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An Examination of the Governance Policies of Maine Nonprofits as They Relate to Endowment and Cash Reseve Accounts

Kenneth S. Spirer
University of Southern Maine

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Muskie School of Public Service

For my Capstone project, I examined whether Maine nonprofit organizations have established policies to manage their endowment and cash reserve funds. Based on survey responses and a literature review, I have identified governance[1] policies that represent best practices for nonprofit organization's responsibilities for the endowment assets. I also have drafted a sample Investment Policy Statement "template" for small nonprofits to use as a basis for developing their own policies.[2]

My limited experience as chair, or a member, of three investment committees of Maine nonprofits and discussions with colleagues affiliated with other nonprofit organizations, led me to the preliminary hypothesis that a number of Maine nonprofits may not have clear policies that help guide them in the governance of their endowment assets. This view was echoed in a 2011 paper by a leading nonprofit investment manager who observed that "governance as it relates to investment management is uneven - pockets of excellence in some nonprofit organizations but mediocrity in many others."[3] My Capstone project research was designed to test whether this premise is correct as it relates to Maine nonprofits and, if possible, to quantify it.

It is my desire that, as a consequence of my research, trustees of Maine nonprofit organizations will gain a clearer understanding of their responsibilities vis-à-vis their organization's endowments. As one lawyer succinctly noted, "[t]he potential consequences of getting it wrong have many volunteer board members looking nervously for an exit." [4]

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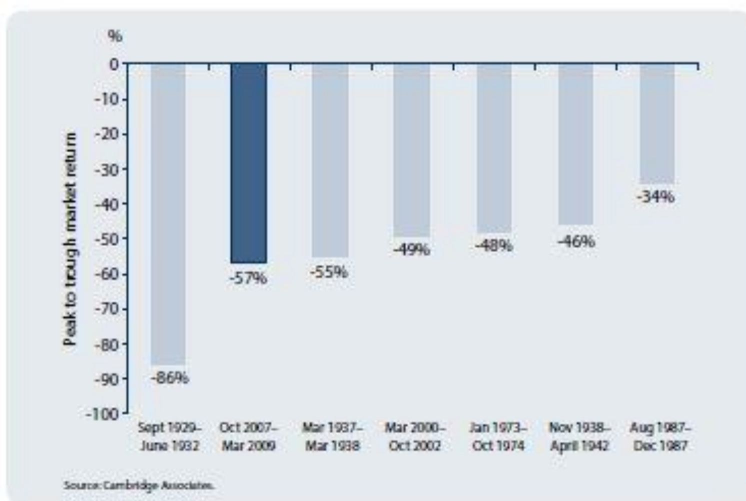
[1] Governance comes from a Greek word that means "to steer". In this Capstone report, I use the term "governance" to mean the policies that direct the oversight of nonprofit endowment and cash reserve accounts.
[2] *See*, Appendix A.
[3] John S. Griswold, *"New World, New Reality: Rethinking the Governance Model for Nonprofit Investment Management",* CommonFund Institute, p. 1, January 2011.
[4] Cynthia Rowland, *Business Lawyer Today*, Vol. 18, No 6, July/August 2009.

The 2008-2009 financial market crash was a shock to the nonprofit sector and the philanthropic donors that support this sector. As the following chart illustrates, "[t]he bear market in stocks that began in October of 2007 and apparently bottomed out in early March 2009 constituted the second most severe crash in stock market prices on record - - exceeded only by the September 1929 to June 1932 crash that ushered in the Great Depression." [5]

Exhibit 1. The 2007–08 bear market in U.S. stocks was the second-most severe since 1929.



This was not a gradual economic slowdown and the endowments of nonprofits were not immune from this sharp market break. "Philanthropy was a train hurtling down the tracks, and someone hit the emergency brake."[6] The 2009 Commonwealth Fund annual report referenced the findings of a study that encompassed large endowments with professional investment management that the average returns of 420 university and foundation

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[5] *"Rethinking the Management of Foundation Endowments",* John E. Craig, EVP and COO, The Commonwealth Fund 2009 Annual report.

[6] Remarks of Bradford Smith, The Foundation Center, teleconference *"Turning Crisis Into Opportunity: A Conversation With Two Nonprofit Sector Leaders"*, July 24, 2009.

endowments tracked by Cambridge Associates[7] was -19.1% for the fiscal year ending June 30, 2009.[8] It may be inferred that smaller nonprofits, many without professional investment management oversight, fared even worse.[9]

Overview

Nonprofit Board members (sometimes referred to as Trustees or Directors depending on the structure of the organization) assume a significant responsibility with respect to the oversight of the nonprofit's endowments. They are fiduciaries[10] when dealing with the assets of the nonprofit they serve. This status does not depend on whether they are compensated or act in a voluntary capacity and the standard of conduct that the law has imposed on a fiduciary is higher than that of a casual business relationship. The best interest of the beneficiaries, *i.e.*, both the nonprofit organization and those it serves, is the paramount responsibility of nonprofit board members. In order to assist them in meeting this high standard of care, nonprofit fiduciaries need to give careful attention to written guidelines or policies when making decisions regarding the investment of endowment assets.

