probability that the future purchasing power of distributions is preserved.	• May suit some iwi with extremely limited funds who require very stable income to meet a tight annual spending budget.
Inflation-based	• Inflation protected distributions	• Stable distributions year-on-year, with purchasing power maintained.	• De-linked from moves in portfolio value, which creates a risk that future distributions might not be sustainable. • Initial level of spending set has a critical impact.	• Might suit some iwi that wish to focus on running a low level of spending for a period of time while they build up their investments.
	• Banded inflation	• Relatively stable distributions. • Partial link to changes in portfolio value.	• Initial level of spending set has a critical impact.	
Market Value based	• Specified % of starting market value	• Simple. • Market value approach allows total return investing, which should, over time produce higher returns than a conservative income-focused fund. • Distributions maintain relativity to the value of the underlying investments.	• Driven solely by the market level at a point in time, which is somewhat arbitrary. • Distributions lack predictability and are prone to volatility.	• Iwi seeking to maximise long term growth in their asset base are likely to focus on total return investing rather than investing just for income. • The Market Value approach provides a method for determining distributions when some of iwi investment returns are coming from capital gains.
	• Moving average (e.g. 12 quarters)	• Provides more stable distributions than rules using the market value at a single point in time. • Distributions maintain relativity to the value of the underlying investments.	• Anomalous temporary portfolio moves have an impact for the whole term of the moving average. • A long term in the moving average calculation can make it slow to adapt to large portfolio moves.	

Rule Category	Methods	Pros	Cons	Examples of possible relevance to iwi*
Hybrid Rules	• Yale / Stanford	• Stable year-to-year spending. • Adapts to changes in the market value of the portfolio, with moderation. • The weightings provide an organisation with the means to customise a policy that balances its needs.	• Dependent on weightings assigned. • Compromise may not result in optimal outcome for any of the primary goals (capital preservation, intergenerational fairness, distribution stability).	• May be suitable for iwi who are investing on a total return basis, but who want greater stability in annual distributions than that provided under a Market Value approach.
	• Stabilisation Fund Alpha/Beta	• Intergenerational fairness. • Effective in different types of markets. • Good at maximising total utility (total distributions + portfolio growth) over time.	• Distributions sensitive to market volatility.	• Versions of the stabilisation fund approach, such as the Alpha/Beta method, may appeal to iwi who wish to run a liquidity buffer alongside their main portfolio of commercial and investment assets. • Some versions of this approach allow the stabilisation fund to run negative balances at times. This particular aspect may not suit iwi who prefer not to use borrowings to support distributions.
	• Yale + Alpha/Beta	• Moderately stable year to year distributions. • Adapts to changes in the market value of the portfolio, with moderation. • Good at maximising total utility (total spending + portfolio growth) over time.	• Dependent on weightings assigned. • Trades off some of the value generated by the Alpha/Beta in return for the greater stability of Yale.	• May be suitable for iwi who want to run a stabilisation fund but want greater stability in annual distributions than that provided under a standard Alpha/Beta approach.
	• Milevsky Brown	• Preserves real value of fund capital.	• Complex to calculate. Reliant on assumptions. • Higher volatility in distributions. Can get large reductions in distributions when portfolio drops.	• The administrative complexity and distribution volatility seems unlikely to suit many iwi.

** This column does not provide an exhaustive list. It is not meant to be prescriptive in any way and the intent is only to provide examples for consideration.*

Prevalence of distribution rules amongst US Endowment funds

The table below shows the types of distribution rules used by endowment funds in the US in 2010.

Distribution Rule	Category	Proportion of funds using
Percentage of moving average assets	Market value based	75%
Percentage of beginning market value	Market value based	4%
Yale/Stanford	Hybrid	7%
Spend all current income	Income only	4%
Select a rate each year	Discretionary	11%

Note: figures do not add to 100% due to rounding. Category definitions may not match exactly with the categories we have described earlier.

Source: Russell Research, "Non-profit spending rules", October 2011; which sourced the data from the NACUBO-Commonfund Study of Endowments 2010 Survey.

- A strong majority used rules linking distributions to a percentage of asset values, with most opting for a moving average approach.
- Usage of the Yale/Stanford type of rule is more prevalent amongst larger endowment funds. While we do not have details of why this is the case, we suspect it may be at least partly due to the larger funds being at the "leading edge" of policy development. 15% of endowment funds with assets over US$1 billion and 12% of those with assets US$500m-$1bn use this type of rule.[9]
- Approximately 3% of funds use inflation-based rules, i.e. they grow distributions at the rate of inflation. (We do not know which category in the above table this is recorded in.)

Provisions for liquidity

Following the liquidity crisis in 2008/2009 there has been more focus on whether or not US endowment funds should make liquidity provisions to guard against future liquidity squeezes. Two key considerations are:

- How much cash to put aside (e.g. enough to cover a set period of spending requirements); and
- How to invest the cash that accumulates in the liquidity fund (e.g. high quality government or money market investments with maturities throughout the likely period of spending need).

An example might be to segregate 5-10% of the market value of the fund into a separate portfolio invested in high quality liquid investments, such as 90 day Treasury bills. The organisation can draw on this fund when the performance of the main fund is below the target distribution rate or when liquidity is an issue.

Another alternative is to borrow funds to cover a temporary liquidity squeeze, although this relies upon borrowings being available.

1.7 How well do the distribution rules work?

US Experience with Moving Average Rules

Looking at the predominant rule used by US endowments, the moving average rule, trends over the boom and bust of the tech bubble in the early 2000s provide some interesting observations[10]:

1. At the start of the year 2000, 65% of institutions were using a moving average rule.
2. The tech bubble then burst and complying with the moving average rule became a struggle. In 2001 the proportion of institutions using a moving average rule dropped to 43%.
3. Markets subsequently recovered and by 2004 the proportion of institutions using a moving average rule was up to 73%. It has stayed around that level since.

While a high proportion of funds use a moving average rule, many of them also make "special appropriations" outside of the rule. In the years immediately prior to the onset of the GFC 12% to 16% of funds were doing this. As the recession onset in 2008 this proportion rose to 19%.[11] While that means 81% didn't reach into the pot to supplement distributions (many of whom would have implemented budget cuts instead), 19% is still a significant enough figure to make one cautious of adopting a moving average rule on a "set and forget" basis. Operating a moving average rule during periods of large market declines can be challenging.

US organisation Commonfund[12] reports anecdotal evidence that more organisations are considering moving away from a moving average approach, and towards an inflation-based or hybrid method instead.

9 "Endowment Spending: Building a Stronger Policy Framework", Verne O Sedlacek and William EF Jarvis, Commonfund Institute, October 2010.

10 Ibid., page 9.
11 Ibid., page 9.
12 Ibid., page 18.

European analysis

A paper by Cardinale, Purcell and Bishop[13] investigates the spending policies of European foundations. The paper identifies 3 properties for determining a good distribution rule, based on an intergenerational fairness test, and runs simulations to look at how well various distribution rules perform. The 3 properties are:

1. Maintain the real (inflation adjusted) value of the fund capital.
2. Provide smooth distributions from year to year.
3. Maximise distributions over the long term.

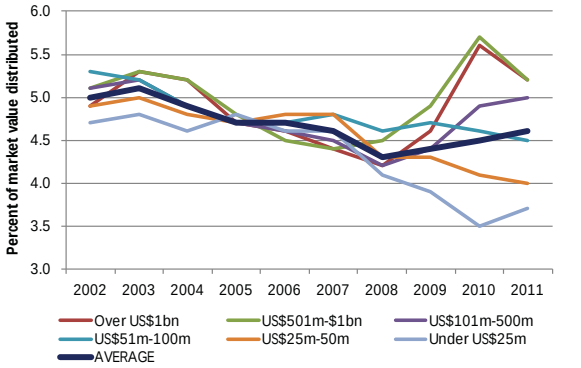
Some of the conclusions of their analysis are:

- A simple inflation linked spending rule is highly dependent on initial conditions. It will have difficulty in preserving capital if the initial spending rate is high and the fund's investment mix is conservative.
- The Yale rule is often cited as an example of best practice in the US. In the European analysis it was potentially very risky if the implied expected return is too optimistic relative to the fund's investment mix.
- The Alpha-Beta rule seemed to perform better than a standard Yale rule at preserving capital and maximising distributions over time. But the volatility in distributions from year to year was higher than using a Yale rule. Changing parameters can help with the volatility but at the expense of the other two objectives.
- The Milevsky-Brown rule ensures that capital is preserved, but the more risk averse a fund, and the shorter the timeframe, the greater the impact on permitted distribution level.
- Complex rules, such as Alpha-Beta and Milevsky-Brown, provide a more sophisticated way of managing the trade-offs than the more conventional Yale and inflation linked rules.

1.8 How have the distribution rates of US endowment funds tracked over the past 10 years?

The chart below shows how the effective distribution rates for US college and university endowment funds have tracked over the past 10 years. The distribution rate is expressed as a percent of the fund's market value at the start of the year. It measures the amount available for spending after deducting expenses associated with managing and administering the fund. The table following shows the investment returns of the funds (net of fees).

Effective Distribution Rate by Fund Size



Fund size US$	Average Net Investment Returns % pa			
	2011	3 year	5 year	10 year
Over $1bn	20.1	2.4	5.4	6.9
$501m-1bn	18.8	2.6	4.8	6.0
$101m-500m	19.7	2.6	4.4	5.3
$51m-$100m	19.3	2.8	4.4	5.1
$25m-$50m	19.4	4.2	4.7	5.0
Under $25m	17.6	4.6	5.2	4.9
All 823 funds	19.2	3.1	4.7	5.6

Data Source: The 2011 NACUBO-Commonfund Study of Endowments.

http://www.nacubo.org/Research/NACUBO-Commonfund_Study_of_Endowments/Public_NCSE_Tables.html

Interestingly, the current distribution rates across most fund sizes are higher than their 3 year and 5 year annual investment returns. The global financial crisis continues to have a strong negative influence.

The strong investment performance in 2011 is having a significant impact on the returns figures. In 2010 the average 5 year return across all funds was 3.0% pa, compared to 4.7% pa when measured in 2011.

1.9 What distribution rate is sustainable in perpetuity?

A closer look at US distribution rates: Is 5% too high for a diversified investment portfolio?

As one "marker" for the upper bound of what the sustainable distribution rate might be, the US UPMIFA legislation specifies that if a distribution

13 "Are Spending Policies of European Foundations Sustainable?" Mirko Cardinale, Richard Purcell and Marcus Bishop, Technical paper February 2007, page 13.

rate is over 7% of the market value of the portfolio, then the onus is on the fund to justify that the distribution rate is not imprudent.

Most US public endowment funds have a distribution rate much lower than 7%. Typically, distribution rates are equivalent to between 4.0% and 5.5% of the market value of investments (refer chart in previous section).

Another type of US organisation, the charitable private "foundation", is *required* to distribute at least 5% of the value of its endowment each year in order to maintain favourable tax status. Consequently, there has been a lot of analysis in the US around the suitability of a distribution rate equal to 5.0% of the market value of a permanent investment fund.

