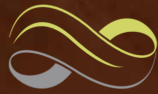
NATIONAL CENTER FOR
FAMILY PHILANTHROPY

SPLENDID LEGACY

CREATING AND RE-CREATING YOUR FAMILY FOUNDATION

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FINANCE

BY JASON BORN, PAM HOWELL-BEACH, AND SARAH STRANAHAN

"The highest use of capital is not to make more money, but to make money do more for the betterment of life."

—Henry Ford

Fiduciary defined

A fiduciary is a person, company, or association holding assets in trust for a beneficiary. The fiduciary is charged with the responsibility of investing the money wisely for the beneficiary's benefit. Most U.S. states have laws about what a fiduciary may or may not do with a beneficiary's assets. For instance, it is illegal for fiduciaries to invest or misappropriate the money for their personal use.

Source: Barron's Dictionary of Finance and Investment Terms

When your family creates its foundation, it has a responsibility to manage and invest its philanthropic assets. The responsibility, which comes with a number of complex questions and decisions, is — or can be — both a challenging and rewarding experience, and is probably best thought of not only in terms of the value of the assets, but also of the value of what those assets can accomplish.

As someone who is about to establish or join the governing board of a family foundation, you may or may not be familiar with and skilled at thinking about your personal or business investment goals and strategies. But regardless of your financial background and experience, you will have a special responsibility as a fiduciary when you agree to serve on the board of a family foundation.

A fiduciary agrees to invest and manage assets on behalf of another, and fiduciary duty is held to the highest standard of care in equity and law. In the case of a private foundation, your fiduciary duty is to the foundation's charitable mission.

As a foundation board member, you will be making important financial decisions for a legal entity that is regulated by the Internal Revenue Service and state agencies. You will assume legal and ethical duties of obedience, loyalty, and care to the foundation. Those duties require you first and foremost to adhere to the foundation's charter and mission, avoid self-dealing and conflicts of interest (see the legal chapter), keep the foundation's best interests in mind, and act as a "prudent investor" on behalf of the foundation. Private foundations enjoy special tax privileges because they are dedicated to serve a charitable purpose, and this charitable purpose, or mission, should inform all aspects of your financial decision making; governance and management structure, goals, investment policy; grant budget, and administrative and investment expenses.

You will be acting in a community of other board members; often your siblings, children, or in-laws, and next generations who also need to understand and exercise their fiduciary responsibilities with regard to the foundation.

This chapter aims to help you and your board develop finance and investment policies and practices that meet all legal requirements and are consistent with the goals and mission of your foundation. Sections in the chapter aim to help you:

- Link financial goals to philanthropic mission
- Establish the spending policy and administrative budget
- Create an investment policy and management policies
- Establish and review asset allocation targets
- Oversee your investment policy
- Avoid self dealing and other legal pitfalls

FIGURE 1: Glossary of Key Investment Terms for Family Foundations

ASSET ALLOCATION. The practice of spreading risk across a range of investment assets and management styles to balance the effect of market forces and volatility in relationship to the risk level that is acceptable to the investor. According to modern portfolio theory, as much as 95 percent of the return of a diversified portfolio of assets is attributable to the distribution (allocation) and regular rebalancing of a range of investment classes and styles within those classes.

EXCISE TAX. The tax on the net investment income of private foundations of 2 percent per year. This tax may be reduced to 1 percent under certain circumstances.

FIDUCIARY RESPONSIBILITY. The task of investing money or acting wisely on behalf of a beneficiary. In the foundation field, such responsibility is exercised on behalf of the donors and the grantees.

LIQUIDITY. The ease with which a financial asset can be converted to cash.

PAYOUT REQUIREMENT. The Internal Revenue Service requirement that private foundations must distribute 5 percent of the value of their net investment assets annually in the form of grants or eligible administrative expenses.

RATE OF RETURN. A measure of investment performance for a specified pool of assets. The rate is determined on a total return basis, including realized and unrealized changes in market value in addition to earned income (i.e., dividends and interest income). Managers may report returns before or after management advisory fees, but returns are always reported after brokerage and trading costs.

REBALANCING. A common strategy used to ensure that asset allocation guidelines are met over time, as changes in the portfolio occur due to changes in the values of individual assets. There are two primary rebalancing strategies: calendar and threshold. Calendar rebalancing is typically done on a quarterly or annual basis. Threshold rebalancing is done whenever guideline ranges are exceeded. Under either method, trustees can choose to rebalance back to the endpoints of the asset allocation guideline ranges or back to the target or "normal" allocation. Many consultants favor rebalancing back to the target on an annual basis because it results in lower transaction costs than other approaches.

RETURN REQUIREMENT. The rate of return on investment needed by a private foundation to meet its spending goals. For example, for a foundation that intends to exist in perpetuity, the return requirement is that its investment returns be equal to (or greater than) the total of (1) its grants spending objective, (2) the expected average annual inflation rate over the investment time horizon, (3) its estimated annual operating expenses, and (4) its estimated investment fees and expenses.

RISK. The measurable possibility of losing or not gaining value.

SOCIALLY RESPONSIBLE INVESTING. A style of investment decision making that takes into account social and environmental, as well as financial, concerns. One form of this is known as "mission-related investing," which attempts to align an institution's mission with its investment strategies.

SPENDING POLICY. An agreed-upon policy that determines what percentage of a foundation's endowment will be spent to cover both the operating costs and grants of an institution. Typical spending rules combine calculations based on previous years' spending, the current year's income and investment return rates, and the policy of the foundation for covering grant commitments.

VOLATILITY. A measure of the degree to which the price of a security goes up or down over a specified period. Highly volatile stocks tend to move up or down more than the market as a whole, while those with low volatility move up or down less than the market as a whole.

Linking Financial Decisions to **Philanthropic Purpose**

If you and your family have a clear and shared understanding of your foundation's mission, many of your financial decisions will flow naturally from that mission. Your philanthropic mission will inform the spending policy of your foundation, the investment strategy designed to support that spending policy, and the administrative structure and expenses that best support those goals.

If you are still working to establish your mission, don't despair. You can still exercise fiduciary responsibility while working to define a mission, and you can even thrive with a broad and evolving mission if that is the best way to fulfill your hopes and dreams for the foundation.

The answers to a few basic questions about your foundation's lifespan, mission, size, staffing and scope will help determine what financial goals and structures makes sense for your foundation.

- Are you creating a long-term legacy that you hope will survive for many generations, or do you have a shorter term goal for your foundation?
- Do you have a specific measurable mission or will your foundation support a wide range of interests and projects?
- Are you considering aligning your investments with your philanthropic mission?
- How large are your foundation's assets? Are they likely to grow in the foreseeable future though additional contributions?
- Will your board do most of the work of the foundation, or do you plan to hire professional investment and grantmaking staff?

An Important Note on Mission-Related Investing

Foundations have traditionally managed their investments to achieve the greatest possible financial returns. In turn, they were agnostic about where they invested their money — even if it meant that some of the companies in their portfolios might operate in industries that run counter to their missions.

But over the past 30 years, an increasing number of foundations have chosen to align their investment practices with their missions through a practice called "mission-related investing".