Literature Review

Since a trustee is a fiduciary and must act prudently, it will be helpful to briefly review the evolution of the concept of "prudence." While legal writing, including statutes, regulations, judicial opinions and treatises, is hardly ever included under the broad term

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[7] Cambridge Associates is a private independent firm that provides consulting and investment oversight services to more than 900 institutional clients worldwide.

[8] *See*, note 5 at p. 2. Similar negative results were reported by other studies of larger nonprofits, for example, a CommonFund study estimated 2008 foundation losses at 26% and the Foundation Center found that foundation assets declined 22% in 2008, *see*, note 6 at p. 5.

[9] The results of the survey I conducted through the Maine Association of Nonprofits in May 2012 generally confirmed this assumption. 50% of the 24 respondents with Endowment Accounts suffered a loss of between 20%-40% during this period.

[10] A fiduciary is someone who assumes a relationship of trust or confidence between parties.

"literature," an overview of the body of legal writing on the subject of fiduciary responsibility must be included in order to understand the standard of prudent behavior required for effective nonprofit endowment governance. For the most part, however, the extensive writings in this area focus on the nature of permissible investments that a trustee may make rather than a trustee's overall governance responsibilities. Nonetheless, a brief review will serve to frame the issues.

The Prudent Man Rule

While "[i]t is axiomatic that fiduciaries must be prudent in the investment of funds for which they are responsible . . . [d]efining prudence may always have been a challenging matter." [11] The historic formulation of a fiduciary's standard of care evolved from American case law. The so-called Prudent Man Rule was first formulated by the Massachusetts Supreme Judicial Court in 1830 in the case of Harvard College v. Amery[12]. This common law-created "rule" established the standard for permitting only conservative and safe investments by trustees. The view evolved that it is the primary duty of a trustee to preserve the trust property for others. Preservation of principal rather than entertaining any possibility for growth was the governing rule and investments were considered on an individual and not a collective basis.[13] Diversification of assets had been considered to be imprudent and therefore an inappropriate course of management for an endowment's assets. The state of trust law in the early part of the 20th century became the standard for the role of a nonprofit trustee. This standard -- the Prudent Man Rule -- viewed the prudence of any investment in isolation, instead of evaluating it as part of the overall portfolio. While this

[11] Foreward, Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* (1986) p. vii.
[12] 26 Mass (9 Pick.).
[13] Longstreth noted that these constraints, as elaborated in treatises and case law, would virtually compel a fiduciary to act imprudently in terms of economic reality, *see* note 11 p. 5.

approach was intended to provide more flexibility and clarity for fiduciaries, one commentator has noted that interpretations of that rule have made it more like a "black hole" for fiduciaries.[14]

Longstreth Study – "Modern Investment Management And the Prudent Man Rule"—1986

The 1986 Longstreth survey of trustee investment practices found that many fiduciaries were of the opinion that trust law did not permit certain types of investments. [15] This view was based on their understanding of the Prudent Man rule and state statutes codifying that restrictive view.

Longstreth noted that [p]ervasive changes in the financial marketplace . . . and advances in financial theory and practice . . . have rendered the Restatement [of Trust's] [16]quarter-century-old prescriptions for prudent conduct self-contradictory and sometimes self-defeating. [17] Trustees were also reluctant to hire outside investment professionals to assist them. Addressing this reluctance of fiduciaries to seek outside investment management assistance, Longstreth commented that

> "Before World War II, it made sense for several reasons to restrict the ability of a fiduciary to delegate investment selection to others. <u>It was thought to be relatively simple and even routine to manage a portfolio.</u> Until the post-war period, the idea of selecting and holding 'permanent investments' prevailed, particularly for fiduciaries. It was reasonable to expect the fiduciary chosen to do the selecting. Moreover, there were not others who demonstrably knew more about the limited field of available investment products than the typical fiduciary of that era. . . . As the marketplace has grown more complex, and the skills required to master even small segments of it more demanding, it is not surprising to fund fiduciaries seeking help not only to deploy the assets under their charge, but