The 5% distribution rate has attracted much criticism. For example:

- A report published in the early 2000s by Sedlacek and Clark[14] estimated that a 5% distribution rate would result in the market values of approximately one third of endowment funds not being able to keep pace with inflation.
- A 2010 report by Ho, Mozes, and Greenfield[15] investigates the interplay between endowment distribution policy and the volatility of investments. Their analysis shows that in order to support distribution rates of 4% to 5% of the market value of investments, and stay within reasonable risk guidelines, the investment portfolio must perform considerably better than typical market portfolios have over the past 20 years. Without sustained significant out-performance, endowment funds with high distribution rates will need to either reduce those rates or accept a higher probability of suffering a significant loss.
- Evidence reviewed by the Drafting Committee for the UPMIFA suggested that few funds could sustain spending at a distribution rate above 5%, and that at that time (circa 2007) 5% might even be too high[16].
- A 2012 report[17] by Russell Investments uses 112 years of data to analyse the likelihood of a fund being able to maintain its value, on an inflation adjusted basis, for different combinations of distribution rates and portfolio mix.
  - Using 20-year periods, the analysis indicated that there was only a 50% chance of maintaining the inflation-adjusted investment base when using a 5% distribution rate.
  - Including "alternative assets" as well as stocks and bonds in the portfolio gave a slight improvement.
  - The report also includes analysis of forecasts of 10 year forward returns, using data from a Survey of Professional Forecasters maintained by the Federal Reserve Bank of Philadelphia. Using a portfolio with a shares/bonds split of 60/40, the data imply average returns over the next 10 years of 5.3% per year, before adjusting for inflation, and 3.0% after adjusting for inflation. Interestingly, the forecasts have been steadily trending down for the past 20 years. In the 1992 survey the equivalent 10-year forecasts were 8.7% for returns before adjusting for inflation and 5.0% after. While forecasts are always highly debatable, the changes in expectations over time strongly suggest that a 5% distribution rate might not be as viable as it seemed 20 years ago.

Please note: While at face value, distribution rates of 4% to 5% might at first appear low, given levels of investment returns, we need to remember that the distribution rate reflects the need of endowment funds to protect against inflation over the long term. So, a 4.5% distribution rate might reflect expected long term investment returns of 7.0% (after fees) and expected inflation of 2.5%. In other words, the distribution rates discussed in this section are analogous to expected real (i.e. inflation adjusted) returns.

Sustainable distribution rates: New Zealand context

The US-centric distribution rates won't translate exactly to New Zealand iwi. In particular, the portfolio mix of iwi is in many cases very different from that of a US endowment fund.

A range of other factors also need to be taken into account, such as differences in interest rates and tax status. US public endowment funds tend to be tax exempt, as are many iwi. Adjustments may also be needed for factors such as holdings of undeveloped land which don't currently generate income and are not for sale.

14 "Why do we feel so Poor?", Verne Sedlacek and Sarah Clark, Commonfund Institute, 2003, page 10.
15 "The Sustainability of Endowment Spending Levels: A Wake-up Call for University Endowments", Gregory P. Ho, Haim A. Mozes, and Pavel Greenfield. The Journal of Portfolio Management, Fall 2010.
16 p27 of the UPMIFA Act with prefatory notes and comments.
17 "Are 5% distributions an achievable hurdle for foundations? Were they ever?" Steve Murray, Russell Investments, August 2012.

Furthermore, US institutions operating endowments may face inflation rates quite different from those experienced by iwi. For example, when Stanford University reset its distribution rate in 2008, it considered the new rate of 5.5% to be reasonable given the endowment fund's ability to earn expected returns of 10% pa and average institutional inflation of 4.0 to 4.5% pa.[18]

While New Zealand iwi commercial and investment portfolios aren't the same as those of US endowment funds or foundations, the 5% distribution rate figure still provides a useful upper marker. Essentially, distributions that are close to or above 5% of invested funds (equity) will need strong justification to show that underlying investment returns will consistently outperform the returns of many US endowment funds. Otherwise sustainability may be questionable.

However, for many iwi it will be important to grow their assets beyond what is required to preserve them against inflation - population growth also needs to be taken into account.

Generally, the US endowment fund material we reviewed did not consider intergenerational fairness from a per-person perspective. Most US university endowment funds are not established with the intent of sustaining a growing number of beneficiaries[19].

What happens if we add per-person fairness into the mix? For clarity, we are not talking about universal cash payments to individuals here. Rather, we're looking at total iwi spending and/or assets, divided by the number of iwi members.

Statistics New Zealand has prepared projections of the Māori population out to 2026, using 2006 as a base. Using a "medium" scenario, the total Māori population is expected to grow, on average, at 1.3% pa over the period 2006-2026.

As an example, let's say an iwi wants the ratio of the amount they spend each year (or the value of assets) divided by the number of iwi members to be consistent over time (adjusted for inflation). Let's also assume that the iwi's population is expected to grow at 1.3% per year.

- To keep up with the population growth, the value of the iwi's investment in commercial and investment assets might need to grow approximately 1.3% more per year than it would if the population was static (we are making a number of simplifying assumptions here).
- To achieve this additional growth in the investment base, the annual distribution rate might need to come down 1.3% compared to what it otherwise would have been, and the amount foregone invested instead.

18 Stanford University Budget Plan 2007/08, page 8.
19 House Committee on Constitutional Revision, Texas House of Representatives Interim Report 2002, page 10.

The analysis in this example is "partial analysis". Wider considerations also need to be taken into account. For example, comprehensive analysis would allow for factors such as investment returns not being a constant percent rate every year, population growth rates varying and interaction effects. We also acknowledge that the time horizon to 2026 is much shorter than the very long term, intergenerational perspective of many iwi, and deeper considerations are also necessary.

Putting everything together, let's now look at what sorts of distribution rates might be sustainable for New Zealand iwi who want to grow their wealth sufficiently to protect against inflation and keep pace with population growth. To do so we draw on extensive modelling and analysis work done by BNZ Private Bank.

We look at one hypothetical portfolio, as a reference point. Because each iwi's portfolio of commercial and investment assets requires unique analysis, we stress that this is a starting point only, and not a substitute for the expert investment advice that is ultimately required.

The analysis assumes a portfolio or balance sheet split 35% into income assets (e.g. bonds and term deposits) and 65% into growth assets (e.g. shares in companies). A shift in this ratio in either direction will have an impact on the sustainable distribution rate achievable and volatility of returns (riskiness).

The following table provides indicative distribution rates for the reference portfolio, showing how the rate varies under different assumptions for tax and population growth.

Indicative sustainable distribution rates for an example portfolio

		Effective tax rate	
		0%	**28%**
Population growth	**0%**	5.0%	3.4%
	1.3% p.a.	3.7%	2.1%

Source: BNZ Private Bank

If a hypothetical iwi had a mix of assets that matched the reference portfolio and desired to grow their assets sufficiently to keep pace with population growth and inflation, then their sustainable distribution rate might be between 2.1% and 3.7%, depending on their tax rate.

A rate above this range may be sustainable if the asset mix is more aggressively growth oriented (but will incur commensurate additional risk); and a rate below this range might be appropriate if the asset mix is highly conservative.

1.10 Other considerations

Strategic spending

Strategic spending, such as spending on large infrastructure assets or Treaty settlement protection, can benefit multiple generations. Furthermore, spending on these items can often be "lumpy", rather than evenly spread over many years. These factors need to be taken account of when modelling distribution rates and assessing fairness or utility (benefits to tribal members).

This is a very important consideration when it comes to assessing distribution levels.

Possible reasons to run a conservative distribution rate

- Future returns are unknown. History is typically used as a guide and to determine inputs for simulation models, but there is no guarantee the future will map out the same.
- Governments can sometimes cut back on spending. Iwi might want to increase assistance to members during those times.
- The world is potentially moving into a low growth, low inflation environment. The ability to distribute at past levels may be severely restricted for quite some time.

Wealth and income constraints

The strength of financial position varies considerably amongst iwi and influences which types of distribution, spending and investment polices are most appropriate. Some iwi may be served best by a clear, simple approach; whereas others may need more comprehensive management policies. For example:

i. Limited income and wealth can constrain some iwi to using investment earnings for collective tribal maintenance and governance activities (e.g. marae upkeep), with a small amount available for targeted grants to individuals.
    - With limited room for discretion, simple, easy to manage, distribution and spending policies may be appropriate.

ii. Some iwi are asset rich but income poor. In some such cases the preference might be to use investment earnings primarily for further investment, such as the commercial development of selected land holdings.
    - Detailed considerations around distribution policy may not be a priority for some time yet. Such considerations may take on more significance once a "critical mass" is reached by the investment base.

iii. Other iwi are in a stronger income and wealth position. They have a much wider range of spending and investment options available to them.
    - For this group, a more comprehensive distribution policy might be appropriate.
    - A well designed distribution policy can provide multiple benefits. It can enhance governance and accountability; facilitate the achievement of intergenerational fairness; and help withstand cyclical political pressures (e.g. the pressure to spend more in the good times, rather than save for the inevitable not-so-good times).

Financial modelling of investment and distribution policies – important components

We strongly recommend detailed financial modelling to fully explore the dynamics of the investment and distribution policies. It will:

- Assist in determining the most appropriate policy combinations.
- Provide an education tool – through examining different scenarios, risks and interactions.
- Provide a means of ongoing monitoring to help keep on track.

Important components of the modelling process are briefly canvassed below.

1. Establish measurement criteria
    - Measures need to be established to determine whether the distribution policy is achieving relevant tribal objectives, such as intergenerational fairness. While there is a discretionary element to assessing intergenerational fairness, for long run modelling we focus on more easily measurable financial aspects. Measures need to take account of both inflation and demographic changes. Possibilities include:
        - Consistent real (inflation adjusted) annual tribal spending, when calculated on a per-person basis.

- Consistent real (inflation adjusted) value of assets, when calculated on a per-person basis.
- A combination of the above.

2. Generate projections of long run returns from commercial assets and other investments
   - The modelling needs to estimate what returns the current and future asset base are likely to generate, taking account of growth and compositional changes. The amount available for new investment each year will vary with the distribution policy being modelled.
   - Investment policy is beyond the scope of our report, but will cover aspects such as asset allocation, acceptable risk parameters and other constraints such as tribal asset preferences.
3. Model the impact of different distribution policies and distribution parameters
   - Distributions will finance both the core spending level that needs to be maintained and additional discretionary spending.
   - Results from modelling distribution scenarios alongside investment scenarios may cause reconsideration of aspects of the investment policy. For example, an ultra-conservative investment policy may not produce sufficient growth to meet future requirements, which may necessitate spending cuts and/or a greater weighting to "growth" investments, which tend to carry more risk.
4. Model different scenarios, including short term volatility
   - In addition to modelling long term returns and distributions, specific consideration needs to be given to short term volatility. For example, in a year of very low commercial/investment returns, will assets be sold so that tribal spending can be maintained? Will discretionary tribal spending be cut back? Will borrowings be increased in order to maintain distributions?

Many iwi may need to seek professional advice in this area.

No one size fits all

The distribution rules that we have outlined are a starting point only. Multiple variations are possible and each organisation needs to do their individual analysis, and adopt or customise rules to suit their situation and objectives.