Foundations that practice mission-related investing seek to avoid specific investments in industries such as tobacco or fossil fuels, that run counter to their missions. Clara Miller, director of the F.B. Heron Foundation, explains how her foundation chose to invest only in companies that support its mission:

> *"Grants are one tool — but not the only tool — we have at our disposal, and to define ourselves primarily as a grantmaking foundation is limiting. Endowments have always been a source of investable capital for fostering businesses, industries, and nonprofit organizations that may be able to help in overcoming the new economic*

challenges. Philanthropy's financial tool kit should include every investment instrument, all asset classes, and all enterprise types. The way we deploy capital and the assumptions and approaches we use to do so can in themselves make a difference. We plan to invest 100 percent of our endowment—as well as other forms of capital—for mission."

Foundations that choose to engage in mission-elated investing have access to a number of resources to help guide their decisions. A good place to begin is the Mission Investor's Exchange, a clearinghouse and resource center dedicated to helping foundations design their own mission investment programs.

Considering Perpetuity

Will your foundation last for a specific number of years, cease to exist when it achieves a specific goal, or exist in perpetuity? The answer to this question will shape your foundation's investment strategy. If you are the founder, you can spare future generations a great deal of hand-wringing by making your intentions clear.

If your main goal is to support an issue that requires urgent attention, you may choose to focus your foundation's grantmaking activities over a short and concentrated period of time. Trustees of a foundation destined to spend all assets by a certain date will want to emphasize current income and liquidity in their investment strategy. Those governing a perpetual foundation will likely want to develop a strategy designed for long-term growth. However you may feel about the question of perpetuity, consider carefully what you want to accomplish — and what you want your family to accomplish — prior to committing to a long-term investment strategy or spending policy.

The number of family foundations that have decided to spend down is still small — fewer than 10 percent of U.S. family foundations have chosen to limit the lives of their organizations, according to NCFP's 2015 Trends in Family Philanthropy Survey. But the Trends results also show that this number is growing. Nearly 20 percent of the newest family foundations have already chosen to operate with a limited life, the survey found. By comparison, only three percent of those founded before 1970 have made this decision.

If that trend continues, the percentage of family foundations operating as spend down will likely grow substantially in the future. Perhaps even more significantly, more than 60 percent of family foundations in the country indicated that they have not yet made a decision around life span, or that they revisit the question of perpetuity from time-to-time.

The choice between spend-down and perpetuity ultimately should be based on what is best for the family and its philanthropic goals. But the fact that the choice exists — and is being talked about — is a very healthy development. Choice provides flexibility and offers the ability for families to be able to achieve the most possible good with their philanthropic investments.

One foundation that chose to spend down is the Aaron Diamond Foundation. In the late 1980s, foundation president Irene Diamond and the rest of its trustees recognized that they had an opportunity to make a real difference in AIDS research, an area that at the time was sorely lacking funding. With this in mind, the foundation increased its annual grantmaking to a level that allowed it to become a key supporter in AIDS research. Despite the fact that this decision resulted in the foundation spending itself out over the next decade, the board felt that the subject was important enough to warrant such an approach.

An equally compelling case can be made for creating philanthropic funds that build resources now and for

the future. This approach has long guided the Harris and Eliza Kempner Fund in Galveston, Texas. Started in 1946 by five members of the Kempner family, the original donors, as well as the current trustees, recognized the value of a perpetual foundation, as described in the fund's 1996–1997 biennial report:

> *The impetus for starting a foundation in 1946 came from the family's concern for the many local charities it supported. They realized that conditions that typically follow economic depressions and wars could affect their ability to support charities in times of greatest need. A philanthropic philosophy thus evolved: "Allow the more prosperous years to provide for the lean ones."*

Establishing the **Spending Policy**

Your family foundation's spending policy determines the annual budget both for operating costs and grants. Internal Revenue Service regulations require that private foundations spend at least 5 percent of their net investment assets as "qualifying distributions" each year. Qualifying distributions — also referred to as "payout" — of a foundation generally include:

- Grants to public charities, nonprofit organizations, and individuals (note: special IRS rules must be followed when making grants to individuals)
- Amounts paid to acquire assets used directly in carrying out the charitable purposes of the foundation
- Administrative and programmatic expenses associated with grant-making

Not all operating costs count as qualifying distributions. For example, the cost of overseeing your investments; investment management and advisory fees, investment committee expenses, custodial fees, and investment accounting and tax preparation do not count toward your qualifying distributions.

Bottom Line:
The IRS mandated payout is a minimum not a maximum

Your family foundation must meet federal annual minimum payout requirements, but you may choose to pay out more. Foundation boards address a number of important questions when setting — or evaluating — the spending policy of their foundation, including

- Does your foundation board want to exceed annual, minimum payout requirements? If so, by how much? In every year, or only in years in which the foundation's investments do well, or counter-cyclically, by spending a greater percentage in years in which the endowment value is down, and less in high-return years.
- What administrative structure and staffing will best support your philanthropic mission? There is a fine line between the virtue of frugality and the folly of failing to invest in your own capacity. Which investments in professional staff, travel, education and development, and networking will make you a more effective foundation?

Examples of the primary goals for spending policies adopted by foundations include:

- Meet the minimum distribution requirement (5 percent annually);
- Maintain or moderately increase the value of the endowment and distribute the remainder of the investment return; and/or
- If your foundation is spending out, pay out at an aggressive rate of 10 percent or more per year, with the expectation that all assets will be paid out within a predetermined horizon.

Determining Your Administrative Needs

There is no set rule for determining your foundation's administrative budget, but it is vital for determining your overall spending policy and thus your investment strategy. Administrative costs can vary significantly from foundation to foundation, depending on a number of factors. Boards must make key decisions regarding mission and grant priorities, which then determine staffing and other administrative needs. Considerations include:

- What is the geographic scope of your giving: local, regional, national, or international?
- Will you be making a few large grants to well known repetitive grantees, or do you expect numerous and frequent new applicants?
- Does your mission require you to develop, contract, or hire deep expertise in a particular issue area?
- How much time and energy do you plan to spend on due diligence of grant applications and on evaluation of your grantmaking program?
- Which administrative tasks is your board ready, willing, and able to handle? And how much professional staff support will you need?

Generally, staff or a board committee will prepare a detailed administrative budget based on the resources needed to accomplish these goals. Your board will review and approve this budget, and track actual and budgeted expenses monthly throughout the year. This process is completed every year, and administrative needs will likely change as the trustees revisit your foundation's priorities over time.

FIGURE 2: Example of a Family Foundation Spending Policy

INTRODUCTION:

The foundation is adopting the following spending policy in order to:

- Provide a more predictable and stable stream of revenue for its grantmaking and other activities; and
- Maintain the purchasing power of this revenue stream and the foundation's assets over the long term.

To achieve these goals, over a multiple-year period the trustees will take actions that will result in total spending equaling no more than 5.3 percent of a 3-year average of the market values of the foundation's assets at the beginning of the fourth quarter.

SPENDING RULE:

In calendar year 2018, the foundation will set its annual spending at the 2017 spending level, plus funding needed for one-time capital expenses of the __________ project.

In calendar year 2019, spending will be set at the 2018 spending level or 5.3 percent of the average of the market values of the foundation's assets on October 1, 2017, and October 1, 2018, whichever is greater.

In subsequent calendar years, spending will be set at the previous year's spending level or 5.3 percent of the average of the market value of the foundation's assets at the beginning of the fourth quarters of the preceding 3 calendar years, whichever is greater. In no case will spending exceed 6 percent of the previous year's market value (as determined as of the beginning of the previous year's fourth quarter).