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[14] *See,* Longstreth, note 11.
[15] *See,* Longstreth, note 11.
[16] This view is outlined in Scott on Trusts, which is a legal treatise on the law of trusts. The American Law Institute ("ALI"), an independent non-profit U.S. organization that works to clarify, modernize and improve the law, compiles, from time to time, existing case law and summarizes current legal views in a specific area. The ALI has published the Restatement Third of Trusts and is in the process of circulating the Fourth Restatement for comment.
[17] *See,* Longstreth, note 11, p. 14.

to find those most capable of undertaking the deployments." [18] (emphasis added)

Uniform Prudent Investor Act- 1994

As historic trust principles were being challenged, some states were amending their statutes to move closer to a prudent investor rule, thereby loosening the constraints of the Prudent Man rule. [19] The English rule, which existed when the United States was founded in the late 18th century, was extremely conservative. "The emphasis was on insuring the safety of the corpus at all costs; the rule was extremely risk-averse."[20] Although the English rule was originally rejected in favor of a more flexible approach,[21] the so-called Prudent Man rule "quickly rigidified into a rule allowing only safe and conservative investments."[22] For many years, most states adopted a legal list statutory approach which specified permissible trust investments. Studies at that time "showed that returns on trust investments in 'prudent man' states were almost double the returns in 'legal list' states.[23] As a result, many states replaced legal list statutes with some version of the prudent man rule.

The work done by many economists in the early 1950s, most notably, Harry Markowitz, focused attention on the entire portfolio, rather than on individual investments. This, in turn, led to criticism of the Prudent Man Rule and the embrace

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[18] *See*, Longstreth, note 11, p 73.
[19] Begleiter, Martin D., *Does the Prudent Investor Need the Uniform Prudent Investor Act—An Empirical Study of Trust Investment Practices*, 51 Maine Law Review 1 (1998).
[20] *See*, Begleiter, note 18 p. 31.
[21] Harvard College v. Amory, *see* note 12.
[22] Martin, John H., *A Preface to the Prudent Investor Rule,* 132 Tr. & Est. 42, 42-43 (Nov. 1993) cited in Begleiter , note 18 p. 31.
[23] Aalberts, Robert J. & Poon, Percy S., *The New Prudent Investor Rule and the Modern Portfolio Theory: A New Direction for Fiduciaries, 34 Am. Bus. L. J. 39, (1996)* cited in Begleiter , note 18, p. 32.

of modern portfolio theory. A model statute, the Uniform Prudent Investor Act, was adopted by the American Law Institute in 1992 to reflect a modern portfolio approach to fiduciary investment conduct. This model statute requires that nonprofit board members and others carefully assess investment goals, risk versus return and proper diversification of assets. Trustees are required to use modern portfolio theory and invest as a prudent investor would invest.

Uniform Management of Institutional Funds Act (UMIFA)-1972

In an attempt to provide uniformity, the National Conference of Commissioners on Uniform State Laws has undertaken, from time to time, to promulgate uniform statutes for consideration and adoption by the various states. In 1972, this body approved the Uniform Management of Institutional Funds Act (UMIFA), which was subsequently adopted by 47 states and the District of Columbia.[24] As states enacted this uniform statute (or some variant), nonprofit trustees were no longer restricted to make investment decisions as if they were trustees of private trusts. This, in turn, allowed nonprofit endowment fund managers to more closely follow modern portfolio techniques. UMIFA was designed to guide charities in the management and investment of funds and provide rules on spending from endowment funds.

Until that time, there had been a tremendous uncertainty regarding the standards that governed trustees or directors of nonprofit corporations. These trustees looked to trust law for guidance; however, as previously noted, that body of law significantly restricted

[24] Maine adopted UMIFA in 1993.

decision making. It was UMIFA that made total return[25] investment possible. UMIFA created a set of rules that made investing for total return possible for charities organized as nonprofit corporations.

Modern Portfolio Theory

At the same time that UMIFA or some variant was being promulgated in virtually every state, economists were developing empirical support for a different approach to portfolio management. The evolution of Modern Portfolio Theory began in 1952 with the publication of a paper, by Harry Markowitz, that articulated the view that the overall risk and return of a portfolio required an analysis of the entire portfolio.[26] Evaluating risk and return necessitated an analysis of the entire portfolio or corpus, rather than individual investments. The goal of Modern Portfolio Theory is to use diversification of the risks and returns in the portfolio to balance risk and return.

Despite this analytic breakthrough suggesting that historic restrictive portfolio management thinking was impeding the legal rules governing the conduct of charitable fiduciaries, it only began to have an influence in the mid 1980'S with the publication of Longstreth's carefully researched and thoughtful book.[27] While Modern Portfolio Theory has been accepted by financial managers and academics since the middle of the 1970's, it was not accepted by trust law until 1990.[28]

Uniform Prudent Management of Institutional Funds Act ("UPMIFA")- 2006

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[25] When measuring performance, total return is the actual rate of return of an investment or a pool of investments over a given evaluation period. Total return includes interest, capital gains, dividends and distributions realized over a given period of time.