Some iwi may not feel the need for a distribution rule at all and may be comfortable with a discretionary approach. But at the very least, it is prudent to monitor aspects such as intergenerational fairness and the purchasing power of income generated by assets held, and ensure appropriate governance is in place.

Part 1: Summary comments

- **Policies governing the allocation of income between spending and investment can have a profound impact on long term iwi outcomes and need careful consideration. There does not appear to be a lot of formal framework development across the wider iwi community, but we expect greater focus on this area as iwi incomes grow and settlements progress.**
- **A range of approaches for determining the best spending/investment allocation have been adopted by permanent funds overseas. No one size fits all, and different approaches - or combinations of approaches - may suit different iwi.**
- **The proportion of income being spent each year needs to be sustainable over the ultra long-term if intergenerational fairness is important. If the spending rate is too high, then the value of the underlying assets won't be able to grow sufficiently to keep pace with inflation. US evidence suggests that the sustainable annual amount of spending is probably less than 5% of the value of equity invested.**
- **If an iwi is seeking to sustain their real (inflation adjusted) level of spending on a per-person basis, then they also need to allow for population growth. This will lower the sustainable distribution rate.**
- **Given the potential for the world to enter a low-growth, low-inflation environment, the ability to distribute at past levels may be severely restricted for some time.**

1.11 Interview with iwi regarding distribution policy

Q&A with Mike Sang, CEO of Te Rūnanga o Ngāi Tahu

Ngāi Tahu have put a lot of thought into the best approach for working out appropriate levels of annual distributions. How important do you think it is to have a formal policy that sets the parameters for making distributions from the commercial arm to the social arm?

Te Rūnanga o Ngāi Tahu put a lot of time and effort into developing the Investment Policy Framework. This covers matters such as Strategic Asset Allocation, Capital Structure and the Distribution Rule. We saw it as very important for a variety of reasons including providing greater financial certainty to enable us to develop long term plans and to protect the asset base through generations.

What do you see as the main risks of not operating a formal policy to determine the level of distributions from the commercial arm?

It becomes difficult to plan distribution programs. These programs tend to be multi-year or even intergenerational. The consequence of turning them on and off is significant to our whānau so we desire to be disciplined and consistent in our approach. A formal policy ensures that the asset base and the distribution is enhanced and grown for both the benefit of this and future generations.

Your 2011 annual report refers to a rule within your Investment Policy Framework that determines the level of annual distribution from Ngāi Tahu Holdings to Te Rūnanga o Ngāi Tahu (TRONT). Could you please talk us through the rule you use?

It is part of a broader Investment Policy Framework. When developing it for Ngāi Tahu we referred to practise and examples elsewhere including the Yale Endowment Fund. But it is customised for Ngāi Tahu.

Essentially it is based on a mix of operating returns and the market value of assets. It is a minimum of 4% of market value and a maximum of 5.5%. Where we fall within this range depends on how profitable we have been over prior years (it has a smoothing component).

What persuaded you to adopt this approach?

A number of reasons: 1) it provides greater financial certainty for planning and sustainable investment and it also enables Te Rūnanga to provide clear direction to the NTHC Board, thereby improving the relationship, 2) the ongoing need to grow both the distribution and asset base in real terms at a minimum.

What sort of modelling and testing did you undertake when deciding on the most appropriate rule to use?

We referred to a variety of examples around the world. We needed an approach that smoothed distributions (the rule takes account of previous year's distribution) and would not compromise the future distribution generating ability of the asset base (hence the distribution level has a lower and upper band).

Strategic Asset Allocation (SAA) modelling was done to ensure the investment asset base was capable of generating an appropriate return over the long-term.

Is there a prescribed "floor" level that applies to distributions from Ngāi Tahu Holdings. Are there any other specific TRONT requirements?

The minimum distribution is 4% of the market value of our investments. The Investment Policy Framework also covers Strategic Asset Allocation and Capital Structure. All three of these policies work together to provide the certainty, risk management, intergenerational thinking, liquidity etc. that is required for both distribution and commercial growth.

Is there any scope for flexibility to go outside the rule's parameters? Under what kinds of circumstance?

Yes – the rule calculation allows for some of its parameters to be changed depending on historical performance and prevailing market conditions. The intent is that the upper band of 6% of the Market Value of the portfolio will not be breached. There is the ability for the investment manager (NTHC) to go outside the SAA targets (policy portfolio) based on current opportunities. This in turn can influence both the market value of the portfolio and its return capabilities (cash and capital) over the short to medium term.

How often will the distribution rule be reviewed?

Because our policies complement each other and work together, the distribution rule will be reviewed as part of our Investment Policy Framework review (probably every five years).

In what ways has the need to balance current spending requirements alongside intergenerational fairness requirements influenced the long term strategy for your investment portfolio?

The above is the whole basis behind our Investment Policy Framework in respect to SAA, Distribution Rule, and Capital Structure.

Once the long term portfolio is fully established, what do you think the sustainable distribution rate from Ngāi Tahu Holdings is likely to be?

The upper band of 6% of the Market Value of the Investment Portfolio is the maximum. However it is likely that our upper band will lie between 5% and 5.5% of the Market Value of the Investment Portfolio. This scenario is a number of years away.

Is there much flexibility to adjust tribal spending if distributions from Ngāi Tahu Holdings suffer a downturn?

Yes of course. We can't be locked into a corner and having experienced the global financial crisis like everyone else we know we must plan for the downturns and the upturns. But there are consequences for reducing tribal spending – reducing education grants or te reo programs or Whai Rawa has a negative impact on achieving our vision.

Our SAA, Distribution Rule and Asset Management Approach are all intended to mitigate short term disruptions. We are constantly assessing the makeup of our investment portfolio and our approach to asset management. Like all asset managers a major and sustained global economic crisis will obviously impact on our portfolio. The lesson learnt from the last crisis relates to liquidity in relation to sustaining our distribution program.

What about borrowings? Do your current policies permit the use of borrowings to maintain distributions and spending if there is a temporary downturn in the commercial returns of Ngāi Tahu Holdings?

It is not that explicit but generally no. There is flexibility to be used appropriately by the NTHC Board (on a very sound commercial basis), but this is more likely for short term events. Over the medium to long term if returns fall, so should the distribution (based on declining Market Value of the Investment Portfolio). Once the Investment Policy Framework is properly bedded in this should not be an issue. Again, liquidity within the investment portfolio is the key.

What are the main reasons for not tending to use borrowings for this purpose?

Borrowings attract interest and have to be paid back. Realistically we have to use our own money and assets to pay for our own distribution programs. The Investment Portfolio is geared to generate a certain level of cash return and this requirement is known by the investment manager (NTHC).

Participation in the Whai Rawa savings scheme seems strong, especially in respect of children under 16. What is the general nature of feedback from members in relation to the scheme?

It is very popular. It's important to note this is more than just matched savings – our goal is to improve savings rates and financial literacy, as this leads to a range of benefits including healthy homes, education options, etc.

Do you think the scheme satisfies iwi members' desire for direct distributions?

There are so many demands for the pūtea and so many ways to achieve the vision. I think this scheme goes a long way but it is not our only direct distribution. Whānau can access education grants, Ngāi Tahu Fund, etc.

What is your long term vision for the scheme?

We would like to more closely complement Kiwisaver, further improve savings rates, get whānau engaged earlier and grow membership. We see this leading to higher home ownership rates, accessing higher education and much more.

When iwi members present you with investment opportunities how do you decide whether they are best handled by your commercial arm or your social arm?

Commercial projects focused solely on commercial returns belong with NTHC. Social projects with the Office. When they cross over we will work together as we do in many other aspects. But each party must make a decision based on the mandate and direction given to them by Te Rūnanga.

BNZ wishes to thank Mike Sang for generously sharing with us these insights into Ngāi Tahu's approach to distributions;

and

Matthew Slater (Chief Investment Officer of Ngāi Tahu Holdings Corporation) for his assistance with aspects of our report.

PART 2:

Spending Policies

PART 2: SPENDING POLICIES

2.1 Introduction

In this Part of the report we look at some of the issues and current practices relating to iwi spending policies. We give particular focus to the topic of universal cash payments to individual iwi members. This is an area which may attract more attention as iwi wealth and incomes continue to grow.

2.2 Iwi objectives, values and principles ultimately drive the spending policy

The starting point for establishing appropriate spending policies (and for that matter distribution and investment policies as well) is an iwi's core values and objectives (desired outcomes). These need to be clearly articulated, and for many iwi this will already be the case.

The spending policy is a servant of these objectives and needs to be aligned accordingly. For example, a strong value placed on the learning and development of tamariki might be reflected in the granting of financial assistance for education. The iwi's objectives frame the territory and provide an over-riding benchmark for determining whether particular approaches to spending are acceptable or not.

Some iwi objectives might be met by spending made in the collective interests (e.g. spending on marae maintenance or measures to influence government decision making). Other objectives are served by payments to individual members (such as education grants). Prioritising these objectives is important and involves applying a set of collective judgments that is unique to each iwi.

2.3 Tax and regulatory influences

Regulatory factors such as tax can have a major influence on how iwi can spend their investment earnings.

Setting up the most appropriate organisation structure requires sound legal and accounting advice (including tax advice), which is beyond the scope of this note. However, we do make a few general comments.

New structures versus historical

Historically, many iwi have structured their organisation predominantly as a charitable trust (e.g. Waikato-Tainui and Ngāi Tahu). Charitable trusts can operate with favourable tax status (tax rate of 0%) and have been widely used.

However, newer structures are taking a different approach.

One example is Ngāti Whātua o Ōrākei, which is implementing a new Post Settlement Governance Entity ("PSGE") in response to settlement of its second treaty claim. The new PSGE will house the iwi's existing assets and the newly settled assets. The new structure moves away from a Māori Trust Board structure that has charitable trust status to a governance structure which will pay tax. One of the reasons the new PSGE is important is the need for distribution flexibility following a significant boost in iwi income from railway land rental. Iwi income is expected to enable distributions to beneficiaries of $70 million over the next 10 years. This is a marked change from the previous grant budget of approximately $100k per year and opens up a wider range of spending options for consideration.

Please note: It is not easy to change organisational structures, which means that some existing iwi structures might reflect legacy decisions and therefore may not be optimal examples for iwi setting up new governance entities today.

Charitable status – flexibility limitations

A charity needs to be registered with the Department of Internal Affairs (since July 2012 - previously the Charities Commission) to receive tax exemptions. To be a registered charity an organisation must have a "charitable purpose". In section 5(1) of the Charities Act a "charitable purpose":

"... includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community."

The Charities Act also has specific provisions relevant to Māori. For example, maintaining and administering land and buildings of a marae on reservation land can be deemed a charitable purpose.[1]

1 http://www.charities.govt.nz/setting-up-a-charity/organisational-structure/iwi-and-Māori/

For some iwi, particularly those with limited funds, meeting the "charitable purpose" requirement might be relatively straightforward. For example, if distributions to individual iwi members are limited to education grants, and other iwi funds are used for maintaining the marae land and buildings.