The trustees will undertake a formal review of the spending rule at least once every 5 years. Should future market values either increase or decrease dramatically, the trustees will reconsider the spending rule, and either adjust spending or make changes in the spending rule as appropriate, keeping in mind the above stated goals.

Developing an Investment **Strategy and Policies**

Once you have established an initial spending policy for your foundation, you are ready to develop an investment strategy to help meet requirements of that policy. Several important steps are involved in developing an investment strategy. These include:

- Determining your risk tolerance
- Designing a management and oversight structure for your finances
- Calculating your target return requirement
- Developing an overall asset allocation strategy
- Developing the strategy and a written investment policy for the foundation

Determining your Risk Tolerance

A core precept of financial theory is that there is a positive relationship between risk and return. Riskier asset classes have greater potential payoff, but a higher likelihood of falling outside of expected returns (sometimes above, sometimes below). By definition, riskier investments can also result in significantly lower returns in some years, potentially making it difficult to meet multiyear grant commitments and future cashflow requirements. Used in moderation, however, riskier asset classes can actually lower the overall risk of the total portfolio.

Risk tolerance refers to your board's tolerance for the likelihood and frequency of realized investment returns falling below expected returns. It is the board's responsibility to assess the trade offs between risk and return, including a frank consideration of worst-case scenarios resulting from excessive risk avoidance or overly aggressive asset allocation. Some boards are uncomfortable with highly volatile asset classes, and choose to steer clear of them in the asset allocation decision.

Apart from certain risks that you must not take — such as self-dealing, jeopardizing investments, neglecting diligence and oversight, and failing to diversify your investments — the amount of risk you are willing to take to maximize your returns or your impact is a board decision. Periodically, the board should have a conversation to determine and review the foundation's risk tolerance. [Note: For an example of how one foundation's board evaluated its own collective risk tolerance, see the sample "Investments Questionnaire" developed by ACG and used by the board of the Stranahan Foundation in the Splendid Legacy 2 online resource.]

Calculating a Target Return

The targeted return for your foundation will depend on your long-term goals. It will include funds to cover your qualifying distributions, investment-management costs, and excise-tax obligations, but often exceeds these minimums to include an inflation or growth premium.

For example, a foundation with a 5.5% spending policy (including grants, allowable administrative expenses and excise tax) that also pays 1% in investment management fees during a period when inflation averages 2.5% would need to achieve an average annual investment return

FIGURE 3: **Calculating the Return Requirement**

RETURN COMPONENT	PERCENT OF AVERAGE ASSETS
Spending objective	5.50
Expected rate of inflation over investment time horizon	2.50
Estimated investment-related fees and expenses	1.00
Average annual investment return required	**9.00**

of 9% in order to maintain the inflation adjusted value of their portfolio. If this foundation hopes to grow the real value of its endowment, it will have to exceed a 9% average annual rate of return over the long term.

In some periods, foundations have been able to achieve target return goals of 10-12% without taking on unusual levels of risk. However, there have also been long periods, for example, between 1968-1981, and again between 2000-2010, when most foundations failed to realize their targeted return and average endowment values declined significantly in real dollars. After the 2009 financial collapse, several of the more aggressively invested foundations even experienced a liquidity trap; that is, their liquid assets were less than their payout requirements.

Since 2008, family foundations have experienced a prolonged period of low returns. Traditionally low-risk investments—like T-bills and high-grade corporate debt— have not had yields that support most foundation's targeted returns. It remains to be seen whether the global economy will return to longer-term average growth and interest rates.

If you hope to realize a 10% return today, you will probably be advised to invest in riskier, more expensive, and often illiquid, assets, such as high-yield bonds, emerging market debt, private equity or hedge funds. It is your board's job to decide what level of risk you are willing to take to reach your targeted return, or if you are willing to accept that you will "under perform" your target in order to reduce your downside risk.

Establishing An Asset-Allocation Strategy

The asset-allocation strategy is the primary determinant of your investment returns. This strategy is the key investment focus of your board (and/or investment committee), and is far more important than individual security or manager selection. Some observers estimate that as much as 95 percent of a foundation's investment returns result from its asset allocation decision. (This estimate comes from Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower, in their "Determinants of Portfolio Performance," *Financial Analysts Journal*, July-August 1986, pp. 39-44. While some practitioners dispute the exact figure, the fact that asset allocation is the single most important determinant of portfolio performance is almost universally accepted.)

As a fiduciary, you are mandated to diversify your portfolio. Diversification among asset classes reduces risk, because each type of asset responds differently to changes in the market. Because asset classes perform differently under different time periods and conditions, foundation rates of return are stabilized and improved by mixing asset classes that have different characteristics and patterns of return. For a visual presentation of the need to diversify your assets, see a sample "Broad Asset Class Performance" quilt showing the variance in best and worst performing asset classes over a 13-year period, available in Splendid Legacy Online (www.splendidlegacy.org).

A Note on **Alternative Investments**

Alternative investments are investments that do not fall under the category of traditional publicly-traded stocks, mutual funds, bonds or cash. Examples of alternatives include hedge funds and private equity. Before including alternatives as part of your investment strategy, it is important to consult with an experienced tax or legal advisor who is knowledgeable regarding the tax and compliance implications for private foundations. For example, some alternative investments may require special reporting (in addition to the 990PF) to the IRS and some may subject the foundation to federal Unrelated Business Income Tax (and related tax filings) and potentially in multiple states. If you invest globally, that opens up yet another whole host of reporting requirements and tax considerations. In determining whether to include alternatives in the portfolio, foundation trustees will wish to consider the additional administrative, compliance, reporting and tax costs that may be incurred.

Adopting the **Strategy** and a **Written Investment Policy**

Your foundation's investment policy helps guide your board, your investment committee, and managers and consultants who manage portions of your foundation's portfolio. This policy addresses the following:

- **Statement of objectives:** ties the investment policy to the mission and goals of the foundation (may include the specific return requirement, description of time horizon, diversification, and target risk levels, etc.)
- **Oversight of the policy:** describes who will be responsible for various investment-related tasks (the investment committee, key staff person, outside investment managers, etc.)
- **Asset allocation:** provides guidelines for the acceptable range for each asset class as a percentage of the overall portfolio (see sidebar)
- **Rebalancing procedures:** describes how and when the portfolio is rebalanced (usually either annually or if one of the asset classes reaches the threshold of its acceptable range)
- **Performance benchmarks:** include any of a number of possible common indexes and measures to help review ongoing performance (examples include the Standard & Poors 500, the Russell 2000, and the Lehman Aggregate Bond Index). Benchmarks are chosen based on their relevance to each asset class Jeffrey Leighton, former chief financial officer for the David and Lucile Packard Foundation and an experienced foundation investment consultant, offers the following advice or developing an investment strategy:

