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