But iwi who want greater flexibility over how they distribute their income might find the requirements for charitable status too restrictive. While the final part of the "charitable purpose" definition might seem wide open, the legal interpretation is more restrictive. Komihana Kaupapa Atawhai (the Charities Commission) has published a guidance sheet[2] which provides helpful further explanation. It states that for a benefit to be a public benefit:

"the benefit must be available to the general public, or to a wide section of the public".

Operating with charitable status can also have implications for investment policy. For example, investing in a listed company that delivers part of their return to investors via imputation credits might be inefficient if the investing entity has charitable status and is unable to utilise or pass on those imputation credits.

Important to seek expert tax and legal advice

Tax and legal structures can get very complex and the impact of an inefficient structure can have significant financial implications. Clearly the difference in tax rates for charities (0%), Māori Authorities (17.5%) and companies (28%) can have a substantial impact on net income. Different blends of charitable trusts, Māori Authorities, commercial companies and partnerships will yield different results in terms of the cash and tax credits available for distribution. Some iwi operate with both charitable and non-charitable entities.

Structural considerations should include the impact on the tax position of both the organisation and individual iwi members. For example, analysis should take account of tax credits available for distribution and the ability of iwi members to utilise them. If members have a strong ability to utilise tax credits, then an entity structure incurring a 17.5% or higher tax rate, rather than a 0% rate, might not be as disadvantageous as it appears prima facie.

2 http://www.charities.govt.nz/assets/docs/information-sheets/charitable-purpose.pdf

For an introduction to the tax implications of different structures, some readers may find the following publicly available report prepared by Ernst and Young useful:

Report to Crown Forestry Rental Trust: "Tax Advice for Claimant Groups on Post-Settlement Governance Entity Structures", Selwyn Hayes and Amanda Johnston, Ernst and Young, May 2012.

We strongly recommend iwi seek professional tax and legal advice when making structural changes or setting up new structures.

2.4 Why do some organisations separate social and commercial operations?

Ngapuhi's 2011 Annual Report provides an apt quote to open this section.

> *'It is the economic horse that pulls the cultural cart'.* [3]

Commercial objectives and social objectives can often conflict. Consequently we often see organisations operating a separate arm for each. Sometimes it might be referred to as a split between commercial and social. Other times it might be referred to as a split between investment (to earn the income) and distribution (spending the income).

There is strong supporting precedent for this type of structural separation. In New Zealand we have several highly visible examples at the level of central government, with SOEs like Meridian and Genesis Energy focused on being good commercial businesses; and social objectives handled by other government departments with appropriate specialist expertise (e.g. in the areas of environment, health or welfare). While under the State Owned Enterprises Act 1986 an SOE can potentially have non-commercial roles, doing so requires Ministers to pay the SOE for services provided.

Prior to the formation of SOEs, government enterprises were performing poorly. A review[4] identified the major problem as "a lack of clear objectives for departmental trading activities". Many departments had multiple objectives.

3 Quote is by American Native Indian Chief Clarence Louie of the Osoyoos Indians. Sourced from page 12 of Ngapuhi's 2011 Annual Report.
4 "State Owned Enterprises: History of Policy Development and Implementation", September 1996, The Treasury, page 9.

For example, the New Zealand Forest Service was on the one hand responsible for protecting conservation interests, while on the other hand involved in commercial harvesting operations. The proposed solution was the State-Owned Enterprises model, the primary aim of which was "to clarify objectives faced by managers of state businesses and at the same time establish managerial autonomy and accountability"[5]. If commercial operations can perform better, there is more income generated to put towards achieving social goals.

Like central government, iwi may have both commercial and non-commercial objectives. The separation of these objectives, for operational purposes, provides clarity of focus and accountability and many iwi organisations are now structured this way.

The separation into commercial and non-commercial arms at an operational level does not mean they're separated in all respects. For example, the governing body might require an element of regional focus to the investment policy. Investments will still be run purely commercially, but local iwi members benefit from things like the associated job creation.

Iwi examples of separate commercial and non-commercial arms

Iwi	Commercial/Investment Arm		Distribution/ Social Arm
	Entity	Principle Objective	
Ngāi Tahu	Ngāi Tahu Holdings Corporation (NTHC)	Use "the assets of the Trust allocated to the company and prudently to administer them and its liabilities by operating as a profitable and efficient business"	Distributions are managed by Office of Te Rūnanga o Ngāi Tahu (TRONT)
Waikato-Tainui	Tainui Group Holdings (TGH)	"...maximise Shareholder wealth through a sustainable asset portfolio."	Waikato Raupatu Lands Trust (parent entity of TGH) manages distributions
Ngāti Whātua o Ōrākei	Whai Rawa (proposed)		Whai Maia (proposed)
Ngāti Awa	Ngāti Awa Group Holdings Ltd (NAGHL)	Grow the underlying real capital value of NAGHL's assets over the long term.	Development Ngāti Awa is the social arm.

5 Ibid., page 10.

2.5 How do iwi currently spend their income?

For less wealthy iwi, spending is predominantly on tribal expenses and discretionary grants.

Others spend on a wide range of tribal development and support activities.

Restrictions of charitable status constrain spending options for charitable entities.

Ngāti Whātua o Ōrākei will provide a useful new reference point for a non-charity, as their income ramps up.

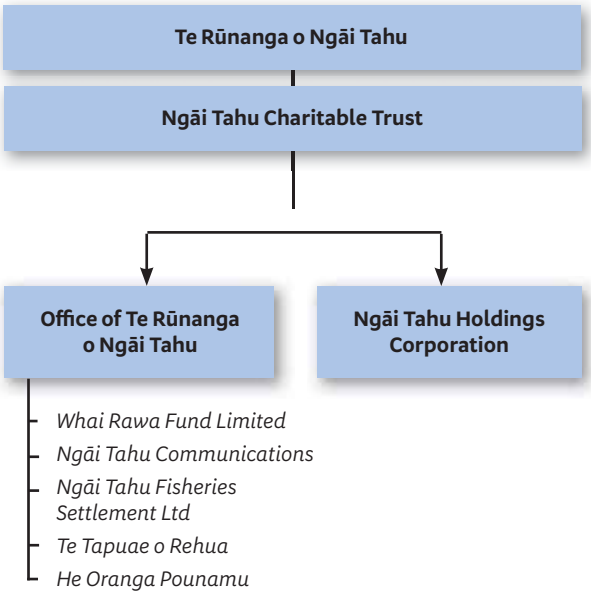
Spending under charitable restrictions

To recap, in order to retain charitable tax status, the distributions for many iwi entities are restricted to the following purposes:

1. The relief of poverty.
2. The advancement of education or religion.
3. Marae administration and maintenance (if criteria are met).
4. Any other matter beneficial to the community (acceptable to the authorities).

Iwi who operate charitable entities manage to accommodate a wide range of activities within these constraints. The next two sections show the organisational structures and spending compositions of Ngāi Tahu and Waikato-Tainui, who primarily operate charitable structures.

Ngāi Tahu



Spending on Te Rūnanga o Ngāi Tahu (TRONT) operations was approximately $25m in FY2012, split 40% on operational expenses and 60% on tribal, Rūnanga and whānau spending, net of related revenues. (Please note that the 60% figure picks up just the direct costs of programs. General operational and admin expenses associated with the programs are included in the 40% figure.)

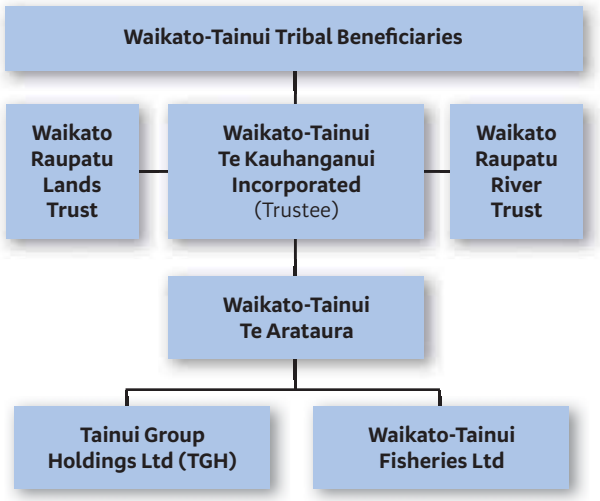
The strategic document "Ngāi Tahu 2025" identifies 9 distinct areas of importance for Ngāi Tahu to impact and influence. The composition of spending in recent years across these areas and overall governance is provided in the following table.

Ngāi Tahu spending composition

Spending composition by financial year	2009	2010	2011	2012
Papatipu Rūnanga Development Support to Papatipu Rūnanga, economic development, taonga commercial development and Te Pūtea	21%	20%	34%	24%
Social Development Whai Rawa savings programme, health and social projects	10%	18%	15%	20%
Tribal Communications & Participation	15%	13%	11%	10%
Organisational Development	16%	14%	10%	11%
Natural Environment Fisheries, DOC interaction, tribal heritage & cultural mapping, RMA advocacy, tribal property	7%	7%	7%	10%
Culture and Identity Cultural projects, art centre and exhibitions, membership, Te Reo initiatives	9%	8%	7%	8%
Education Advocacy, scholarships and grants	3%	5%	5%	4%
Influence Engagement with the Crown and other organisations to influence outcomes	7%	7%	5%	6%
Investment planning	2%	1%	0%	0%
Governance (TRONT Board)	10%	7%	6%	7%

From 2009, 2010, 2011 and 2012 annual reports.

Waikato-Tainui



Of the $10m-$11m dividend received each year by the Waikato Raupatu Lands Trust from TGH, between $4m and $7m has been used to make grants.

The grants made in 2011 and 2012 were as follows:

Grant purpose	2012 $000	2011 $000
Education	885	786
Kiingitanga	3,494	1,327
Marae	1,000	950
Marae facilities	638	590
Other	740	706
TOTAL	**$6,757**	**$4,359**

From the 2012 annual report of Waikato Raupatu Lands Trust.

Grant examples

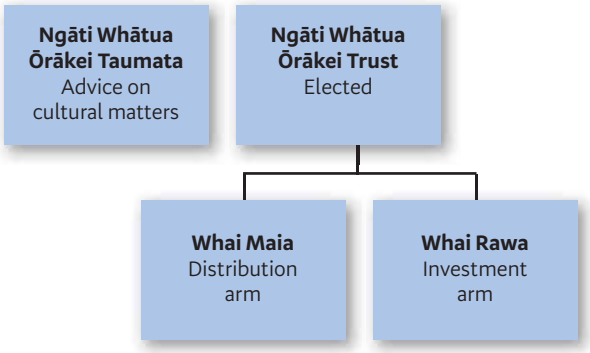
- Kaumātua medical grants of up to $500 per 12 month period are available to all registered kaumātua aged 60+.
- Tertiary Education and Doctoral Scholarship grants.
- Health and Well Being grants.
- Grants to assist tribal members wanting to participate in Māori arts and crafts, music, drama or dance.
- Maatauranga grants seek to promote, preserve, advance and maintain tribal mātauranga.
- Grants for the construction, maintenance and upgrade of main marae facilities.

We do not have a detailed breakdown of how remaining expenditure is allocated among areas such as tribal administration and social and cultural development.

