

PRECURSORS TO EFFECTIVE ENDOWMENT INVESTING

Darren B. Moore

BOURLAND, WALL & WENZEL, P.C.

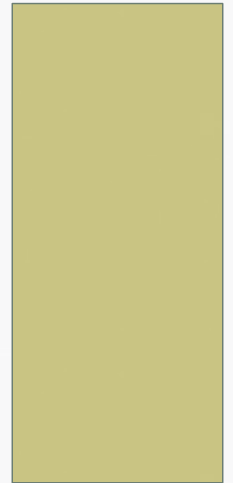
301 Commerce Street, Suite 1500

Fort Worth, Texas 76102

(817) 877-1088

(817) 877-1636 (facsimile)

E-mail: dmoore@bwwlaw.com



WHAT IS AN ENDOWMENT?

- Donor's view
- Accountant's view
- Board's view
- Lawyer's view



- "True" endowments vs. "Quasi-endowments"

RATIONALES FOR HAVING AN ENDOWMENT

- Intergenerational equity
- Cover revenue shortfalls
- Assure continuation of mission/reputation/values



COMMON LAW FIDUCIARY DUTIES



Duty of Care



Duty of Loyalty



Duty of Obedience

REASONABLY PRUDENT

Prudent



Not prudent



DEVELOPMENT OF THE LAW OF PRUDENCE

```
graph LR; A[English Rule] --> B[Prudent Man Rule]; B --> C[Modern Portfolio Theory/Total Return Policies]
```

English Rule

Prudent Man
Rule

Modern
Portfolio
Theory/Total
Return Policies

THE “LEGALIZATION” OF MODERN PORTFOLIO THEORY

1969

- PF Investment Rules

1974

- ERISA

1972

- UMIFA

1994

- Uniform Prudent Investor Act

1994

- Uniform Principal & Income Act

2006

- UPMIFA

UPIA

- “A trustee shall invest and manage trust assets as a **prudent** investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust.”
- In satisfying the Prudent Investor Rule, the trustee must exercise **reasonable care, skill and caution**
- Investment and management decisions regarding individual assets must be evaluated in the context of the **portfolio as a whole**, and as part of an overall investment strategy having **risk and return objectives reasonably suited to the trust**

UPIA

- Trustee shall **diversify** the investments of the trust unless the trustee reasonably believes that special circumstances necessitate otherwise
- Trustee may **delegate** management/investment functions, but must exercise reasonable care, skill and caution in:
 - Selecting an agent
 - Establishing the scope/terms of delegation (consistent with trust terms/purpose)
 - Periodically reviewing agent's actions to monitor performance/compliance with delegation terms
 - Agent owes duty of reasonable care to comply with the terms of the delegation

UPMIFA

- Uniform law governing management, investment, and expenditure of funds held by charitable organizations within its scope.
- Intended to modernize the rules for expenditures from **endowment funds** and update provisions governing the release and modification of restrictions on charitable funds.
- Standard of Care: Ordinary business care and **prudence** under the facts and circumstances prevailing at the time of the action/decision
 - Prudence standard consistent with the UPIA

UPMIFA

- Endowment spending restrictions apply to certain endowments (varying depending on size of endowment)
- Requires **diversification**, unless special circumstances exist
- Must evaluate investment in context of **portfolio as a whole**
- Verify facts (due diligence)
- Can **delegate** investment/management of fund

STATE LAW STANDARDS OF PRUDENCE

- Circumstances to consider in whether to make a particular investment (UPIA/UPMIFA):
 - General economic conditions
 - Possible effect of inflation or deflation
 - Expected tax consequences of investment decisions
 - Role that each investment/strategy plays within portfolio
 - Expected total return
 - Other resources of the charity
 - Needs for liquidity, regularity of income, and preservation or appreciation of capital
 - An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries
 - The investment policy statement of the charity

DRAFTING TIPS COMMON TO ALL POLICIES

- Involve the Board (they're adopting it!)
- Use understandable language/define terms
- Coordinate terms with provisions of governing documents
- Don't try to be Nostradamus
- Don't create something you won't follow
- Create a system for annual review and update as necessary

SETTING A SPENDING POLICY

- What are the objectives to be met? (rationales for endowment)
- What are the charity's funding needs?
- Consider smoothing by including use of rolling average for calculating value of endowment



CREATING AN INVESTMENT POLICY STATEMENT

- What is the purpose/objective of the endowment?
- What are the constraints or guardrails to stay within?
- What type of investment structure/asset allocation make sense based on objectives/constraints/risk tolerance?
- How will the charity monitor performance?
- What will be the roles of the Board? The Investment Committee? The outside professionals?
- What will be the process to review the policy for compliance and necessary adjustment?

WE HAVE AN IPS, NOW WHAT?

1. Select appropriate investment managers
 - Background checks/Interviews/Reference checks
 - Analyze operational/business structure
2. Monitor the investment performance per the IPS (utilize appropriate benchmarks)
 - Ask questions/seek to understand strategy and risks
 - Consider how risk is being managed in relation to objectives
3. Rebalance as appropriate over time
4. Periodically review policy
5. Follow conflict of interest policy in investing

The information set forth in this outline should not be considered legal advice, because every fact pattern is unique.

The information set forth herein is solely for purposes of discussion and to guide practitioners in their thinking regarding the issues addressed herein.

Non-lawyers are advised to consult an attorney before undertaking any issues addressed herein.

Unless otherwise stated herein, pursuant to requirements prescribed by the Internal Revenue Service under Circular 230 for tax practitioners, Bourland, Wall & Wenzel P.C. must inform you that any U.S. federal tax advice or opinions contained in this paper are not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code or promoting, marketing or recommending to another party any transaction or matter addressed in this communication.