[26] Markowitz, H.M. "*Portfolio Selection.*" The Journal of Finance (March 1952). This was later expanded into a book, Markowitz, H.M. *"Portfolio Selection: Efficient Diversification of Investments."* New York, John Wiley & Sons (1959).

[27] *See*, Longstreth, note 11.

[28] *See,* Begleiter, note 20 p. 36.

As the law governing fiduciaries has evolved, the need to update the prudence standard for the management and investment of charitable funds became more apparent. After four years of study and drafting, the Uniform Prudent Management of Institutional Funds Act (UPMIFA) was approved by the National Conference on Uniform State Laws in July 2006 to update and replace the older and outdated 1972 Uniform Management of Institutional Funds Act ("UMIFA"), which Maine had adopted in 1993. UMIFA had been designed to provide guidance and authority to charitable organizations concerning the management and investment of funds held by these organizations. The changes made by UMIFA permitted charitable organizations to use modern investment techniques.

Approximately 40 states have adopted UPMIFA since 2006. In 2009 Maine Governor Baldacci signed LD 1402, An Act to Enact the Uniform Prudent Management of Institutional Funds Act (UPMIFA).[29] As stated in the Prefatory Note to the Maine adoption of UPMIFA, "[the statute] modernizes the rules governing expenditures from endowment funds, both to provide stricter guidelines on spending from endowment funds and to give institutions the ability to cope more easily with fluctuations in the value of the endowment."

UPMIFA provides rules for the investment of funds held by charitable institutions and the spending of funds donated as "endowments." While UMIFA applied the 1972 prudence standard to investment decision making, UPMIFA, in contrast gives charities updated and more useful guidance by incorporating language from the Uniform Prudent Investor Act, modified to fit the special needs of charities. The commentary from the Uniform Draftsmen stated that UPMIFA imposes "a modern, well accepted, prudence standard based on The Uniform Prudent Investor Act ("UPIA").

[29] 13 MRSA Chapter 99, enacted September 12, 2009, effective retroactively to July 1, 2009.

UPMIFA places a greater burden on nonprofit trustees vis-a-vis the investment of nonprofit endowment assets than had previously been the case. Therefore, nonprofit trustees must approach their responsibilities with respect to their organization's endowment funds with increased care and diligence.

UPMIFA represents a substantial modernization of UMIFA and, among other provisions, allows managers greater investment flexibility than existed under UMIFA. UPMIFA moved away from trying to define income and principal, as was done under trust law.[30] It eliminated the concept of historic dollar value, that is, the value of contributions made to an endowment fund that must be preserved in perpetuity in the absence of specific donor stipulation for spending or accumulation.

Prudence is a standard that evolves over time and first UMIFA, and now UPMIFA, updated the statutory concept to provide fiduciaries with more precise direction. UPMIFA enumerates the following factors that nonprofit boards should take into account as they consider decisions involving spending from the corpus of their endowments:

(1) the duration and preservation of the endowment fund;
(2) the purposes of the institution and the endowment fund;
(3) general economic conditions;
(4) the possible effect of inflation or deflation;
(5) the expected total return from income and the appreciation of investments;
(6) other resources of the institution; and
(7) the investment policy of the institution.

A number of changes from existing law embodied in UPMIFA are relevant to my Capstone project. Nonprofit trustees are given more flexibility in (a) invading the corpus of

[30] Because the legal standards were unclear for many institutional nonprofits, their boards were concerned that they had to mimic the investment standards that were followed by the trustees of private trusts. Essentially this meant that the nonprofit's assets were characterized as either income or principal for accounting purposes. What this meant in practical terms was that, if a nonprofit was limited to spending the income from its endowment, it had no incentive to seek investments with the potential for capital appreciation.

the endowment and (b) spending policies. Each of these should be addressed in an organization's investment policy statement.

> (a) historic dollar value—under UMIFA, the value of a donor's original contribution - - the historic dollar value - - established a default amount for the endowment fund which must be preserved in perpetuity in the absence of specific donor stipulation. By contrast, UPMIFA permits organizations to go below the historic dollar value of an endowment if they follow carefully articulated standards of prudence.
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> (b) spending policies – UPMIFA modified UMIFA by promoting a total return approach to spending, that is, "spend at a rate that over the long term will affect the donor's intent to serve the charitable purpose [of the organization] each year . . ."[31]

CommonFund Institute study-2011

As the fiduciary standard for nonprofit trustees was evolving, more attention was being paid to governance issues. In 2011, John S. Griswold of the CommonFund Institute presented an extensive and thoughtful argument for better governance for nonprofit investment management.[32] Griswold points to two forces that are shaping the environment for nonprofits today, namely, (1) a greater need and dependence on the services provided by nonprofits[33] and (2) the greatly increased complexity in investment management. Intertwined in the second factor is an increasingly complex legal and regulatory environment.