Spending without charitable restrictions

Ngāti Whātua o Ōrākei will provide a useful new reference point for a non-charity, as their income increases significantly. The iwi is continuing to develop their distribution and spending strategies in anticipation of a strong revenue stream from land rentals.

Ngāti Whātua o Ōrākei



- Ngāti Whātua o Ōrākei is establishing a new, non-charitable PSGE, which will improve spending flexibility.
- The iwi expects to make distributions of $70m over the next 10 years, low in the first 3 years and building up from there.
- The spending strategy will recognise that the most appropriate form of assistance varies across ages.
- Criteria in the spending strategy include:
  - Reasonable and low administration costs.
  - Focus on hand up rather than hand out.
  - Reflect awareness of tribal aspirations.

In considering the financial position of Ngāti Whātua o Ōrākei, an aspect that stands out is the high level of income relative to the number of iwi members. The table below provides context. Please note that the estimates are very rough and are only for high-level illustrative purposes. For example, we haven't considered aspects like tax; some estimates of the number of members are dated; and the actual annual level of distributions for Ngāti Whātua o Ōrākei is not known.

Annual dividend from commercial operations relative to number of iwi members

	Dividend	Members	Dividend / Members
Ngāi Tahu	$26.3m	49,185	$534
Waikato-Tainui	$11.0m	63,000	$175
Ngāti Whātua o Ōrākei	say, $7m	5,000	**say,$ 1,400**

Sources: Dividends: Waikato-Tainui is from 2012 annual report (combined dividend from TGH and Waikato Tainui Fisheries Ltd), Ngāi Tahu is from 2012 annual report and Ngāti Whātua o Ōrākei is a crude estimate using the iwi's reference to $70m in distributions over the next 10 years. Members: Ngāi Tahu figure is from 2006 census; Waikato-Tainui figure is from 2012 annual report of Waikato Raupatu Lands Trust; and Ngāti Whātua o Ōrākei figure is from a July 2010 New Zealand Herald article[6].

The commencement of railway land rental revenue is one of the reasons given by Ngāti Whātua o Ōrākei for why their new PSGE structure is important. While we can't draw conclusions about preferred organisational structures from this table (e.g. Ngāi Tahu and Waikato-Tainui's structures are at least in part reflective of legacy decisions), we would certainly expect the desire for greater distribution flexibility to increase as the amount available for spending (relative to membership numbers) reaches high levels.

6 http://www.ngatiwhatuaorakei.com/index.php?option=com_content&Itemid=2&catid=1&id=155&lang=en&view=article

Focus topic: Universal cash payments to individual iwi members

2.6 Policy considerations

In this section we briefly consider some of the issues in relation to universal cash payments to individuals ("per capita payments").

Note beforehand: Some Māori organisations already make distributions directly to individuals (such as some land trusts which pay dividends to shareholders). The discussion that follows is intended more for consideration by organisations managing collective iwi assets that don't have allocated individual shareholdings.

Universal cash payments may become more of an issue

One of the key philosophical debates that can come up when considering tribal spending policies is whether to make universal cash payments to individuals. By this we mean making cash payments to all members within an iwi (not necessarily payments of equal value).

So far in New Zealand, spending by Post Settlement Governance Entities ("PSGEs") has tended to be allocated on a targeted basis, aimed at achieving specific social outcomes. This partly reflects the limited income generation historically across many iwi and in some cases may perhaps reflect the constraints of operating under historical structures designed around charitable tax status. However, as iwi wealth continues to grow over time, and further settlements are paid out, the issue of universal cash payments to individuals may gain prominence. We could also see more internal political pressure within iwi for these types of payments.

Typical arguments for and against making cash payments to each tribal member ("per capita distributions")

*Typical arguments **for** per capita distributions*

- Individuals and families are best placed to determine what use of cash best meets their needs. People should be allowed to think for themselves, rather than have an external committee decide what's good for them. For one family, cash might be best spent on improved medical treatment; for another it might be best spent on remedial education.
- Per capita distributions allow all members to share in the wealth and success of their iwi. The income generated from iwi assets belongs to iwi members. It's theirs.
- Per capita distributions are fair, because all benefit equally (if equal payments).
- Per capita payments can be structured in ways that promote behaviours that iwi wish to encourage. For example, making deductions to a family's payment if their children's school attendance is too low; or paying a slightly higher payment if the iwi member speaks Te Reo.[1]
- Initiatives run by governments – whether tribal governance authorities, central government or local councils – can often be inefficiently run, achieve poor results and waste money.

*Typical arguments **against** per capita distributions*

- Some recipients can view per capita distributions as hand-outs and this can contribute to an attitude of dependency.
- Individuals might not use the cash "appropriately" (e.g. not directed towards the social needs of them or their family, or not in a manner consistent with wider iwi values).
- Generous per capita payments can potentially lead to tribal registry issues. The prospect of cash payments incentivises people to get on the iwi register so they can benefit. This could lead to arguments over the criteria for iwi citizenship.
- If the asset base is very narrow (e.g. heavily reliant on a particular industry or sector), then the funds may be better off invested in ways which diversify the asset base, to provide a more stable platform for the future.
- Once established, per capita distributions can potentially become a restrictive drag on the underlying commercial businesses. An expectancy to get their annual payments could develop amongst iwi members, putting political pressure on the cash generating businesses to pay out more than the underlying businesses deem commercially appropriate.
- Public good can be better enhanced if funds are applied from a holistic perspective. The central body is better placed to build social infrastructure - like a new kindergarten.

1 Please note that these examples are illustrative only and are not necessarily recommended. Policy tools need careful crafting to avoid unintended behavioural responses and to ensure money is well spent.

General considerations

For many of the above arguments, for either side there is a counter argument. The debate can be endless. A few general comments we would make are:

- In some cases there are mitigants or policy responses which can help reduce adverse effects (or perceived adverse effects) of per capita distributions.
- Per capita distributions and public good initiatives are not mutually exclusive. For example, a system of per capita cash payments can sit alongside other initiatives like education grants, sports scholarships and a social infrastructure program.
- In some ways the issue of how best to spend iwi funds for the social benefit of members faces similar policy considerations to those central government faces when deciding how to achieve social outcomes. However, an important difference is that all iwi members are effectively owners of their tribe's commercial assets and the income, which can produce a sense of individual entitlement that's not dependent on "need".
- Regardless of philosophical position, an overriding constraint is the availability of cash. For some iwi the capacity to pay per capita distributions is very limited. In some cases it might, for example, be more effective to pay one person a $400 education grant, rather than 400 members a $1 cash payment each.
    - When considering Ngāi Tahu's Whai Rawa savings scheme later in this report (section 2.8), it seemed to us that an annual payment of around $200 appears "meaningful". A lower figure might be too, but we don't have any basis for stating one.
- The cost of administration for per capita payments is an important factor that needs to be taken into account. What is the size of administrative expenses relative to the value of distributions?
- Once an iwi is in a position to pay meaningful per capita payments (should it wish to do so), financial modelling is required to properly assess the proposition, including considerations such as sustainability, operating costs and intergenerational fairness.
- Establishing or altering an organisational structure to facilitate the spending flexibility required for per capita payments can be a major decision that needs careful analysis of the costs and benefits (including tax and legal advice). If per capita distributions are a future possibility, then organisational structure issues should be considered well in advance (to the best extent possible, given that it is not possible to anticipate all future regulatory changes). Once established, some structures may be difficult to change.

Cash (and tax) constraints aside, the choice of whether it's better to make per capita distributions or not comes down to the desired objectives and values of individual iwi. This is a crucial point, and it's a judgement call.

2.7 Overseas experience with universal cash payments - American Indian tribes

The US regulatory setting

Many American Indian tribes receive a large part of their revenues from gaming operations. The Indian Gaming Regulatory Act (IGRA) was enacted in 1988, to regulate the conduct of gaming on American Indian Lands. IGRA establishes the National American Indian Gaming Commission (NIGC) and a regulatory structure for Indian gaming in the United States.[2]

American Indian tribes are entitled to use revenue from gaming operations to:[3]

i. Fund tribal government operations or programs;
ii. Provide for the general welfare of the tribe and its members;
iii. Promote tribal economic development;
iv. Donate to charitable organizations; or
v. Help fund operations of local government agencies.

If a tribe wishes to go beyond this list and allocate any gaming profits using per capita payments, then they must submit a Revenue Allocation Plan (RAP) for approval by the Bureau of Indian Affairs. The RAP outlines how the tribe will use their gaming revenues.

Tribes need to distinguish between per capita distributions and distributions for the purposes of (i) to (v) above, for tax reasons. Payments for items (i) to (v) are general welfare measures and are not subject to federal taxes. Per capita payments are subject to federal taxes, which are collected through withholding taxes.

2 http://www.nigc.gov/Laws_Regulations/Indian_Gaming_Regulatory_Act.aspx
3 Sec 290.9 Ref: http://www.ho-chunknation.com/?PageId=304

A RAP must meet 5 basic criteria[4]: The plan must:

- Allocate an "adequate" portion of net revenues for one or more of the items in (i) to (v) above.
- Contain sufficient information to enable the government to test compliance.
- Protect the rights of minors and others legally incompetent.
- Have a system to notify members of their tax liabilities.
- Contain eligibility criteria for establishing tribal membership.

4 Sources: http://www.casinoenterprisemanagement.com/mp3-library/rap-primer and http://www.nigc.gov/Laws_Regulations/Indian_Gaming_Regulatory_Act.aspx (sections 3 and 2(B))

Specific approval is required if per capita payments represent over 50% of tribal net gaming revenue.[5]

Examples of how American Indian tribes allocate their gaming revenues

The table below provides examples of how American Indian tribes allocate their gaming revenues, for a sample of tribes that make per capita payments. Figures are sourced from tribe Revenue Allocation Plans.

5 http://www.bia.gov/cs/groups/xraca/documents/text/idc013360.pdf

Spending allocations for a sample of Amercian Indian tribes

Tribe/ Confederated Tribes/ Community	Date	Tribal Government Operations & Programs	Tribal Economic Development	General Welfare of the Tribes & its Tribal Members	Donations to Charitable Organisations	State and Local Governments	Other / Category allocation unclear	Per Capita Payments
Klamath	2006	19%	19%	19%	2%	1%		40%
Stockbridge-Munsee	c2007	35%*	35%*	30%*	1%x max			Determined annually and funded from general welfare bucket
Ho-Chunk Nation	2006	13.68%	7.48%	78.26%	0.30%	0.28%		Determined annually and funded from general welfare bucket
Puyallup	2006	27.6%	1.6%	35.4%				35.4%
Grand Ronde	c2006							25%
Eastern Band of Cherokee	c2009	21.5%		15.25%			13.25%	50%
Bishop Paiute	2006	20%	25%	15%				40%
Little Traverse Bay Bands of Odawa	c2006	40%	13%	25%	2%			Up to 20%. Any surplus is allocated to General welfare
Siletz Indians of Oregon	2009	11%	29%	15%	0.5%			40%
Rincon Band of Luiseno Mission Indians		8% to 13%	8% to 12%	8% to 15%	0% to 1%		0%-9% discretionary reserves	50% to 70%
Poarch Band of Creek Indians	2011						80%	Max 20%
Forest County Potawatomi Community							>= 50%	Max 50%
Gila River	2007	30% to 64%	10% to 44%	15% to 49%	0% to 1%	0% to 1%		11%
Elk Valley Rancheria	2002						70%	Max 30%
Yavapai Apache	2004						Max of 85%	10% now and a further 5% invested for future allocation%

** Adjustable. Eastern Band of Cherokee figures outside of per capita are approximate groupings only from adding together itemised categories. Siletz economic development figure of 29% includes 17% for "Economic Development" and 12% allocated to "Investment".*

Incidence of per capita distributions

Many American Indian tribes don't make per capita distributions because they simply can't afford to. For others the choice of whether or not to make per capita distributions is a policy decision.

