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INVESTMENT POLICIES AND FIDUCIARY DUTIES*

* including summary of legal parameters under federal and state law

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INVESTMENT POLICIES AND FIDUCIARY DUTIES

I. INTRODUCTION. The focus of the joint presentation today will be to discuss how private foundations, endowments and other charities should consider asset allocation, investment and spending policies, and advisory relationships within the context of fiduciary duties and state and federal laws. In these written materials, the author will provide some general background on the legal parameters of investment policies, including applicable state and federal laws.

II. WHICH CHARITABLE ENTITIES SHOULD AND/OR USUALLY HAVE INVESTMENT POLICIES?

- A. Private foundations -- while most (if not all) large, established private foundations have written investment policies, my experience as an attorney is that the newer, smaller foundations focus on other policies (such as grant-making and/or spending policies) first, and may only feel the need to develop a formal investment policy after they have "lived through" one or more crises, OR perhaps when the foundation has obtained all of its anticipated funding.
- B. Endowments and other "supporting organizations" of large, established public charities -- my experience is that most of these entities do have written investment policies, many of which were developed at the same time they were created.
- C. Universities and similar institutions -- universities and similar institutions, many of whom rely on their endowments for scholarships, salary enhancements, etc. almost always have detailed written investment policies.
- D. Donor-driven investment policies -- these are less common than donor-imposed spending policies, but do exist. Charities that already have investment policies in place typically require donors to accept those, although obviously depending on the size of the gift, exceptions can be made. Caution: Beware a donor who makes a charitable donation and requires the recipient charity not to change a particular investment. This is problematic for several reasons.
- E. Other charitable entities -- one might argue that all charitable entities have (and should have) an investment policy, it just might not be written down. And one can also argue that all charities subject to state laws such as TUPMIFA (defined and described in Section V, E below) should have an investment policy.

III. WHY DOES ANY CHARITY NEED A FORMAL INVESTMENT POLICY?

- A. All charities -- in addition to the "best practices" aspect, an investment policy facilitates the furtherance of a charity's stated charitable purposes and any adopted mission statement.
- B. Private foundations benefit from a written investment policy to (i) facilitate compliance with various private foundation prohibitions found in Sections 4941,

4943 and 4944 of the Internal Revenue Code of 1986, as amended (the "Code"), and (ii) achieve financial returns needed to comply with the required distributions under Code §4942.

- C. The fiduciary duties of directors under state law may be interpreted as including the duty to invest as well as spend "prudently."

IV. WHAT POLICIES ARE INTEGRALLY RELATED TO DEVELOPMENT OF AN INVESTMENT POLICY?

- A. Charitable Purpose (in governing documents) and Mission Statement -- before a charity can reasonably develop an investment policy, it must understand its charitable purpose, which is sometimes (but not always) separately documented in a mission statement.
- B. **Spending Policy -- regardless of which is the "chicken" and which is the "egg," these two policies should work together, conceptually and realistically, in order for the two policies to both succeed.**

V. STATE LAW REQUIREMENTS

- A. Charitable Purposes and Mission Statement
 1. A governing board adopting any investment policy must consider the charitable purpose(s) of the charity and its written mission statement, in order for the investment policy to accurately reflect the needs of the charity. For example, is the charitable purpose of the entity really "perpetual," or is the focus one that is expected to be accomplished within a shorter time period?
 2. The charitable purpose(s) are found in the governing documents of the charity and should be consistent with those described in the exemption application (Form 1023) originally submitted to the Internal Revenue Service ("IRS"). If the charitable purposes and activities have changed, such changes should be reflected in updated governing documents and board minutes (and notice of such changes should have been timely submitted to the IRS). Finally, it is becoming increasingly common for the purpose of a charity to be further explained in a mission statement.
 3. Review of the charitable purposes and mission of a charity should clarify for the governing board:
 - a. the charity's short-term operations and the financial resources needed to fund those;
 - b. the charity's long-term mission and goals, and the financial resources needed to meet those;
 - c. whether and to what extent any "special purpose" funds are needed; and

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