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[31] Rowland, Cynthia R., *"UPMIFA, Three Years Later",* Business Law Today, Vol. 18, No. 6, July/August 2009.

[32] *"New World, New Reality:Rethinking the Governance Model for Nonprofit Investment Management",* Griswold, John S., CommonFund Institute, January 2011.

[33] The endowment of a nonprofit plays a few different functions. It can generate income which can help fund the annual operating expenses of the organization. Depending on the restrictions, if any, on these endowment funds, it can also serve as an emergency fund to be used for unanticipated expenses. A significant decline in endowment values can result in staff reductions, the decrease or elimination of funds for some programs or deferring maintenance on fixed assets. And, of course, a material decline in the assets of foundations, which are the primary funding sources for many nonprofits, may have a negative impact on their grant making to nonprofits. *See,* Longstreth, note 11 p. 13.

Complex investment vehicles such as hedge funds, derivatives and commodities require a greater level of skill and knowledge than had been required of nonprofit trustees in the past. In fact, this complexity, the enhanced level of required due diligence, monitoring and oversight and the increased liability risks may make it more difficult for nonprofits to find individuals willing to serve as trustees with investment oversight responsibility.

Griswold cites a 2009 survey by the Bridgespan group, a consultant and advisor to nonprofits, which found that 56 percent of surveyed nonprofits, (double the rate of a survey conducted about 8 months previously), had reported an increase in requests for their services. This increased demand was underscored by the impact of the 2007-2009 financial crises. Griswold also noted the decline in asset values for nonprofit institutions during this period. He referred to a 2009 CommonFund study that found that 842 institutions of higher education reported an average 18.7% decline in asset values in the fiscal year ending June 30, 2009. He then noted the impact of this decline—reducing staff, deferring maintenance decreasing or eliminating funding for some programs, among other steps. [34]

Methodology of My Survey and Scope of Research—May 2011

My operationalized hypothesis is that a significant percentage of Maine nonprofit organizations with endowments with a market value of over $250,000 either (i) do not have written endowment governance policies or (ii) have policies that are limited in scope. I also wanted to test the hypothesis that the larger the dollar value of an organization's

[34] In 2009, the Council on Foundations reported the results of a survey which found that, in response to the 2007-2009 market break, 48% of foundations reported plans to reduce their total grant making by 10% or more in 2009, 60% reported cutting their 2009 operating budgets and 45% implemented salary freezes. *"Foundations Respond to the Needs of Families Even as Their Assets Have Declined"* (May 6, 2009).

endowment, the greater the likelihood is that it will have a formal, written investment policy.

I sought only aggregate, as opposed to individual organizational data. My identity as a Muskie student was disclosed, by a reference in the electronic newsletter disclosing that the Maine Association of Nonprofits ("MANP") was conducting the survey in conjunction with my research as a Muskie student. The units of analysis that I selected for my research project are organizational. Six hundred and seventy-five nonprofit organizations are members of MANP. Most of these 675 MANP member nonprofits are IRS reporting organizations.[35] The subjects of my research were those nonprofit organizations out of the 675 MANP members that responded to my survey. The survey is designed to provide a picture of how Maine's nonprofits are addressing the governance issues relating to their Endowment and Cash Reserve Accounts as well as providing an explanation of the responsibilities assumed by a nonprofit Board as they relate to Endowment and Cash Reserve Accounts

Prior to the commencement of the Capstone survey, a request for IRB Review was submitted to the USM Office of Research Integrity and Outreach. This request included a description of the proposed survey. On November 22, 2011, the Office of Research Integrity and Outreach advised that data collection activities could begin and set forth its determination that:

> "[b]ecause this is a systematic investigation that does not involve seeking information about a living individual through

[35] I have been advised by the staff of Maine Association of Nonprofits that there are approximately 2,300 nonprofit organizations in Maine that are "reporting" entities, i.e., they file a federal Form 990 with the Internal Revenue Service. An entity that is exempt from federal income taxation is required to file an IRS Form 990 if it has either (1) gross receipts greater than or equal to $200,000 or (2) total assets greater than or equal to $500,000 at the end of the tax year. Instruction for Form 990; http://www.irs.gov/pub/irs/i990.pdf.