As at March 2008, approximately 73 out of over 200 American Indian tribes that operate casinos had Revenue Allocation Plans in place for making per capita distributions[6].

American organisation Two Hawk Institute conducted a series of research interviews with North American Indian tribes, looking into perceptions, experiences and policies regarding per capita payments[7]. Findings included:

- In general tribes making per capita payments and tribes not making per capita payments defended their own positions.
- There was an overall belief that: "per capita money by itself would not cause harm, but that desirable outcomes were dependent upon how it was used."
- "A great deal of effort must be expended to ensure a successful program that does not jeopardize tribal members and tribal financial systems."

While the last point suggests a note of caution, we suspect the comment about not jeopardising tribal members might reflect the sometimes very large payments involved. Some payment amounts to tribal individuals are sufficiently large (thousands of dollars) to influence decisions over whether or not to seek higher education or employment.

Using per capita distributions to influence behaviour and help achieve social outcomes

While American Indian tribes predominantly make equal per capita payments to all members, there is a growing trend towards varying payment amounts according to circumstance and attaching conditions to payments.

Examples[8] include:

- Making additional payments to elders and members with special requirements.
- Accumulated payments to minors, which are held in trust, being paid when they are 18 years old if they receive a high school diploma, but otherwise not paid until they are 25.
- Paying minors a certain portion of their payments held in trust when they receive a high school diploma and the remainder when they receive a college degree. Without a degree they need to wait longer.
- Redirection of all or part of per capita payments when child support payments are not being met by the member.
- Deductions from a member's payments if they are in jail.
- Deducting from a family's entitlements when children miss school.

A raft of examples of measures to achieve beneficial behavioural outcomes exists in the wider context of general social policy.

Effects that the size and frequency of payments can have

Anecdotal evidence[9] suggests that relatively small per capita payments (small is not defined, but let's assume hundreds of dollars as opposed to thousands of dollars) can have positive effects on people's lives. Modest payments are typically spent on school uniforms, house repairs, debt reduction, general living expenses and the like. As payments get more significant, negative effects can start to appear. For example, one tribe reported a drop in motivation amongst tribal members once they introduced payments of around US$2,000 per month[10].

The timing and frequency of payments can also affect how they get used. For example, small regular payments may be more likely to discourage impulse spending, compared to large lump sums. American Indian tribes making payments over $2,000 per year tend to break it into multiple smaller payments.[11] Tribes with modest distributions are more likely to make them via a single payment. Some tribes align payments with times of year when members face budget pressures (e.g. Christmas time or the start of the school year).

6 http://www.casinoenterprisemanagement.com/mp3-library/rap-primer
7 http://www.twohawkinstitute.com/seminars-publications/per-capita-issues-and-concerns/
8 Primarily from: "Per Capita Distributions of American Indian Tribal Revenues: A Preliminary Discussion of Policy Considerations", S Cornell, M Jorgensen, S Rainie, I Record, R Seelau and R Starks, Udall Centre for Studies in Public Policy, The University of Arizona, 2007. Pages 11 and 12.
9 ibid., page 9.
10 ibid., page 9.
11 ibid., page 12.

Considerations when drawing inferences for New Zealand

Many American Indian tribes receive a significant level of revenue from casino operations. In some cases this revenue can fund substantial distributions. For example, the Puyallup tribe uses 40-55% of its gaming revenue in its per capita program (up from 35% in 2006), with individual tribal members receiving pre tax payments of approximately US$2,000 per month.[12] For many tribes, actual amounts distributed to members are often not disclosed, but suggestions are that some monthly payments can be very large – even over US$10,000 for the very rich American Indian nations[13].

When using the US examples to make inferences for New Zealand we need to be careful to take into account that some of the American Indian tribes are very rich, which influences their decision making.

Another important factor to take into account is that the United States has a substantially different government funded welfare system to New Zealand. This has implications for how American Indian tribes might use their funds. For example, some tribal distributions might be used to pay for welfare services which in New Zealand are already provided adequately by central government.

To us, one of the main observations from reviewing the American Indian experience is that it reinforces the tribe-specific nature of the decision on whether or not to make per capita payments.

2.8 Ngāi Tahu's Whai Rawa programme - details and comparison versus universal cash payments

Details of the programme

Ngāi Tahu operates a unit trust savings scheme for members called "Whai Rawa", which was launched in October 2006. According to Ngāi Tahu's 2008 Annual Report, Whai Rawa was developed in response to a request from Te Rūnanga o Ngāi Tahu (TRONT) for a programme that:

- "Provided for direct distributions to Ngāi Tahu whānui; and
- Resulted in increased social and economic independence and self sufficiency for Ngāi Tahu whānui."

12 http://www.puyalluptribalnews.net/news/view/per-capita-program-designed-to-meet-long-term-needs/
13 Cornell et el. (2007) page 9.

The reference to "direct distributions" (which are via matched savings across a wide tribal member base) caught our attention. Particularly as Ngāi Tahu operate primarily under a charitable structure.

The investments of Whai Rawa are currently managed by Mercer (N.Z.) Limited and comprise a conservative mix of defensive and growth assets.

TRONT may make contributions to members participating in the scheme.

- These contributions may take the form of an amount matching the member's contribution, or may be a straight distribution (no matching requirement).
- The levels of distributions and matched payments are at TRONT's discretion and can be varied from year to year.
- Payments can be varied between members.
- Members aged 65 years or older do not receive matched TRONT contributions, but can otherwise participate in the investment fund.

For the 2012 calendar year:

- TRONT matches member's savings contributions by $4 for every $1 saved by children under 16 and $1 for every $1 saved by adult members.
- Maximum TRONT contributions are $200 per child or adult member for the year.
- A distribution of $60 is available to tribal members who enrol before their first birthday.
- Some of the administration fees associated with the programme are paid for by TRONT.

For individual members, withdrawals from the fund are restricted to:

- Financing tertiary education.
- Assisting with the purchase of a house (generally restricted to first home buyers).
- Retirement withdrawals, once a person has reached 55 (can withdraw entire balance).
- Finance for special circumstances (discretionary).
- Payments to personal representatives in the event of the member's death.

Other features:

- There is no requirement for members to make ongoing payments into the fund.
- Retirement withdrawals are for a minimum of $500 at a time (this figure can vary).

As at end of FY12, TRONT had contributed $13.5m since conception and members $10.7m. 16,710 people are enrolled in the fund, which represents approximately one third of Ngāi Tahu's circa 49,000 tribal members.

For further details, please refer to the Whai Rawa Investment Statement or Prospectus.

http://www.whairawa.com/publications

Tax treatment of TRONT contributions

The Retirement Scheme Contributions Tax (RSCT) is applicable to contributions members receive from TRONT. The rate will vary between 10.5% and 33%, depending on the member's circumstance.

- Ngāi Tahu entities that do pay tax generate tax credits that can be applied to the contributions TRONT makes to Whai Rawa members. TRONT is taxed on its business income at the Māori Authority rate. (Note - the Ngāi Tahu Charitable Trust and its subsidiaries have charitable status for income tax purposes, with the exception of Ngāi Tahu Seafood's Australian subsidiary.)

- Consequently, contributions made by TRONT will generally have Māori Authority Tax Credits (MATCs) attached to them. Members can use these to partly offset personal tax obligations, including RSCT. The maximum level of credits is 19.5%, but the actual level varies. In the most recent year the level was 10.5%.

Comments and observations

Whai Rawa compared to direct cash payments to all

The programme clearly provides the opportunity for iwi members to receive direct distributions. Key differences compared to universal cash payments include:

- Members need to contribute their own capital and expose it to investment risk.

- There is a delay in being able to access the benefit (less so for some groups e.g. senior secondary students planning tertiary education and members aged over 55).

- Iwi members aged over 65 do not receive TRONT matched savings contributions.

- The programme encourages desired behavioural outcomes (e.g. saving habits and financial literacy).

Policy observation

Often with central government savings incentive programs the bulk of the benefits can get captured by the middle and upper classes, because they are the ones who can best afford to save. But with Whai Rawa the benefits are capped at a dollar amount and the thresholds for both participating and obtaining maximum benefits are low:

- Minimum initial investment is $10.

- Annual contributions of only $50 for a child or $200 for an adult (about $4 per week) will currently attract the maximum contributions from TRONT.

Take up rate

Participation by iwi members:

- Scheme membership growth has steadied to around 5% per year over the past 3 years.

- Ngāi Tahu reported in 2010 than over 50% of registered tribal members aged under 16 were enrolled in the scheme. Of these, 60% were actively saving (which implies "over 30%" of registered tribal members aged under 16).

- As a rough estimate, the 2010 figures suggest that perhaps around 30% of registered tribal members aged 16 or higher were enrolled in the scheme (exact figures not published). 45% of these people were actively saving, which suggests that around 10-15% of registered tribal members aged 16 or higher were actively saving in the scheme.

In considering per capita distributions earlier, one of the things we were interested in was how large a per capita payment would need to be for it to be "meaningful". While we have to be careful to not read too much into limited analysis of the Whai Rawa figures, it seems to us that:

- A payment of $200 per person appears "meaningful", given the current take up rate of circa 30%+ in respect of members under 16 years of age, despite the need to tie up $50 pa of their own money and having to wait a number of years before receiving the benefits; and

- Raising the requirements to access the benefits can make a big difference to the take up rate. In this case, the need for people aged 16 and over to tie up $200 of their own capital instead of $50 to access the full benefits, and in many cases face a much longer waiting period, are likely to

be important factors in the lower take up rate by the over 16s – which looks like it's below half of that of the under 16s.

Overall scheme cost

In 2012 costs for Whai Rawa "distributions and development" were $2.9m[14]. This is equivalent to 11% of the dividend TRONT receives from NGH. The cost to TRONT for Whai Rawa matched savings and distributions in that year was $2.2m,[15] which is presumably incorporated within the $2.9m figure.

The Prospectus for Whai Rawa gives TRONT flexibility around the level of matched savings and distributions, which is a useful stabilisation factor. For example, if the dividend to TRONT from NGH is impacted adversely by difficult economic times, the matched savings contributions can potentially be adjusted.

Scheme administration costs

A key consideration for investment funds of this type is the cost of administration and investment management. The fund needs to be sufficiently large so that fixed costs (such as a trustee fee of perhaps $20k pa) aren't too burdensome. In Ngāi Tahu's case, TRONT has been subsidising fees and will continue to do so (albeit at a lesser rate from July 2012) until a review in 2016.

