

Due Diligence for Managing Endowments

United Jewish Communities
Endowment and Foundation Roundtable
Washington, D.C.

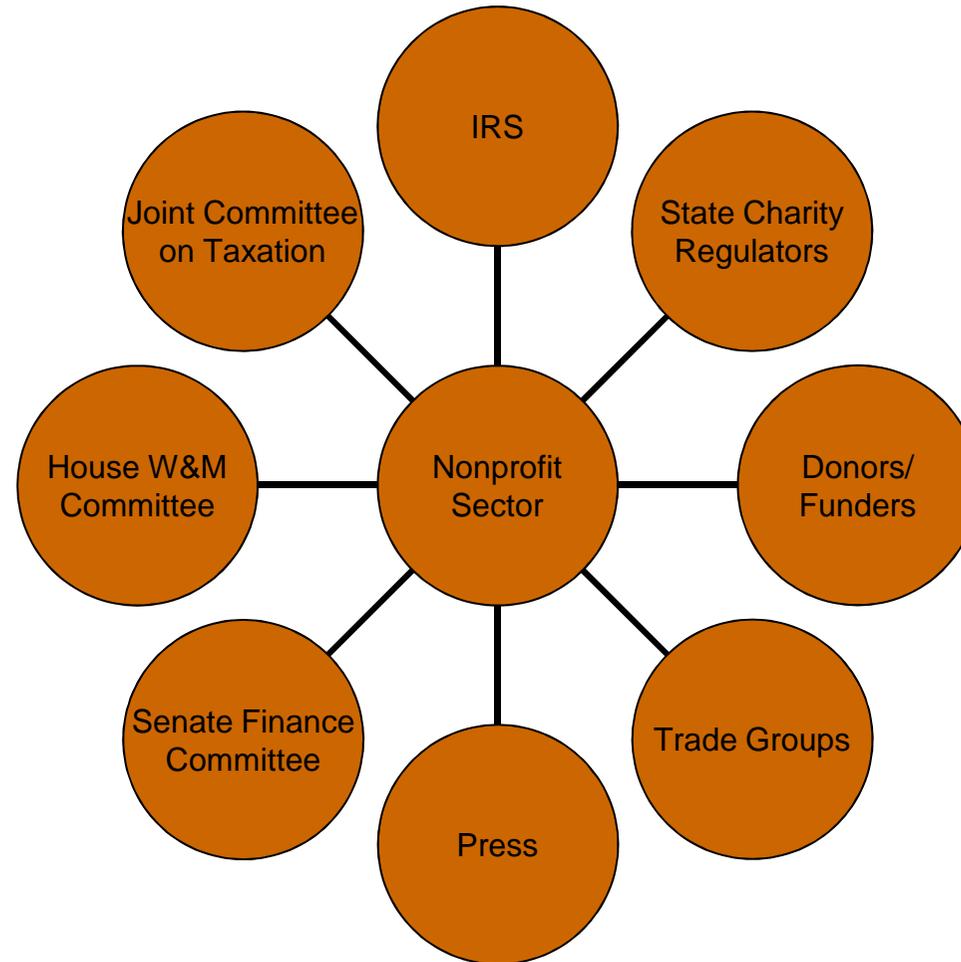


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Agenda

- Interested stakeholders
- Role of best practices and policies
- Laws regulating investment decisions
- Fiduciary duties
- Delegation of duties
- Investment committee
- Standards for prudent investment management
- Investment policy

Interested Stakeholders



Role of Best Practices and Policies

- Best practices and self-imposed rules
 - Fills gaps left by the law
 - Guides decisions in hard cases
 - Helps ensure consistency
 - Provides training for board members: explains what standards apply to whom
 - One size does not fit all
- Policies
 - IRS and state charity regulators will ask for them
- Disclosure and transparency
 - Explains decisions
 - Creates record of decision making

Laws Regulating Investment Decisions

- Federal law
 - No rules directly applicable to public charities
 - Jeopardy investment rules apply only to private foundations, not public charities
- State laws
 - Uniform Management of Institutional Funds Act (UMIFA) (1972)
 - Uniform Prudent Management of Institutional Funds Act (UPMIFA) (2006)
 - Uniform Prudent Investor Act (1994)
 - Different standards may apply to charitable corporations and trusts
- Keep current - remember that laws change and evolve over time