> interaction or intervention, it does not fall under the definition of research with human subjects as described in 45 CFR Sect. 46.102, and therefore does not require review or exemption determination by the Administration."

I developed a questionnaire and, with the assistance of the Maine Association of Nonprofits, created a survey document using Survey Monkey.[36] MANP agreed to participant in and facilitate this survey with the belief that the results would be of benefit to its members since they will receive the results of the survey and compare their approach to endowment and cash reserve account governance decisions to their peer organizations.[37] There is no anticipated potential for harm for any participating organization. Because there were not face-to-face interviews and, thus, non-sampling errors did not occur. There was no pre-test of the survey.

The survey was sent by MANP to its members that are Maine nonprofit organizations with an endowment account greater than $250,000 in market value at the time of the survey. After consulting with the staff of MANP, I expanded the scope of my survey to include the cash reserve accounts of Maine nonprofits since the MANP staff advised me, based on their knowledge of their membership, that there were a limited number of nonprofits in Maine with endowments over $250,000.

My online survey was conducted in May 2012. There were 1,400 "opens" of the MANP electronic newsletter and 5% (70 organizations) clicked on the link for the survey. MANP staff advised me that this "click" rate was about average for their online member surveys. Of the 70 clicks on the survey link, I received 31 responses or 44.3% of the clicks. I subsequently sent the link to the survey to 8 additional nonprofit organizations, which I

[36] Attached as Appendix B is a copy of the survey document with tabulated results.
[37] My preliminary survey results were presented at MANP's Finance Camp held on September 27, 2012 in Freeport, Maine.

selected based on my personal knowledge, all of whom responded, for a total of 39 responses to the survey questionnaire.

Metrics of Responding Nonprofit Organizations

(a) Operating budgets

Of the 39 respondents in my survey, 71.8% had operating budgets of $250,000 to over $2 million while 38.5% had operating budgets over $2 million.

(b) Assets

84.6% of the respondents to the survey had assets over $500,000 with an asset range for all respondents of from $100,000 to over $500,000.

(c) Endowments

Twenty-four of the 39 responding nonprofits had an endowment while 15 did not. Sixty-one percent of those with endowments (16) said they had endowments of over $1 million. Slightly more than half had both an Endowment and a Cash Reserve Account.

(d) Cash Reserve Accounts

All respondents had Cash Reserve Accounts and the size of their Cash Reserve Accounts ranges from $25,000 to over $250,000. More than half (56.4%) had Cash Reserve Accounts over $250,000

Conclusions

Although the universe of Maine nonprofits that responded to the survey is relatively small (39 responses), certain findings have emerged. There was not a consistent governance standard for Endowment and Cash Reserve Accounts among the nonprofit organizations that completed the survey. In many instances, responsibility for oversight of these accounts appears to be loosely defined and spread among different organizational functions. The governance documents were sometimes silent on Board responsibilities. Nonprofit organizations should acknowledge that Endowment Account governance is a Board of Director's responsibility and strengthen their governance policies and procedures. The overview of Cash Reserve Accounts is generally viewed as a cash management function with less specific governance procedures and policies for most nonprofit organizations. My recommendations (underlined and bolded) follow.

Endowment Accounts

1. Oversight and Monitoring of Endowment Account

(i) responsibility for oversight

The survey results indicated that, in 43% of the organizations, the Endowment Account monitoring function resided with staff, generally the Executive Director. Because of its fiduciary responsibility, a nonprofit organization's bylaws should expressly state that **the oversight function for an organization's Endowment Account is a Board and not a staff function.** While it is generally not practical to have the entire Board of Directors assume responsibility for the oversight of an organization's Endowment Accounts, this function may be delegated to a designated subcommittee of the Board, generally an Investment Committee or, sometimes, the Finance Committee.

(ii) frequency of oversight and scope of monitoring

All respondents indicated that they regularly monitor their Endowment Accounts with over 90% conducting a review either monthly or quarterly. **Oversight should include regular monitoring of the account, reporting to the Board, and development and**

regular review of an Investment Policy Statement. A regular meeting schedule with the outside Investment Manager should also be implemented.

2. Investment Committee

(i) establishment

Over 90% of responding organizations have an Investment Committee and approximately two-thirds make provisions for an Investment Committee in their bylaws. **The establishment of an Investment Committee, and its authority to oversee the Endowment Account, should be expressly stated in an organization's governing documents.**

(ii) membership

While two-thirds of respondents state that the authority to be a member of an organization's Investment Committee comes from their bylaws, one-third indicate that "custom and past practice" provide the basis for the organization's authority for membership on this important committee. Ninety percent of respondents allow non-Board members to be on their Investment Committee. Given the specific skill set and expertise necessary to appropriately meet this responsibility, it is appropriate to go beyond Board members for this task. As the senior staff member, the Executive Director can recommend members for the Investment Committee, subject to the approval of, or in conjunction with, the chair of the Investment Committee. **The organization's bylaws should expressly address the membership of an Investment Committee and permit non-Board members to be on the Investment Committee**.