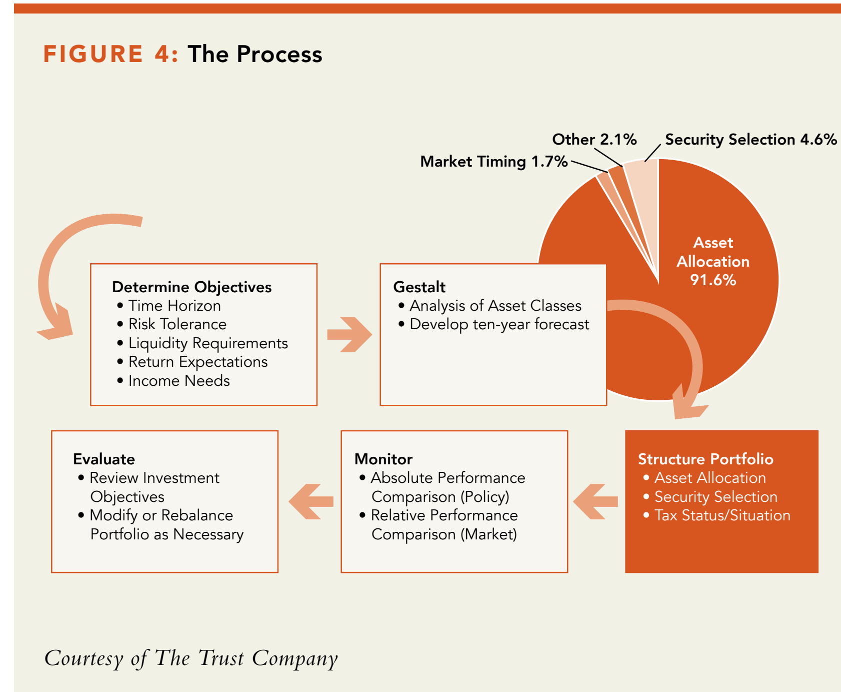
- The single most important strategy decision is the asset allocation policy. Manage risk by diversifying and investing to meet return objectives, not to maximize returns.
- Give policies and strategies time to work and stay the course through market upswings and downswings. Don't abandon a new strategy too soon. Investors who chase after the best returns end up doing just that — chasing after the best returns.
- Don't try to time or outguess the market. William Sharpe, a Nobel Prize winner in Economics, noted that the markets, on the whole, are likely to do just as well when an investor is out as when the investor is in.

- Avoid fads. David Salem, former president of The Investment Fund for Foundations, has noted that by the time a new asset class has proven worthwhile, the big bucks have already been earned.
- Review manager and total portfolio performance at least annually. Make sure that investment guidelines are being followed.
- Control costs. The best way for many organizations to improve overall returns is by exercising better cost control over fees and transaction costs.
- Rebalance the portfolio when you exceed asset allocation guideline ranges. Failure to rebalance the portfolio is tantamount to a decision to change the asset allocation strategy.
- The best investment strategy focuses on the investment process and policies, not the details.

SOURCE: Jeffrey R. Leighton. "Developing and Overseeing an Investment Strategy," Investment Issues for Family Funds: Managing and Maximizing Your Philanthropic Dollars.

The following flow chart shows the iterative process of creating, adopting, adjusting and evaluating your investment policy:

FIGURE 4: The Process



Courtesy of The Trust Company

An example of one investment policy, with descriptions of each of these components, is presented in Figure 5 (on p. 181).

FIGURE 5: Example of an Investment Policy for a Family Foundation

The purpose of this statement is to establish the investment policy for the management of the assets of the _____________ Foundation.

OBJECTIVES: The goals for the foundation's investment program are (1) to earn sufficient investment returns to provide for a 5 percent level of annual charitable distribution plus operation expenses, (2) to earn an additional return to maintain the purchasing power of the foundation's invested assets after distributions and expenses, and (3) to enhance the purchasing power of the invested assets, if possible. These goals will be pursued without incurring undue risk relative to the practices of comparable charitable foundations.

DISTINCTIONS OF RESPONSIBILITIES: The Investment/Finance Committee is responsible for establishing the investment policy that is to guide the investment of the foundation's assets. The investment policy describes the degree of overall investment risk that the Committee deems appropriate, given prudent investment principles and the basic objective of the preservation of the purchasing power of the foundation's assets.

Investment managers appointed to execute the policy will invest foundation assets in accordance with the policy and assigned policy guidelines, but will apply their own judgment concerning relative investment values. In particular, investment managers are accorded full discretion, within policy limits, to (1) select individual investments and (2) diversify assets.

ASSET ALLOCATION: It is the policy of the Investment/Finance Committee to invest the foundation's assets as follows:

ASSET CLASS	TARGET ALLOCATION (%)	ALLOWABLE RANGE (%)
Domestic Stock	55	51 – 59
Non-domestic Stock	15	11 – 19
Total Stock	70	67.5 – 75
Bonds*	30	26 – 34

**Bonds will have a minimum rating of BBB or its equivalent.*

REBALANCING PROCEDURES: Normal cash flows will be used to maintain actual allocations as close to the target allocations as is practical. At times, markets may move in such a way that normal cash flows will be insufficient to maintain the actual allocation within the permissible ranges. In these cases, balances will be transferred as necessary between the asset types to bring the allocation back within the permissible ranges, as described above. Rebalancing shall take place no less than once, and no more than twice, per year.

DIVERSIFICATION: The investment program shall be broadly diversified in a manner that is in keeping with fiduciary standards to limit the impact of large losses in individual securities on the total invested assets of the foundation.

LIQUIDITY: The foundation will advise investment managers of any anticipated needs for liquidity as such needs becomes known. Investment managers are to presume no need to maintain cash reserves other than those identified by the foundation.

PROXY VOTING: The Investment/Finance Committee delegates the responsibility for proxies to the individual investment managers. The Committee will vote proxies consistently and in the best interest of the foundation.

PERFORMANCE BENCHMARK: The foundation's investment objectives are to achieve a rate of return consistent with the asset allocation policy stated earlier. Over reasonable measurement periods, the rate of return earned by the foundation's assets should match or exceed that of a policy benchmark comprised of the following broad market indices and weights:

	POLICY BENCHMARK
Wilshire 5000 Stock Index (%) 55	55
MSCI All Country Ex-U.S. Index (%) 15	15
Lehman Brothers Aggregate Bond Index (%) 30	70
Bonds*	30

The individual managers' returns will be compared with appropriate market indices. For performance evaluation purposes, all rates of return will be examined after the deduction of investment management fees.

Overseeing the Investment Strategy

Setting your goals and risk tolerance and reviewing and ratifying key strategic decisions are board responsibilities that cannot be delegated. But your board can delegate much of the day-to-day due diligence of overseeing and implementing your investment policy.

Many family foundations establish an investment committee to oversee their investment strategy. Ideally, this committee is comprised of individuals with broad and diversified knowledge of investments. Investment committee members will be able to articulate the policies, actions, and results of the investment strategy to all current and prospective board members (whose understanding and experience in investments may be quite varied).

