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Role and Duties of Investment Committee Members

An Introduction To Alternative Investments For Non-Profit Organizations

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Statutory Guidance

- Uniform Prudent Management of Institutional Funds Act
 - applies to charities organized as charitable trusts and not-for-profit institutions
 - modernized the UMIFA (see below)
 - rules governing expenditures
 - management of investment management function
 - incorporates many standards set forth in Uniform Prudent Investor Act (adopted in 1994)
 - applies to trustees of trusts, including charitable trusts
 - harmonizes standards for managing and investing institutional funds
 - added “prudent” to emphasize the prudence in management; prudence norms have evolved over time
- Uniform Management of Institutions Fund Act (UMIFA)
 - drafted in 1972; adopted by 47 states



Prudent Management and Investment

- Give primary consideration to donor's intent
- Duty of loyalty – different standards for NFP corporations and charitable trusts
 - NFP directors – “best interests”
 - Trustees – “sole interests”
- Duty of care; prudent investor standards
 - reasonable care, skill and caution; portfolio approach
 - manage in good faith and with the care of an ordinarily prudent person in a like position would exercise under similar circumstances
 - prudence under the facts and circumstances prevailing at the time of the action of decision
 - as applied to a charity (e.g., the charitable nature of the institution affects the decision making of a prudent person)
 - high standard for directors selected who have particular expertise or experience in investment management
- Duty to minimize costs: reasonable costs to invest and manage, considering:
 - size of assets
 - purposes of the institution
 - skills/sophistication of investment committee
 - third party adviser costs should be reasonable



Prudent Decision Making

- In managing and investing an institutional fund, the following factors, if relevant, must be considered
(Section 3 of UPMIFA; substantially mirrors UPIA §2(c))
 - general economic conditions
 - the possible effects of inflation and deflation
 - the expected tax consequences, if any, of investment decisions of strategies
 - the role that each investment or course of action plays within the overall investment portfolio of the fund
 - the expected total return from income and the appreciation of investments
 - other resources of the institution
 - the needs of the institution and the fund to make distributions and to preserve capital
 - an asset's special relationship or special value, if any, to the charitable purposes of the institution



Fiduciary Responsibilities

- Duty to investigate: reasonable efforts to verify facts pertaining to investment management
 - How are the assets going to be managed?
 - By board or subcommittee
 - Delegation to another officer (e.g., CIO)
 - Delegation to third parties (e.g., RIAs, BDs, banks)

- Modern Portfolio Theory: decisions about each asset in the context of the portfolio
 - e.g., consider risk and return objectives of entire fund
 - hedge funds, private equity, real estate funds

- Diversify unless due to special circumstances

- Dispose of unsuitable assets

- Develop investment strategy appropriate for the fund and charity



Establish Investment Process

- Develop Asset Allocation Strategy
- Prepare and Maintain Investment Policy Statement
- Implement Investment Strategy
- Monitor and Supervise Implementation of Investment Strategy
- Procedures for Controlling and Accounting for Expenses

- Process is key:
 - Evidence competence: be able to illustrate awareness of fiduciary responsibilities
 - Substantiation:
 - Document analysis
 - timing of reviews/analysis
 - details of reviews and analysis (e.g., issues reviewed, persons involved, supporting calculations; background research and analysis)
 - Have a process to review your process



Develop Asset Allocation

- Analyze current position
- Identify risk level and an expected return to meet investment objectives; identify an investment time horizon
- Select asset classes consistent with desired risk, return and time horizon
- The number of asset classes is consistent with portfolio size
- Investments are managed in accordance with applicable laws, trust documents and written investment policy statements



Formalize Investment Policy

- Clearly define:
 - duties and responsibilities of all parties involved;
 - diversification and rebalancing guidelines;
 - due-diligence criteria for selecting investment options;
 - monitoring criteria for investment options and service vendors;
 - procedures for controlling and accounting for investment expenses and appropriately structured, socially responsible investment strategies (when applicable).



Delegation of Investment Authority to Third Party Advisors

- Delegation of portfolio management function may be made to third parties; investment policy function cannot be delegated
- Board or investment committee, as applicable, must act prudently in selecting such third party
- Periodic review of performance and compliance with scope and terms of delegation required
- Must ensure costs are reasonable
- Directors and investment committee members are not liable for actions or decisions of third parties if selection is proper
- Still responsible for selection and retention – reasonable care required



Monitor and Supervise

- periodically review investment performance with appropriate index, peer groups and IPS objectives
- review investment process for consistent application
- reviews of organizational changes
 - changes in investment committee or others responsible for investment research or decisions
 - changes in chief legal, compliance or other chief administrators
 - review Form ADV (for RIAs) and prospectuses (for mutual funds) and other regulatory documents for material changes
 - Review due diligence questionnaire
- periodically review policies and procedures, including those related to:
 - allocation of investment opportunities and other conflicts of interest
 - best execution; handling of trade errors
 - soft dollars
 - proxy voting
 - be sensitive to changes in such policies and/or procedures
- review fees for reasonableness and compliance with agreements