(iii) oversight

About 40% of respondents allow their Executive Director to monitor the Investment Committee. Functional oversight should reside with the Board and the responsibility should be expressly stated in the organization's governing documents. The Executive Director may also review the Endowment Account; however, it should be clear in the governing documents and in practice that, given the Board's fiduciary responsibility for the Endowment assets, **monitoring the work of the Investment Committee is a Board, not a staff responsibility and the Investment Committee should report directly to the Board.**

(iv) frequency of meetings

Investment Committee meetings should be scheduled on a regular basis as part of the oversight responsibility of the Board. Many organizations do not spell out in their bylaws the frequency of Investment Committee meetings. **The frequency of Investment Committee meetings should be made explicit in the organization's governing documents.**

3. Investment Policy Statement

An Investment Policy Statement is a written document "designed to address the objectives, constraints, unique circumstances and overall policies that govern investment-related activities of the nonprofit."[38] **The Board of a nonprofit organizations with an Endowment or Cash Reserve Account should prepare, review and approve a written Investment Policy Statement.** All respondents in the survey stated that they have an Investment Policy Statement and that it was subject to Board approval.

[38] A sample Investment Policy Statement is attached as Appendix A.

(i) preparation of an Investment Policy Statement

Sixty percent of respondents said that their Investment Committee prepared their Investment Policy Statement while 30% said that their Investment Manager prepared this document. **The final Investment Policy Statement should be presented to the Board for its approval.**

(ii) content

The level of detail that is contained in a nonprofit organization's Investment Policy Statement will vary, depending on the needs of the nonprofit, its culture, and the requirements or desires of the Board of Directors. At the very least, an Investment Policy Statement should describe the nonprofit organization and its mission, the objectives for the investment of the endowment, and outline the responsibilities of the relevant parties, to wit, the Board, the Investment Committee, the staff and the outside investment manager, if applicable. Conflicts of interest in the investment context may be addressed in an Investment Policy Statement, although the nonprofit's overall conflicts policy should cover the subject. Many organizations choose to include a reference in the Investment Policy Statement, either general or specific, to the asset allocation philosophy or range of asset classes for the endowment fund. Frequently, this will include a target asset allocation presented with broad ranges.

One nonprofit group[39] suggested that an investment policy should include the following:

- Delegation of authority
- Conflict of interest

[39] Nonprofits Assistance Fund, *"Investment and Endowment Policies"*, September 9, 2009.

- Objectives
- Asset diversification
- Investment criteria (based on mission or social responsibility)
- Investment tolerances (risk
- Reporting requirements

Restrictions on asset classes or specific securities, if relevant, are frequently spelled out in the Investment Policy Statement. Finally, the spending policy for the organization should be set forth in sufficient detail to permit budget decisions.

(iii) review of Investment Policy Statement

A regular review of the Investment Policy Statement by the Board of Directors would enhance the governance of these Endowment Accounts. The findings of the survey indicated that 76% of the respondents reviewed their organization's Investment Policy Statement on only an "as needed" basis. Conducting such a review on an "as needed" basis, runs the risk of the Board's attention being directed to other, more pressing, immediate issues and may divert attention from the oversight of the Endowment Account. **A review of the Investment Policy Statement should be more formalized with an annual review as part of the broader oversight of the Endowment Account by the Board or a designated Board committee.**

4. Investment Manager oversight

(i) selection of Investment Manager

The due diligence for the selection and oversight of the Investment Manager is another important responsibility of the Board or its designated committee as it exercises its fiduciary duty. Yet, 53% of responding organizations delegate this function to the Executive Director. **The responsibility to conduct the search for the Investment**

Manager and oversee its performance is not a staff function and should be lodged with a Board committee.

The process for manager selection may be set forth in the Investment Policy Statement, although it is more common to keep this reference general if it is included at all. The duties and responsibilities of the manager, including reporting responsibilities, may be spelled out in some detail in the Investment Policy Statement.

(ii) Investment Manager Agreement

Surprisingly, 10% of the survey respondents have no written agreement with their Investment Manager. Given the importance of this relationship and, in light of the ongoing fiduciary responsibility of the Board, **a written agreement with the Investment Manager should be used in all instances**. It was somewhat perplexing to observe that a large number of respondents skipped the two questions in the survey addressing whether a written agreement with the Investment Manager existed. Whether this was due to a misunderstanding of the question, "survey fatigue", an embarrassment regarding their organization's lack of attention to this aspect of oversight, or some other explanation cannot be determined.