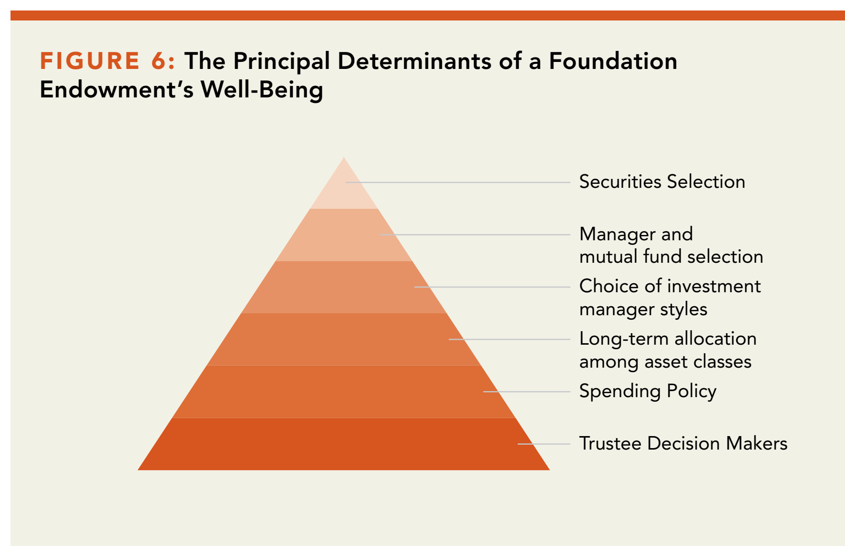
In addition to an investment committee, many foundations will hire investment consultants, investment managers, administrative staff, accountants and tax experts, and, for charitable trusts, a custodial bank, to oversee and manage their finances. As a result, it is important that investment policies clearly spell out:

- Which decisions can be made by each member of the team
- Who is responsible for which executing each step
- The time frame for reporting, review and evaluation of decisions
- Which records are neededand why,
- Communication protocols for each member of your team.

Foundation Endowment **Management Models**

In his seminal 2009 article, "Rethinking the Management of Foundation Endowments," John E. Craig, Jr., the longtime Executive Vice President and Chief Operating Officer of The Commonwealth Fund, describes several core foundation endowment management models. Craig notes that the management model is one of the key determinants of long-term performance, as illustrated in Figure 6.

FIGURE 6: The Principal Determinants of a Foundation Endowment's Well-Being



In his article, Craig describes three typical investment management models that family foundations may wish to consider:

- **Solo investment committee model.** For many small and mid-sized family foundations, the board's investment committee has virtually all of the strategic and operational responsibility for the endowment—working with little or no internal staff or consultant support. In such cases, the foundations typically delegate portfolio management to a brokerage firm, mutual funds, or external investment managers (often using commingled funds shared with other investors).
- **Investment committee-investment consultant model.** Foundations with larger endowments or more complex investment strategies will often hire an investment consultant to work with the investment committee to help inform and guide its decisions, and sometimes to help implement them. The amount of responsibility delegated by the committee ranges significantly under this model, depending on the capacities and preferences of the committee and the ability and services offered by the consultant.
- **Investment committee-internal financial staff-investment consultant model.** Foundations with assets of $250 million or more are likely to pursue a more sophisticated diversified investment strategy. Under these circumstances, the day-to-day management responsibilities require qualified staff. Often a professional staff member is also needed to ensure best use of the time and skills of the consultant and committee members. As a result, this model entails higher de facto (if not formal) levels of responsibility delegation by the investment committee.

Determining Investment Committee Responsibilities

Your investment committee generally assumes some or all of the following responsibilities:

- Ensures that the foundation's investment goals and objectives are in line with its grantmaking goals and objectives;
- Determines long-term allocation among asset classes;
- Determines choice of preferred investment manager styles;
- Determines whether to use separate accounts or mutual funds;
- Selects individual managers, consultants, and advisors (if necessary);
- Reviews the performance of individual managers and asset classes, and;
- Reports to the full board on the endowment's recent and long-term performance.

Depending on the complexity of these decisions, the committee may engage investment consultants to help them think through these responsibilities. In addition, a number of endowment management tasks must be undertaken regularly by committee members, foundation staff (if they exist), or an outside professional (accountant, lawyer, etc.). These activities typically include:

- Managing endowment cash flow;
- Monitoring asset allocation;
- Ensuring accurately reported quarterly and cumulative investment performance for individual managers and the endowment as a whole;
- Ensuring proper custody of endowment holdings and necessary recordkeeping on investment transactions;
- Preparing agreements with managers, mutual funds, brokers, and securities custodians;
- Ensuring that shareholder proxies are voted;
- Managing the investment consultant (if present); and
- Providing necessary staff support for the investment committee (scheduling meetings, distributing reports for discussion in advance, as well as providing advance reports on the endowment for board of trustees meetings).

SOURCE: John E. Craig, Jr. "Understanding Trustee Responsibilities and Duties," Investment Issues for Family Funds: Managing and Maximizing Your Philanthropic Dollars.

Finding Investment Advisors

Many family foundations work with outside investment advisors for some tasks. Below are several steps to consider when looking for outside assistance:

- Determine what types of assistance you are looking for (see sidebar);
- Develop a position description that lists the attributes you are looking for, including educational, experience, and performance requirements, as well as personality requirements and investment style;
- Talk with foundations, institutions, and individuals you know to get suggestions for prospective managers and consultants;
- Send a request for proposal (RFP) to those individuals/firms you would like to meet. This RFP will help your foundation determine each firm's experience, performance, fee structure, and staffing, as well as its research policy and practices, reporting procedures, and client service procedures; and
- Set up interviews with those candidates who meet your qualifications and requirements.

Selecting Investment Managers

Once your foundation has established an investment policy and asset allocation strategy, you may decide to hire one or more investment managers to select the actual investments, buy and sell stocks and bonds and handle the administrative aspects of investments.

Any investment firm or individual you approach will have tailored information on its performance over specific time periods. To ensure that you get helpful performance figures, make sure that those you meet with calculate performance in accordance with the guidelines of the Association for Investment Management and Research, and that they give you returns for 3-, 5-, and 10-year periods.

Questions you may wish to consider when interviewing managers include:

- What is their general approach to investing?
- What is the succession plan if they retire, become ill, or leave the firm?
- What other foundation clients do they work with? May you talk with them?
- What type of reporting and evaluation arrangement do they typically follow?
- What questions do they have about the position?

FIGURE 7: Family Foundation Investment Advisors

Trustees may find it useful to identify the particular talents they need. The following descriptions may offer a starting place:

- **Investment Committee:** Boards of many family foundations, even small ones, assign oversight duties to an investment committee, which typically reports to the full board quarterly.
- **General Advisor:** A family member, lawyer, accountant, consultant, or other person who offers general advice to the board.
- **Consultant:** A person who can help trustees to establish a decision making structure for investment management, develop a strategic plan, and find investment advisors and managers.
- **Manager:** A trustee, foundation employee, or outside manager who selects actual investments, buys and sells stocks and bonds, handles administrative aspects of investments, and reports to the investment committee.
- **Custodian:** A bank or trust company that holds assets, collects income, and reports periodically on investment activities.

SOURCE: Excerpted from Kathryn McCarthy. "Engaging Investment Advisors," *Resources for Family Philanthropy: Finding the Best People, Advice, and Support.* National Center for Family Philanthropy, 1999.

Before you hire a manager, you should ask yourself the following questions:

- Am I comfortable working with this manager? Does his or her style match my own?
- Am I confident that the foundation will receive significant added benefit for the fee dollars I am spending?
- Are there other options (index funds, mutual funds, etc.) I may wish to explore as an alternative to hiring an investment manager at this time?

Working with Investment Managers

If you decide to hire investment managers, you will want to establish reporting arrangements that make sense for both of you. Identify and agree on the performance benchmarks you would like to use, and establish reporting schedules for each of your managers. Investment managers should be expected to outperform their benchmarks on a net-of-fee basis, and if they fail to do so over an extended period (a couple of years or more), inquire as to the reasons why. Remember, though, that even the best managers will have periods where they under perform in relation to their peers or benchmarks.