Fiduciary Duties

- Follow donor intent and restrictions
- Duty of care
 - Make decisions with the care an ordinarily prudent person in a like position would exercise under similar circumstances
 - Devote time, attention and resources to make informed decisions (active participation)
 - Attend board meetings, review and understand relevant materials
 - Request and receive adequate information (duty to inquire)
 - Act in good faith
 - Honesty and faithfulness to the director's duties and obligations
 - Disclose nonconfidential material information other directors do not already know
 - Duty to use special skills or expertise if appointed to board or committee in reliance on those skills

Fiduciary Duties

- Duty of loyalty
 - Make decisions in the best interest of the organization
 - Manage or avoid conflict of interest
 - Financial conflict of interest (require affirmative decision of independent directors)
 - Non-financial conflict of interest (appearance of a conflict)
 - Conflict of interest doesn't disappear even if there is good reason to engage in the conflicted transaction
- Business judgment rule
 - Courts will generally not question decisions that were made consistent with exercising fiduciary duties

Delegation of Duties

- Board members may rely on others in carrying out their duties
 - Board members may rely on information, opinions and reports from staff, committees and outside professionals the board member reasonably believes to be reliable and competent
- Board's responsibilities when delegating
 - Act in good faith with the care that a “prudent person” would exercise under the circumstances
 - Proper selection based on informed decisions
 - Establish scope and terms of delegation
 - Require periodic reporting and good recordkeeping
 - Monitor/evaluate capabilities and diligence
 - Continued supervision and oversight
- Document rationale if Board or Committee declines to accept recommendation of expert

Delegation of Duties

- Responsibilities that cannot be delegated
 - Must look to state law
 - Nonprofit Corporation Act
 - UPMIFA
 - Allows for very broad delegation of investment management
 - Addresses only external delegation
 - UMIFA
 - Narrower than UPMIFA (e.g., board cannot delegate responsibility to set investment policy)
 - Addresses both internal and external delegation
- Board should retain final approval of investment policy and spending rate

Investment Committee

- Board appoints investment committee
- Board sets requirements and guidelines for composition
 - Board members and non-board members
 - Committee chair should be a board member
 - Financial expertise
 - Independence
 - No single, uniform definition of independence
 - Look to state law and Form 990 definitions
 - Independence from investment advisors and managers
 - Independence from internal staff/management
 - Independence from board and committee members

Investment Committee

- Board and committee should work together to define committee's role and define what roles are delegated to committee
 - Select investment advisors and managers
 - Delegate management with periodic reporting or require advisors/managers to make recommendations for approval by committee?
 - Recommend changes to investment policy
- Committee should have adequate resources for its work
 - Due diligence of investment advisors and managers
 - May assign internal staff person (or outside legal counsel) to assist with committee's due diligence functions
- Document decisions
- Periodically report to the Board

Standards for Prudent Investment Management

- Delegate investment management as warranted
 - To investment committee with expertise and/or outside managers
- Duty to investigate
- Make investments consistent with the organization's purposes and circumstances
- Modern Portfolio Theory
 - Evaluate based on total return of portfolio, not each individual investment
 - Consider returns in the context of risk

Standards for Prudent Investment Management

- Diversify
 - Exception in special circumstances, such as donated assets or donor restrictions
- Take costs into consideration
 - Reasonable costs to invest and manage assets
 - Passive vs. active investment management
- Legal compliance is evaluated at time the investment is made (not in hindsight)
 - Cuts both ways – spectacular returns do not make an investment prudent

Investment Policy

Special considerations for Board to address

- Set realistic spending rates that will not force investment committee to pursue risky investments that are outside the general risk tolerance of the organization
- If spending rate greater than investment return, then make sure legally permitted to spend from endowment funds and invade corpus
- Ensure that spending rate/policy and investment policy are consistent

Investment Policy

Special considerations for Board to address

- Take special legal restrictions into consideration
 - Donor restrictions on ability to invade principal
 - Restrictions imposed by UMIFA/UPMIFA on spending
 - Spending from “underwater” funds

Investment Policy

Basic provisions

- Purpose and objectives
 - Tied to charitable purposes/mission
 - Spending rate
- Risk tolerance
- Asset allocation
- Process for due diligence
 - Checklist and issues that raise red flags in the selection of investment advisors and managers (e.g., independent custodian, audit firm)
- Permitted and prohibited types of investments

Investment Policy

Basic provisions

- Special type of investments
 - Donor restrictions/intent
 - Socially responsible and mission related investments
- Performance evaluation
 - Investment managers
 - Investment consultants/advisors
 - Investment committee and/or board
- Process for reviewing policy
- Good recordkeeping
 - Document decisions and decisionmaking
 - Process drives compliance with fiduciary duties

Questions and Contact

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