The requirement for critical mass may mean this type of fund may only be an option for wealthier iwi. Corroborative/pooled/outsourcing arrangements may offer alternative means to establish a viable investment fund, but we have not explored these options.

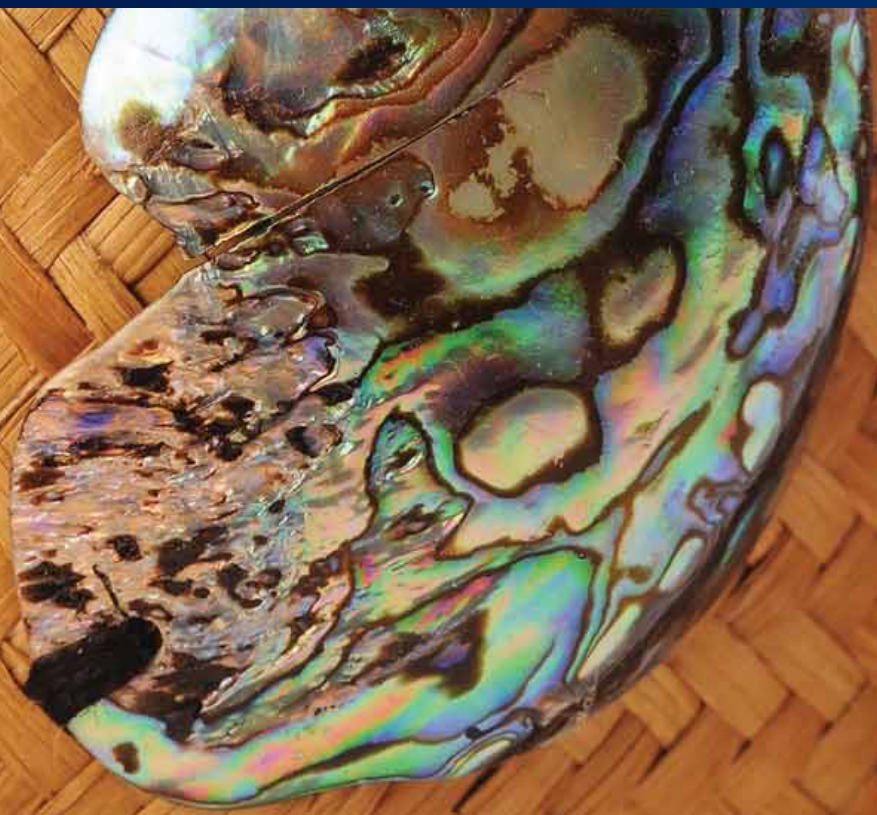
Part 2: Summary comments

- **Structural separation of iwi commercial and social operations enhances clarity and accountability.**
- **As iwi wealth grows we may see more debate around the issue of universal cash payments to members. Ultimately the approach taken is a judgement call, which may vary across iwi. If adopted, universal cash payments can be structured in ways which promote desirable social outcomes.**

14 TRONT 2012 annual report notes, page 39.
15 From Sep 2012 Whai Rawa Prospectus, page 33.

PART 3:

Appendices



Appendix 1: Examples of distribution policies of overseas permanent funds

The examples here are predominantly US universities with large endowment funds. Large funds such as these have a greater preponderance of hybrid rules.

US universities

Yale Endowment Fund [1]

The market value of the Yale endowment was US$19b at the end of FY11. It funded 36% of Yale's operating budget. Yale's policy for distributing the fund's earnings aims to balance the objectives of a stable income flow and preservation of the real value of the fund over time. To do this it uses a long term spending rule and a smoothing rule (refer earlier comments on "Yale Model").

Specific parameters used by Yale in 2011 were:

- The spending rule sets the target distribution rate, which is currently 5.25% of the value of the fund.
- The smoothing rule gradually adjusts the distribution to changes in the market value of the fund. Under the rule, annual distributions are calculated as:
  - 80% of the previous year's distribution; plus
  - 20% of the targeted long-term distribution rate applied to the market value two years prior
- The resulting figure is then adjusted for inflation and constrained so that it falls between 4.5% and 6.0% of the fund's inflation adjusted market value two years prior.

In earlier years Yale had used 30% as the weight applied to the fund's market value, rather than 20%.

1 2011 report of the Yale Endowment.

Stanford University Endowment Fund[2]

The market value of the Stanford endowment was US$16.5b as at 31 Aug 2011. It provides funding for approximately 22% of Stanford's expenses (FY11).

- Stanford uses a smoothing rule which sets the coming year's payout rate to be a weighted average of the current year's payout rate and the target rate.
- Over the 2007-2011 financial years, the annual amount of the fund paid out has ranged between 4.3% and 6.8% of the market value at the start of the year. The current targeted spending rate is 5.5% (the smoothed rate actually paid out will differ from year to year).
- Reductions in distributions from the fund of 10% in FY10 and a further 15% in FY11 were implemented in response to the economic downturn.
- The Stanford board approves the annual payout amounts, taking into account factors such as those listed in Section 4 of the UPMIFA (refer Appendix 3).

The Stanford payout policy is specified as[3]:

$$\text{Distribution} = W \times D_{t-1} \times [1 + \delta] + [1 - W] \times V_{t-1} \times R$$

W	= Weight applied to the previous year's distribution
V_{t-1}	= Value of invested funds at the end of last year
R	= Distribution Rate (%)
D_{t-1}	= Distribution last year $m
δ	= The rate of inflation in the last year

Note: This is effectively exactly the same formula as in section 2.2. We've just changed W to apply to last year's distribution and [1-W] to apply to last year's value of the fund, instead of vice versa, to match the way it's expressed in the source report. The values of W and [1-W] reverse accordingly.

Harvard University Endowment Fund[4]

Harvard's approach to distribution uses a formula that is intended to provide budgetary stability by smoothing the impact of annual investment gains and losses, and to preserve the value of the endowment in real terms (after inflation). The formula's inputs reflect expectations about long-term returns and inflation rates. (We don't have the actual specifications of the formula, but it sounds as though it's likely to be a Yale type of approach.)

2 Stanford University Annual Report, 2011.
3 "Endowment Spending Goals Rates and Rules", P Mehrling (Barnard College), P Goldstein (Stanford University) and V Sedlacek (Commonfund).
4 2011 Annual Report of Harvard University, page 4.

- The Fund has a targeted payout ratio of 5.0% to 5.5% (again, the smoothed rate actually paid out will differ from year to year). The fund believes this level provides a balance between the maintenance of purchasing power for future generations and the desire to pursue current opportunities.
- For the 2011 fiscal year, the approved endowment distribution represented 4.5% of the fair value of the endowment fund at the beginning of the fiscal year.

Massachusetts Institute of Technology (MIT)[5]

MIT believes that to balance the needs of all generations of scholars it needs to minimise fluctuations in year-to-year distributions, whilst also being responsive to changes in the value of the fund. The initial approach MIT used to achieve this was to average the value of the endowment fund over a 3 year period and target a distribution between 4.75% and 5.50% of that average. However, this method did not generate sufficient stability when markets declined in the early 2000s and a change in policy was made.

MIT's new approach adopted a "Tobin Spending Rule", named after famous economist James Tobin. (Note – this is another term for the approach followed by Yale and Stanford.) The formula has two terms – one to generate stability and one to pick up on market movements.

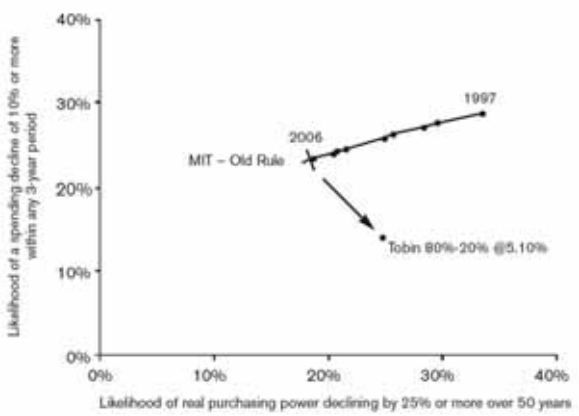
MIT uses the following formula:

Distribution =
80% x (Distribution in prior year increased by inflation)
+
20% x (5.1% x The market value of the endowment fund)

The 80% and 20% weightings can be altered to shift the emphasis between stability and responsiveness to movements in the market value of the fund.

The Institute used a technique called Monte Carlo analysis to simulate a large number of potential outcomes. Over the short term, MIT is focused on avoiding drops in distributions of more than 10% in any 3 year period. Over a longer term (50 year time horizon) the focus is on avoiding a deterioration in purchasing power of more than 25%. The following graphic shows the impact that moving to a Tobin Spending Rule has on these two measures for MIT.

Endowment Spending Policy at MIT:
Results of applying the Tobin Rule



Graphic source: MIT Faculty newsletter May/June 2008.

Princeton University Endowment Fund[6]

Princeton has one of the larger US university endowments, with assets of approximately $17 billion (June 2011). This fund is operated using two policy settings to achieve a prudent trade-off between current needs and stability, and maintaining long term purchasing power:

- The *Spending Rate* is the amount distributed by the endowment divided by the endowment's market value at the beginning of the financial year. The policy band set by trustees currently allows the spending rate to be between 4.00% and 5.75%.
- The *Spending Rule* stipulates that the distribution paid by the endowment will increase by a set percentage each ear. The current rate is 5% per year. The rule may be modified for a given year, such as in situations where it would result in a spending rate outside of the policy band.

5 MIT Faculty newsletter, May/June 2008 http://web.mit.edu/fnl/volume/205/alexander_herring.html

6 http://finance.princeton.edu/policy-library/endowment/endowment-spending/ (October 2011 update).

University of Texas Fund[7]

The Permanent University Fund (PUF) in Texas provides funding to a group of state universities. It was established in 1876. The state government vested land assets with the fund, and the PUF benefited substantially from the subsequent oil boom.

As at 30 June 2012 the market value of the PUF was US$13.1 billion, exclusive of land acreage. Assets include a portfolio of investments and land holdings.

Distributions from the fund are subject to the following over-riding conditions:

- Distributions cannot exceed the previous year's level unless the purchasing power of the PUF's investments has been preserved, for any rolling 10 year period (except as necessary to pay debt servicing on PUF bonds).
- The minimum amount payable is the amount needed to pay any debt servicing on bonds issued by the PUF. Debt servicing on PUF bonds is deducted from PUF distributions. Remaining distributions are used to fund academic programs at the recipient universities.
- The maximum amount payable is 7% of the average fair market value of PUF investments in any fiscal year (except where necessary to pay debt servicing on PUF bonds).

7 https://www.utsystem.edu/cont/Reports_Publications/LARs/14-15AUFLARAug.pdf and the PUF's 30 June 2012 Semi-Annual Report.

Other overseas examples

Cambridge University[8]

The Cambridge University Endowment Fund (CUEF) had a market value of £1,550m as at 31 July 2011. (Note - this is a separate fund to the endowments of the university's independent colleges, which have assets of several billion pounds.)

- The Fund's long term objective is: "to achieve annual growth equal to Retail Price Inflation plus 1% (after distributions are taken into account) in order to keep pace with projected academic costs."
- The long term investment objective is returns equivalent to Retail Price Inflation plus 5.25%. Combined with the above statement, this implies a long term annual distribution rate of 4.25%.