Determine how often you would like the manager to report to the board, and in what form these reports are presented (for instance, quarterly written reports and annual board presentations). Evaluations should also account for the manager's investment style, and how this style may have affected recent performance. Ensure that the manager continues to follow the specific guidelines he or she has been given.

Evaluating Investment Managers

Investment managers are generally evaluated by following three questions:

- Has the manager adhered to the established investment plan and allocated assets as required?
- Have assets performed as expected?
- Is the chemistry between the family, foundation officers, staff, existing culture, and the manager good?

Monitoring can be done by a consultant, foundation officers, or foundation staff, depending on who has the qualifications and time.

The standard "market cycle" is about three years and it generally takes that long to determine fairly just how well an investment manager is doing. Still, performance should be checked closely for the first year after funds are fully invested and then monitored first quarterly, than annually thereafter. If performance is substandard, with no market-based explanation, a serious discussion or review should be considered.

Replacing Investment Managers

Most investment managers are replaced for one of two reasons:

- They drift away from the agreed-upon style. For example, the manager's style is to buy-and-hold growth stocks; but the manager spots potential "hot" stocks and tries to improve quarterly performance by trading risky equities in the short term.
- Poor performance after two to three years of full positioning. Throughout a full business cycle of expansion and recession, the manager is unable to even out performance for an overall positive outcome.

As a rule, the individuals charged with monitoring the investment manager give a warning of non-performance and try to work out any difficulties, particularly if the relationship has been satisfactory. Typically, termination occurs in the following steps:

- **Step One.** Warn the manager in a face-to-face discussion.
- **Step Two.** Withdraw a portion of foundation assets if problems have not been corrected by the end of a year.
- **Step Three.** Withdraw another portion of assets at the end of the second year if performance continues to drag or style drift is clear.
- **Step Four.** Withdraw all remaining funds.

Although it may seem that this process is somewhat drawn out, in many cases it is preferable to immediate withdrawal of all funds. In making termination decisions, a foundation must weigh the cost of moving a portfolio against transaction costs that would be incurred in correcting the unsatisfactory equity positions.

Determining the **Family's Role**

Because you have set up your foundation as a family foundation, you and your board may want to consider issues with implications for individual family members. Which family members show interest in serving on the investment committee? Must they be board members to do so? Which bring special knowledge or skills to the work at hand? To what extent should branches of the family, or generations, be represented? Also important, of course, are the personalities and interpersonal skills of family members who are called upon to serve in a group environment.

Family members who are selected to serve on the investment committee must be prepared to spend additional time on foundation-related activities. Determining who serves on the investment committee can be a difficult task. Traditionally, these committees have been made up of the founder and those trustees with the most experience in this area. Because all members of the board are considered fiduciaries of the foundation, however, it is important that each current and future trustee has a general understanding of investment activities.

Family foundations employ a wide variety of methods to teach younger and/or less-experienced family members about financial stewardship. Common practices — both informal and more structured — include:

- Placing next-generation and less-experienced trustees on the investment committee with more experienced board members/advisors;
- Spending a day with foundation money managers at their offices;
- Requiring money managers to conduct a 2 to 4-hour instructional seminars for new/future board members;
- Making occasional educational seminars part of the investment counselor's job description;
- Incorporating at least one learning segment related to finances at every board meeting;
- Developing a formal orientation-training program of from 1 to 3 days for next-generation

- members (a significant portion of which covers financial management);
- Sending trustees to professional conferences, seminars, and workshops on investment-related topics; and
- Establishing a separate Next Generation Advisory Board that includes a small fund to manage and a requirement that the advisory board report on its activities at every full board meeting.

SOURCE: Lester A. Picker. "Training the Next Generation," Investment Issues for Family Funds: Managing and Maximizing Your Philanthropic Dollars.

Reviewing Disqualified Persons Requirements

Family members sometimes find themselves playing a direct role in managing one or more of the asset classes or individual funds in the foundation's portfolio. This practice may be illegal under certain circumstances. It is very important, therefore, that you and the rest of the board be familiar with self-dealing rules. Situations to keep a close eye on include:

- **Compensating investment managers who are disqualified persons.** All family members are disqualified persons. The general rule here is that, while technically not self-dealing, the amount of the compensation must be reasonable, where reasonable means that a similar organization would pay such an amount for similar services under similar circumstances.
- **Compensating property managers who are disqualified persons.** This act is defined by the IRS as self-dealing and is, therefore, not permissible.
- **Lending money or extending credit to a disqualified person.** This act is defined as self-dealing and is not permissible.
- **Benefiting from joint investments.** Disqualified persons are generally not allowed to make personal investments in the same investment partnership.

For more information about the self-dealing rules, consult with legal counsel or refer to resources listed in the Appendices. You may also wish to develop a conflict-of-interest statement to make clear the limitations on board member's interaction with the foundation. (See the chapter on legal issues.)

Considering the Role of Future Generations

At some point, you and your board will need to determine how the next generation will be involved in managing the foundation's investments. Common questions that families face in this area include:

- Should the next generation have the option of changing the existing spending policy?
- How can we best prepare the next generation to manage the investments of the foundation?
- What guidelines can we provide the next generation with regard to the investments of the foundation?

Developing these guidelines can be an important and potentially time-consuming task.

FIGURE 8: Roadblocks and Bumps in the Road

Family foundation boards may experience challenging situations while overseeing the investments of the foundation, including:

- **Family members as paid investment managers:** Prudent boards will be wary of arrangements in which a family member is paid to manage the investments of the foundation. Reviewing the performance of a family member is not always easy, and trying to remove a family member as manager can be even more difficult. Combined with the need to ensure that the compensation arrangement is within the self-dealing rules, this practice may not be one that you will want to tangle with.

- **Liquidity considerations:** Foundations have annual payout responsibilities and, in most cases, ongoing operations costs. As such, you need to ensure that an adequate amount is kept in cash or some other easily converted investment type for annual (or more frequent) grant payments and other expenses.

- **Over-management of the endowment:** Just as individual investors do, foundation boards have a tendency to over-manage their investments — buying and selling new funds, changing advisors, and even changing investment styles regularly. Because of the high cost of these transactions, and because foundations usually invest for the very long-term, it is important that the board resist these temptation and, whenever possible, stick to a predetermined strategy through the inevitable ups and downs of the markets.

- **Time lags between meetings:** At the same time, cases arise where individual stocks or classes of stocks experience rapid shifts in price, and action may be needed either to rebalance the portfolio or take other more radical action. Because many foundation boards do not meet more than one or two times per year, it is important to have some system in place to account for these situations — this could be as simple as giving one or more of the trustees discretion to make these decisions.

- **Disparity of interests and abilities:** All board members — regardless of their investment background and experience — need to understand the strategy and decisions made with regard to the foundation's investments. This can be accomplished in a number of ways (see above for specific ideas).

- **Excise tax on net investment income:** Private foundation endowments are subject to an excise tax of at least 1 percent, and up to 2 percent, of investment returns each year. These taxes are paid on realized net gains, and a portfolio with constant turnover will likely trigger the maximum tax payments. Although it may not be possible to avoid the maximum tax in any given year, families may wish to consider working with advisors who have sensitivity in managing the portfolio in a tax-efficient manner.

Diversifying a Family Business Holding

Many family foundations are created by entrepreneurs who created and acquired wealth through successful business careers. Often, the wealth they bequeath to the foundation is in the form of shares of the company they helped to build. In fact, the foundation is often synonymous with the business, as is the case with high-profile families philanthropies like the David and Lucile Packard Foundation, Ford Foudation, and the W.K. Kellogg Foundation.