5. Benchmarking

Approximately 20% of the respondents do not use benchmarks to evaluate the Investment Manager's performance. **Performance benchmarking of an organization's Endowment Account should be instituted in every instance as it allows for a generally accepted standard of performance measurement**. Without benchmarks there is no reasonably way to evaluate the performance of the manager.

Cash Reserve Accounts

The survey was expanded to encompass questions about Cash Reserve Accounts at the suggestion of the Executive Director of the Maine Association of Nonprofits, based on his concern that the response rate would be low if the questions only addressed Endowment Accounts inasmuch as many of MANP's members do not have Endowment Accounts at the $250,000 and above level. Expanding the coverage to include Cash Reserve Accounts would, in his opinion, increase the number of responses to the survey. While inclusion of Cash Reserve Accounts appeared to increase the overall responses, it is apparent that the oversight of the Cash Reserve Account is treated as a cash management staff function rather than as a Board responsibility.

Slightly over one-half of respondents have both an Endowment and Cash Reserve Account while thirty-eight percent have only a Cash Reserve Account. From a governance perspective, much greater Board attention is given to a nonprofit's Endowment Account than is directed to its Cash Reserve Account. There is generally no mention of Cash Reserve Accounts or their governance in an organization's bylaws. Almost 60% have no written policy governing how their organization manages or invests its Cash Reserve Account. For example, most respondents indicated that authority for their organization's Cash Reserve Account oversight function came from "custom and past practice" (75%) or was silent (16.7%) rather than address in its bylaws (8.3%). Further, 94.7% of the respondents said that their bylaws were silent about the frequency of Cash Reserve Account oversight.

There is greater staff versus Board oversight of Cash Reserve Accounts as contrasted with Endowment Accounts. Almost uniformly, responsibility for the Cash Reserve Account resided at the staff level, most frequently with the organization's Treasurer, Finance Director or Chief Financial Officer. Of the 19 respondents who answered the question, almost 90% indicated that their organization's bylaws do not mention oversight of the Cash Reserve Account and almost 95% indicated that the frequency of oversight is not referenced in the organization's governing documents. In those few instances (5) where there is a written oversight policy for a Cash Reserve Account, it was written by the Executive Director (2 times) or by the Finance Committee (3 times). About two-thirds of respondents with Cash Reserve Accounts have the oversight policy reviewed and approved by the Board; one-third do not. The Cash Reserve Account policy is not frequently reviewed by either the organization staff or its Board.

The assets in the Cash Reserve Account are placed mostly in banking products, e.g., checking, savings and money market accounts or Certificates of Deposits. A surprisingly large percentage responded that they put their Cash Reserve Account assets in investment accounts, but that response may be a reflection that they viewed CDs as an investment rather than a banking product.

Every response to the benchmarking question indicated that the Cash Reserve Account's performance is not benchmarked in any way. This may be a reflection of the fact that the Cash Reserve Accounts is used as an organization's checking account or safe "parking place" for its cash rather than as an investment vehicle.

Implications of Research

Respondents reported that there were significant losses during the period of the 2008-2009 market break (late 2007-March 2009)

- 50% of respondents reported losses of less than 20%
- 50% of respondents reported losses of 20% to 40%

Since the 2008-2009 market break, many responding nonprofit organizations

- revised their Investment Policy statements
- expanded Investment Committee membership
- changed their spending policy (generally downward)
- adjusted asset allocation to be more conservative

A few nonprofits either put more funds into cash to mitigate market losses or simply "sat and waited," seemingly paralyzed by the enormity of the market break. If a clear Investment Policy Statement had been adopted by the Board, regular monitoring implemented and benchmarking procedures followed, it may have resulted in the nonprofit organization's weathering the financial storm and, perhaps, participating in the 4 year long financial market recovery post mid-2009.

History has taught us that market fluctuations are not anomalies. Cyclical market fluctuations are a manifestation of the inherent volatility that nonprofit organizations need to acknowledge and plan for. They need to be proactive in their approach to protect their organization's assets.

My research has shown that some Maine nonprofits did not have the policies and procedures in place, and applied rigorously, that are needed to prepare for and weather the financial market storms that could jeopardize their assets and therefore their mission.

Further research might be undertaken to see what Maine nonprofits might do to develop the policies and procedures to manage and protect their endowment assets. It would also be useful to ascertain, through further research, how Maine nonprofit endowment assets performed in the post 2008-early 2009 market crash.