Annual distributions are determined by "a formula based on underlying capital values combined with factors which smooth the rate of spending changes from year to year". This suggests to us a "Yale" type of approach.

As at 30 June 2011, assets comprised: global equities 61%, equity long-short 7%, private investments 3%, absolute return 10%, credit 3%, real assets including property 13%, and fixed income and cash 3%.

Colleges and other charities are permitted to invest in the CUEF.

University of Oxford[9]

The Oxford Endowment Fund is a vehicle to invest gifts and donations in perpetuity. It opened to investors in 2009. As at the end of 2011 the University of Oxford had £709m invested in the fund.

The fund invests on a total return basis (i.e. not solely focused on generating income). It aims to:

- Achieve a real (i.e. inflation adjusted) long-term rate of return of 5% over the Consumer Prices Index.
- Distribute an average rate of 4% to investors to fund their charitable activities.

A smoothing formula is used to minimise the effects of capital value volatility on annual payments and to enable the distribution rate to be achieved over long periods of time.

8 Information has been sourced from Cambridge University's 2011 Annual Report; and Cambridge University Reporter, 21 Dec 2011, Financial Management Information for the year ended 31 July 2011 http://www.admin.cam.ac.uk/reporter/2011-12/special/06/

9 Information sourced from The-Oxford-Funds Annual Report, 2011.

Appendix 2: Case Study: The Alaska Permanent Fund

The Alaska Permanent Fund is an interesting example of a fund with an intergenerational focus that makes universal cash payments to individuals.

Background

In 1976 Alaska voters approved the establishment of the Alaska Permanent Fund. It was created by an amendment to the state constitution that requires at least 25% of the proceeds from various mineral lease rentals and royalties to be paid into the fund.

The fund came about because the state government spent mineral income received in the early 1970s very quickly. With substantial future oil revenue expected, Alaskans wanted to safeguard some of the state's revenue for all generations of Alaskans (including those which will not have income from oil).

- The size of the fund has grown to approximately US$40 billion (as at Sep 2012).
- The fund aims to generate a real return (i.e. inflation adjusted) of 5% per year. The level of risk of the investments is prudent and broadly consistent with that of other large investment funds.
- The principal of the fund can only be used for income producing investments. It is protected from spending. It is not invested in projects which focus on economic or social development.
- Net income is available for appropriation by the state government. Each year the state government allocates these funds for dividends, inflation proofing (additional investment) and whatever other lawful purposes it may decide. There is extremely strong public political pressure for the dividend program to be maintained.
- In 1982 inflation proofing of the fund principal was enacted, to protect the purchasing power of the fund. However, this protection is only partial – the state government decides each year whether to use the Fund's earnings to protect the fund principal from inflation.
- Since 2000 the trustees of the fund have promoted a Percent of Market Value (POMV) approach, which would limit annual spending (including dividends) to 5% of the fund's market value.
- The 5% figure is viewed as the long term expected difference between the return on the fund's investments and the rate of inflation. It is also similar to the median payout of endowment funds in the US at that time (4.9% in 1999).
- Imposing such a spending limit would provide enhanced inflation-proofing, as it removes the state government's discretion in the matter.
- Despite the support of the trustees, POMV has encountered public opposition and we understand that it has not yet been successfully legislated for (requires a constitutional amendment).

Approach to distributions

- Over the last 20 years annual dividend payments to Alaskan residents have mostly been in the range of US$900-US$1,500 per person.
- Alaskans are very favourably disposed to the dividend program and are strongly against allowing the government to tamper with the fund.
- Alaskans must apply each year to receive a dividend. Applicants must meet residency requirements (e.g. resident for all of the prior calendar year and intend to remain a resident indefinitely). Certain criminal offences will render a person ineligible.
- The fund can distribute realised income (such as share dividends, bond interest and net profits from selling assets) to qualified Alaska residents. The fund cannot spend the principal and it cannot distribute non-realised income (income not received in cash) - such as changes in the market value of properties.
- Only half of net realised income is available for dividends each year.
- Annual dividends are calculated in accordance with a formula set in state law. The formula uses the fund's average income of the latest 5 years, which helps keep the dividend amount stable.

1) Total net income from the 5 most recent years.
2) Multiply by 0.21.
3) Divide by 2 (only 50% of earnings are available for dividends).
4) Check that the calculated amount does not exceed 50% of the balance of the realised earnings account. (A defined constraint that must be met.)

5) Make adjustments for operating costs, designated state expenses, etc.

6) Divide by the number of successful applicants.

References

http://www.apfc.org/home/Content/home/index.cfm
[Home page of the Fund]

http://www.apfc.org/_amiReportsArchive/2011Insert.pdf
[Example of dividend calculation]

http://en.wikipedia.org/wiki/Alaska_Permanent_Fund
[Background on the Fund]

http://www.apfc.org/home/Media/publications/2009AlaskansGuide.pdf
[Guide to the Fund]

Appendix 3: Uniform Prudent Management of Institutional Funds Act (UPMIFA)

General UPMIFA guidance on investment decisions and endowment expenditures for charitable organisations

In the US the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) provides guidance on investment decisions and endowment expenditures for charitable organisations. The UPMIFA is law in most US states, although each state adopts its own version of endowment management law. The UPMIFA only applies to endowments that are permanently restricted, by the donor or law. A link to the Act is:

http://www.uniformlaws.org/shared/docs/prudent%20mgt%20of%20institutional%20funds/upmifa_final_06.pdf

The UPMIFA reduced some restrictions of earlier legislation and made it easier for funds to handle short term volatility. The spending floor was removed and US charities could now spend as much as they deemed prudent. However, while the Act does not require principal capital to be set aside from distributions, it does assume that the charity will act to "maintain the purchasing power of the amounts contributed to the fund".

While aspects of the Act are not directly relevant to iwi (e.g. most iwi funds don't come from donors), in many areas the Act provides a useful set of governance considerations for permanent funds. The following three tables provide some of the US Act's requirements in relation to investment and distribution policies.

UPMIFA: Factors, where relevant, that must be considered when managing and investing funds

1. General economic conditions.
2. The possible effect of inflation or deflation.
3. The expected tax consequences, if any, of investment decisions or strategies.
4. The role that each investment or course of action plays within the overall investment portfolio of the fund.
5. The expected total return from income and the appreciation of investments.
6. Other resources of the institution.
7. The needs of the institution and the fund to make distributions and to preserve capital.
8. An asset's special relationship or special value, if any, to the charitable purposes of the institution.

Source: UPMIFA (2006), Section 3 (e)(1).

UPMIFA: Factors, where relevant, that should be considered when deciding whether to distribute or accumulate funds

1. Duration and preservation of the endowment fund.
2. Purposes of the institution and the endowment fund.
3. General economic conditions.
4. Possible effect of inflation or deflation.
5. Expected total return from income and the appreciation of investments.
6. Other resources of the institution.
7. The investment policy of the institution.

Source: UPMIFA (2006), Section 4 (a).

UPMIFA: The Act also requires charities (and those who manage their funds)[1] to:

1. Give primary consideration to donor intent as expressed in a gift instrument.
2. Act in good faith, with the care an ordinarily prudent person would exercise.
3. Incur only reasonable costs in investing and managing charitable funds.
4. Make a reasonable effort to verify relevant facts.
5. Make decisions about each asset in the context of the portfolio of investments, as part of an overall investment strategy.
6. Diversify investments unless due to special circumstances, the purposes of the fund are better served without diversification.
7. Dispose of unsuitable assets.
8. In general, develop an investment strategy appropriate for the fund and the charity.

Source: UPMIFA (2006).

1 These factors reflect that intentions of the donors to endowment funds need to be taken into account. In the case of iwi it is more about the values and requirements of the tribe, but in many other respects the factors above are equally applicable.

Appendix 4: Summary of key information sources and references

Part 1: Distribution policies: How to best allocate income between spending and investment?

1. Annual reports and web sites of New Zealand iwi.

2. "Endowment Spending: Building a Stronger Policy Framework", Verne O Sedlacek and William EF Jarvis, Commonfund Institute, October 2010.

3. "Evolution of Endowment Spending Policies and today's Best Practices" Callan Associates, November 2004.

4. The 2011 NACUBO-Commonfund Study of Endowments.

   http://www.nacubo.org/Research/NACUBO-Commonfund_Study_of_Endowments/Public_NCSE_Tables.html

5. "Sustainable Spending for Endowments and Public foundations: Achieving Better Long-Term Results", Bernstein Global Wealth Management, January 2011.

6. "Which Spending Policy is Best for Your Endowment or Foundation", Lancaster Pollard Investment advisory Group, January 19, 2011 (presentation slides).

7. "Endowment Spending Policy: An Economist's perspective", 2004, Perry Mehrling, Barnard College:

   http://net.educause.edu/ir/library/pdf/FFP0413S.pdf

8. Uniform Prudent Management of Institutional Funds Act:

   http://www.uniformlaws.org/shared/docs/prudent%20mgt%20of%20institutional%20funds/upmifa_final_06.pdf

9. "Long-Duration Trusts and Endowments", James P Garland, The Journal of Portfolio Management 2005.31.3, p44-54.

10. "Are Spending Policies of European Foundations Sustainable?" Mirko Cardinale, Richard Purcell and Marcus Bishop, Technical paper February 2007.

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12. The Sustainability of Endowment Spending Levels: A Wake-up Call for University Endowments", Gregory P. Ho, Haim A. Mozes, and Pavel Greenfield. The Journal of Portfolio Management, Fall 2010.

13. "Are 5% distributions an achievable hurdle for foundations? Were they ever?" Steve Murray, Russell Investments, August 2012.

Part 2: Spending policies

1. Annual reports and web sites of New Zealand iwi.

2. Charities Commission:

   http://www.charities.govt.nz

3. Report to Crown Forestry Rental Trust: "Tax Advice for Claimant Groups on Post-Settlement Governance Entity Structures", Selwyn Hayes and Amanda Johnston, Ernst and Young, May 2012.

4. Ngāi Tahu's Whai Rawa Prospectus:

   http://www.whairawa.com/publications

5. "Per Capita Distributions of American Indian Tribal Revenues: A Preliminary Discussion of Policy Considerations", S Cornell, M Jorgensen, S Rainie, I Record, R Seelau and R Starks, Udall Centre for Studies in Public Policy, The University of Arizona, 2007.

6. "Per Capita: Issues and Concerns"

   http://www.twohawkinstitute.com/seminars-publications/per-capita-issues-and-concerns/

7. "A RAP Primer"

   http://www.casinoenterprisemanagement.com/mp3-library/rap-primer

8. Indian Gaming Regulatory Act.

   http://www.nigc.gov/Laws_Regulations/Indian_Gaming_Regulatory_Act.aspx

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BNZ Contacts

Pierre Tohe
Head of Māori Business

Tel. 09 976 5283
Mb. 021-418 493
Em. pierre_tohe@bnz.co.nz

Gary Baker
Director - Institutional Research

Tel. 09-924 9353
Mb. 021-995 435
Em. gary.r.baker@bnz.co.nz