What should a foundation board do when the majority of its holdings are in a single stock with close ties to the founding family? The mandate to diversify is clear, but the process and timing may be nuanced. The founder may wish to retain an interest, and selling a large block of stock all at once it could negatively affect the company.

You do not need to diversify all at once if you create and implement a plan to diversify gradually. As with all of your investment decisions, the onus on the board is to act prudently and in good faith to protect the interest of the foundation. Fiduciary duty is judged by intention and execution, not by results. In this situation, the board should keep careful records demonstrating that it is aware of the need to diversify, has a plan to diversify, and has taken appropriate action to implement that plan.

If the foundation owns more than 20% or a business or if other family members hold significant positions in the same stock, it would be advisable to seek legal advice to make sure that the foundation is not in violation of excess business holding or self-dealing rules.

Reducing Investment Costs

Your foundation can gain a number of advantage by reducing the costs of its investments. By reducing costs, your foundation may be able to adopt a more conservative portfolio, yet still achieve the returns needed to maintain or increase purchasing power.

To manage costs, many institutional investors invest in index funds, to attain the returns historically associated with equity markets. An increasing number of institutions are also carefully reviewing the high fee structure of many hedge funds and private equity investments. Make sure you seek tax advice before investing in "alternative asset classes", which may be costly, which may be costly, and may have complex compliance requirements for overseas and closely held assets.

Families have a number of other options for limiting their investment costs. They include:

- **Mutual Funds.** Mutual funds are the vehicle of choice for many smaller foundations. Advantages include ease of implementation, moderate costs, low thresholds for investment, and a huge selection of alternatives. On the downside, mutual funds must maintain a cash reserve to meet redemptions, and returns are diminished accordingly
- **Separate Account Managers.** Many foundations hire advisors to manage separate accounts on their behalf. Advantages include the potential for lower costs and negotiated fees; direct input to and feedback from the manager; and the potential for developing a customized portfolio. Many of the better investment managers, however, have investment minimums ranging from several million to tens of millions of dollars. Thus, smaller foundations may be precluded from employing separate account managers.
- **Use of a custodian.** Smaller foundations or funds may choose to make use of existing relationships with the banks or other financial institutions that serve as their custodians. Because the foundation may already be paying the custodian for other services, it can often obtain competitive rates on investment management fees and other costs. [Caution: If you pursue this option, please note that relying on a custodial bank for investment advice can create conflicts of interest, as the bank is inclined to promote their own investment products.]
- **Community foundations.** In addition to their traditional grantmaking and administrative services for advised funds, some community foundations offer investment management services to private foundations.
- **The Investment Fund for Foundations.** The TIFF Investment Program (TIP) — a family of commingled investment funds of grantmaking foundations — is an example of a pooled fund that is open to smaller foundations. TIP employs a performance-based fee system, and in the past has maintained relatively low investment minimums.

How to **Manage the Foundation's Assets:** The Family Office Alternative

Donors and families who form family foundations are concerned about how to manage the foundation assets. Most family foundations are operated by the donor and his or her family, with perhaps a few non-family directors. If the family has a family office, many families prefer that their foundation run out of that office. From the family's viewpoint, operating a foundation through the family office is simply a matter of convenience—the procedures and operations of the family office transfer easily to the day-to-day management of family foundation activities. From the foundation's standpoint, co-location permits sharing of the space, staff, office equipment, and supplies of the family office. The arrangement occurs naturally because, in the early day of operation, most family foundations lack the staff and office space to operate independently.

In addition, managing a private foundation through a family office allows the foundation to benefit from the expertise of existing managers and consultants, including accountants who can keep books and prepare tax returns, legal counsel who are familiar with the family and its assets, and investment advisors who can help invest foundation assets.

Still, issues of self-dealing must be addressed before a private foundation co-locates with a family office. If the family office is a corporation and its stock is held by family members, the IRS will most certainly view it as a disqualified person with respect to the foundation, which may raise a problem. For instance, the foundation cannot sublease space from the family office, because a disqualified person cannot lease space to or from a foundation. Thus, the family office must furnish the space to the foundation without charge. Similarly, although the foundation can pay reasonable compensation to a disqualified person for personal services and thus can pay the family office for the use of its staff, the foundation may not reimburse the family office for the use of supplies, computers, or the photocopying machine. The foundation must buy its own supplies and equipment, or hold separate leases with outside vendors for shared equipment. In addition, the foundation should make payments for utilities directly to providers rather than reimbursing the family office for utility expenses.

Arrangements between a family foundation and a family office can be spelled out such that self-dealing rules are not violated. Although somewhat daunting at first, these arrangements can be worked out if the needs of the foundation are considered and an agreement for the use of family office services and equipment is structured to address those needs in advance of co-location. Once the mechanics have been worked out, having a family office manage the foundation can benefit both the foundation and its trustees.

Revisiting Goals and Objectives

Your foundation's spending and investment objectives and strategies may change over time.. Keep in mind that program goals, rather than the performance of individual managers or asset classes, should drive these changes. Because well thought out grantmaking and investment strategies often require that you stick with a philosophy over an extended period, it is important that you allow these strategies time to develop without making radical or frequent shifts in approach.

However, there are times when it may make sense to change your spending policy and investment objectives. Specific reasons to consider revisiting the spending policy (and associated investment strategy) include:

- **Underperformance:** Your foundation should review their overall portfolio performance at least annually. In some cases, the board may find that the investment objectives are not being achieved over a period of time. This outcome could be because the investment objectives are not realistic, or the spending policy itself is too ambitious.
- **Sustained growth in the markets and economy, or a significant influx of assets:** In some situations, the opposite is true. New gifts or bequests may significantly increase the size of your foundation's endowment. The market occasionally experiences sustained periods of growth, which may lead to significantly higher endowments than expected. In such cases, your foundation might want to consider increasing its payout rate for an indefinite period of time.
- **Interest in adding mission-related investments or program-related investments to your strategies.** The board may identify opportunities to align your investments with your mission, or a charitable purpose that the foundation may be able to support with increased giving or program-related investments.
- **Decision to sunset the foundation (i.e. spend all assets):** Whether you make this decision on your own or with the family, or whether this is a choice that will be made at some point in the future, the decision to sunset or spend out your foundation will have radical implications for how your foundation spends and invests its resources.

The **Stranahan Foundation's** PRI Story

The Stranahan Foundation's board chose to develop a PRI program, in large part because of the fact that PRIs offer a 100% return of principal (and interest, when applicable) that, once repaid, is used to support more causes and address more needs.

To govern its PRI program, the Board appointed a PRI Task Force to explore alternative structures and recommend a course of action.

The Task Force faced a number of key decisions as it rolled out its program — including whether to build the internal capacity of the Foundation to operate and manage the PRI program, or whether to outsource management of the program to an experienced intermediary.

Outsourcing would provide access to resources not currently available in house — such as identifying PRI opportunities, determining how much a charitable organization could reasonably borrow, assessing a borrower's ability to repay a loan, and offering hands on technical assistance/consulting in order to help charitable borrowers succeed in carrying out their project and repaying the loan. On the other hand, working through an intermediary would require relinquishing some control over selecting charities that would benefit from the Foundation's PRI.

