

RECOMMENDED BEST PRACTICES
IN
MANAGING FOUNDATION INVESTMENTS

A Guidance Memorandum from
the Board of Directors of the
Council on Foundations



Council on Foundations

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BOARD RECOMMENDATION: The Board of Directors of the Council on Foundations strongly recommends that when reviewing and approving foundation investment policies and procedures practices, all foundations—private and public—consider the following best practices in foundation investment management.

I. Background

For both private foundations and public charities, the management of foundation investments is regulated by state and federal law. State law imposes fiduciary duties on foundations and their internal and external investment managers through their not-for-profit corporation law or trust law, the [Uniform Prudent Management of Institutional Funds Act](#)¹, Uniform Management of Institutional Funds Act, or [Uniform Prudent Investor Act](#)². Federal law regulates private foundation investment management practices through the prohibitions against self-dealing³, assessment of penalties for making investments that jeopardize the existence of a foundation⁴, and through assessing penalties for a foundation having investments that qualify as excess business holdings⁵. Federal law regulates public charity investment management practices by, for example, creating an intermediate sanctions regime and prohibiting excess benefit transactions⁶ and regulating investments qualifying as excess business holdings⁷.

When foundation investment management practices come to the fore—such as when the economic downturn drastically impacted foundation endowments (and grantmaking) and when 150 private foundations were identified in the *New York Times*⁸ as having direct investments in the \$60 billion Ponzi scheme orchestrated by Bernard L. Madoff—the public, legislators⁹ and the foundation leadership must and do direct their attention to foundation investment management practices.

II. Purpose of this Memorandum: Best Practices in Foundation Investment Management

Over and above the legal requirements and public scrutiny, stewards of foundation investments should go the extra mile to ensure that they are acting in the most prudent fashion

¹ http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.pdf .

² <http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/upia94.pdf> .

³ 26 U.S.C. 4941.

⁴ 26 U.S.C. 4944.

⁵ 26 U.S.C. 4943.

⁶ <http://www.irs.gov/charities/charitable/article/0,,id=123303,00.html> and [26 CFR 53.4958-1](#).

⁷ <http://www.cof.org/files/Documents/Government/Charitable%20Reform%20Resource%20Center/ExcessBusinessHoldings.pdf>

⁸ Reported in *New York Times*, January 29, 2009—Nicholas Kristof, *Madoff and America's Poorer Foundations*, available at <http://kristof.blogs.nytimes.com/2009/01/29/madoff-and-americas-poorer-foundations/?hp> .

⁹ Recent reforms from the Pension Protection Act of 2006 similarly highlight intensive Congressional oversight of the exempt organization sector and foundation investment management practices. See www.cof.org/ppa .

to preserve foundation resources for their intended charitable purposes, to exercise a degree of due diligence¹⁰ over their investments and investment management practices that they exercise over their grantmaking.

Members of the Council on Foundations, through their membership, ascribe to a *Statement of Ethical Principles* that includes a statement for stewardship of financial resources, as follows:

“Stewardship: Our members manage their resources to maximize philanthropic purposes, not private gain, and actively avoid excessive compensation and unreasonable or unnecessary expenses. They pursue maximum benefit through their work, how they work, and by supporting the work of partners, colleagues, and grantees.”

While foundations differ in sophistication, resources, staff, and amount of financial resources, there are both specific responsibilities incumbent on foundation boards and generally accepted principles for investment management. These best practices are universal to effective management of investment portfolios as applied to fit the specific circumstances of each foundation. These best practices rest on the overarching principle common to all foundations: the board or governing body has a fiduciary obligation to prudently manage investment assets either directly if it has sufficient expertise, with the assistance of experts, or by delegating primary responsibility to a committee with sufficient experience and expertise.

The board recognizes that these best practices represent a starting point. Over the next year, the Council will be working with its constituency groups to establish practice tips and online and print resources for each best practice, a legal overview that details federal and state laws that underpin foundation investment management practices, and related educational and professional development offerings. Thus, the board of directors endorses the seven best practices of foundation investment management that follow.

¹⁰ Increasingly, particularly with the adoption of UPMIFA by the vast majority of states and UPMIFA’s inclusion of state law private foundation and trust regulatory concepts, regulation of investment management practices have coalesced around an all-encompassing duty of due diligence.

III. Best Practices in Foundation Investment Management

Practice 1. The board (and investment committee and staff, if any) of a foundation should understand and fulfill their respective fiduciary responsibilities and duties under applicable law and the governing documents of the foundation and stay informed regarding any relevant changes in law, duties, or responsibilities.

Practice 2. The foundation should adopt an Investment Policy Statement that contains a clear description of the roles of the board, an investment committee, if any, staff, and outside investment management service providers. The Investment Policy Statement should also include the foundation's investment objectives and strategy for achieving those objectives, the risks associated with the strategies, liquidity needs, asset allocation approach, permitted investments and diversification among asset classes. The foundation should periodically, but at least annually, review its Investment Policy Statement to ensure compliance and determine whether any changes are warranted.

Practice 3. The foundation's board, consistent with state law, should determine whether to delegate primary oversight of the investment function to an investment committee that has the requisite experience and knowledge to provide prudent oversight; if the board elects not to constitute such a committee it must ensure that the board has the necessary experience and knowledge to perform the oversight function.

Practice 4. The foundation should adopt procedures for selecting, monitoring, evaluating, and terminating each investment management service provider that includes ongoing due diligence. The foundation should periodically review its compliance with the procedures and the effectiveness of these procedures.

Practice 5. The foundation should have, and should ensure that investment management service providers have policies and procedures that provide reasonable assurance of compliance with applicable law and of the prevention or timely detection of unauthorized investment or use of the foundation's assets.

Practice 6. The foundation's board (or its investment committee, if any) should ensure that its members are provided with information, including regular reports, sufficient to permit the board, or committee, to fulfill its ongoing oversight function.

Practice 7. The foundation should adopt procedures to ensure that any conflicts of interest of members of the foundation's board, investment committee, foundation staff, and investment management service providers are appropriately addressed and that the foundation carries out the investment function in compliance with all applicable ethical policies and guidelines.

IV. Legal Advice

The information provided in this guidance memorandum is not a substitute for expert legal, tax, or other professional advice tailored to your specific circumstances, and may not be relied upon for the purposes of avoiding any penalties that may be imposed under the Internal Revenue Code or other federal or state laws or regulations.

Foundations are encouraged to consult with experienced legal counsel. Questions may also be directed to the Council on Foundations Legal Services Department at 703-879-0600.