Ultimately, the Task Force decided that outsourcing to an intermediary would be the most practical solution. At the same time, the Task Force was committed to ensuring that the PRI program would reflect the foundation's mission, values and grant making priorities.

With these goals in mind, the Task Force developed screening criteria for intermediary candidates. To qualify, candidates must:

- Be structured as a 501(c)3 public charity;
- Have a proven track record in administering loan pools that include PRIs;
- Provide one-on-one technical assistance and consulting to help charitable borrowers succeed;
- Serve a broad geographic area (i.e. regional, multi-state or national in scope);
- Provide financing and technical assistance to support projects that:
  - (a) Serve disadvantaged populations, and
  - (b) Address one or more of the Stranahan Foundation's grant priorities in the areas of education, health, human services, the arts, and/or ecological well-being.

Important note: *the above criteria reflect the goals and values of one foundation. Another foundation may have very different objectives, and therefore different criteria.*

Once the Task Force established the criteria, the foundation sent requests for proposals to a short list of possible candidates, which had been surfaced by perusing lists available on the Mission Investors Exchange website, and consulting with colleagues at foundations with long-standing PRI programs.

In reviewing the proposals and selecting finalists, the Task Force decided that, for this first foray into the world of intermediaries, it would prioritize candidates that had been rated by AERIS, an independent third party that assesses both financial strength and social impact.

The Foundation's CEO and Task Force members then conducted in-person site visits to each of three finalists (in three different cities) in order to learn more about their

programs, their experience in managing loan pools and their approaches to working with and supporting nonprofit borrowers.

It ultimately chose an intermediary that had a wealth of experience in providing loans to nonprofits in multiple states, had an AERIS rating substantiating financial stability, and was committed to using the PRI to support nonprofit programs closely aligned with the Stranahan Foundation's grant priorities.

While the foundation could have chosen to receive below-market interest on the PRI, it decided not to charge interest so that all funds would be available for the intermediary to assist its nonprofit borrowers.

Throughout this process, from the early stages of learning about PRI intermediaries, to establishing selection criteria, to identifying candidates, to negotiating the PRI agreement, the Foundation drew on numerous resources for information and advice, including: Mission Related Investors Exchange; colleagues at foundations with deep PRI experience; and knowledgeable tax and legal counsel.

Program-Related Investments **Benefit Communities while Advancing Mission**

What is a Program-Related Investment (PRI)?

A PRI is a tool for providing below-market financing — in the form of loans, loan guarantees, linked deposits, lines of credit, or equity investments — to support chartable activities aligned with a foundation's mission.

PRIs have characteristics of both grants and investments. Like grants, PRIs support projects that fit with a foundation's priorities and can count toward the foundation's 5% payout requirement. Unlike grants, PRIs are repaid to the foundation. The foundation *must* redeploy the funds for new grants or PRIs the same year that repayment is received.

The Internal Revenue Service dictates that certain factors that must be present in order for a transaction to qualify as a PRI (see http://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Program-Related-Investments).

FIGURE 9:. Checklist of Fiduciary Responsibilities

1. Does the foundation file 990-PF and related state forms? **Yes No**
2. Does the foundation publish in a local newspaper the location and availability of the 990-PF? **Yes No**
3. Do staff and board periodically disclose to the governing body the nature of any personal or family affiliations or involvement with any organization that might be considered an act of self-dealing or a conflict of interest? **Yes No**
4. Do you believe that the board fully understands its legal responsibilities? **Yes No**
5. Does the board annually approve a budget and periodically review its implementation? **Yes No**
6. Do board members understand the data presented in regular financial reports? **Yes No**
7. Does the board have members with special expertise who give advice and leadership in:
   a. Long-range fiscal planning? **Yes No**
   b. Investment practices? **Yes No**
   c. Fiscal management? **Yes No**
   d. Budget review? **Yes No**
   e. Analysis of audit reports and recommendations? **Yes No**
8. Do you feel that the board fully accepts its responsibility for prudent fiscal management? **Yes No**
9. Does the board or a board committee hold regular meetings with its investment advisors or investment staff? **Yes No**
10. Does the board get adequate and comparative information on the investment portfolio's performance? **Yes No**
11. Does the board have a policy to guide those responsible for selecting/monitoring foundation investments? **Yes No**
12. Are you generally satisfied with the performance of the foundation's investment managers? **Yes No**
13. Does the board or an appropriate board committee take direct responsibility for voting on shareholder resolutions affecting companies whose stock the foundation owns? **Yes No**
14. Does the board have a conflict-of-interest policy statement that all directors and officers are expected to execute?
   a. Should it be reviewed for substantive content? **Yes No**
   b. Was it, in fact, signed by all directors **Yes No**
15. Was there a meeting at which a director disclosed a conflict of interest regarding a decision? **Yes No**
16. If so, was there an adequate record in the minutes of that disclosure? **Yes No**
17. Was there a vote on the issue to which the director had a conflict? **Yes No**
18. If so, was there a quorum (as defined by the statute of incorporation) for such a vote? **Yes No**
19. If so, was there a vote of an adequate number of disinterested directors? **Yes No**
20. What material is distributed in advance of board meetings?
   a. Minutes of last meeting? **Yes No**
   b. Current financial statements? **Yes No**
   c. Current reports of committees? **Yes No**
   d. Summaries of decisions to be made? **Yes No**

SOURCE: Compiled from the Guidebook for Directors of Nonprofit Corporations of the American Bar Association. Republished from Appendix E. *Investment Issues for Family Funds: Managing and Maximizing Your Philanthropic Dollars.*

A Final Word: **Reviewing the Checklist**

John Craig, the retired executive vice president and treasurer of the Commonwealth Fund, offers the following list of key questions for managing a family foundation endowment:

- Does your foundation have a clear spending policy? Does that policy reflect a consensus among trustees regarding the life expectancy of your foundation?
- Has your board periodically reviewed the foundation's investment goals and risk profile?
- Does your foundation have written investment guidelines for the endowment as a whole and for individual managers? Do these guidelines include targeted allocations to named asset classes with permissible ranges for each?
- Do members of your investment committee have relevant experience for overseeing the management of the endowment?
- Are members of your investment committee fully engaged in the foundation's mission and equally attentive to its grantmaking?
- Is the allocation of your endowment among asset classes regularly monitored? Is corrective action taken when market trends cause allocations to veer beyond the targeted ranges?
- Does your investment committee report at meetings of the board of trustees on the endowment's recent and long-term performance?

SOURCE: John E. Craig, Jr. "Understanding Trustee Responsibilities and Duties," Investment Issues for Family Funds: Managing and Maximizing Your Philanthropic Dollars.

These questions provide a helpful context for the types of conversations and decisions you and your board will be making about the investment of your foundation's endowment and the role of the family in that process. You probably will not be able to answer "yes" to each of these questions. But as you review the development of your strategy, policies, and practices, consider revisiting these questions at each board meeting until you feel comfortable with your answers.

As the late John Kunstadter, president and long-time trustee of the Albert Kunstadter Family Foundation, once wrote,

> *In the end, your satisfaction and joy will come not so much from good investments, but from the grants you have made, the lives you have affected for the better, the Earth which is a little better place for your efforts. There are many roads to these goals, as many roads as there are foundations; so use your common sense, don't take up with the latest fad, keep things in perspective, and your foundation will gladden your heart as you see it accomplish your goals.* ■