Intentional Endowments Network

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Leading Practice Briefing on Fiduciary Duties for Endowments and Foundations

Integrating Nonprofit Mission Goals into Investment Practices*

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Colleges, universities, philanthropic foundations and other endowed nonprofit institutions that enjoy tax exemptions because of their social benefit purposes are increasingly examining how endowment fund investment practices can be better aligned with the institution's mission, values and goals.[1] A range of stakeholders, including students, staff, alumni, donors and the general public, have begun to call on these nonprofit institutions to direct endowment assets toward investments that offer competitive returns and benefit society while moving assets away from investments that undermine institutional mission or risk harming society.

This overview is intended to provide nonprofit investment fiduciaries with an overview of how industry leaders are seeing fiduciary duty principles as a guide to alignment of investment practices with their nonprofit's mission goals. As more and more sophisticated investors find long-term competitive advantages in strategies that incorporate material environmental, social and governance ("ESG") factors into investment analysis, questions have arisen about whether fiduciary duties permit the use of such practices by foundations and endowments. We conclude that prudent adoption of mission-aligned investment techniques is consistent with, and even encouraged by, fiduciary duties.

Application of Fiduciary Duties to Foundation and Endowment Leading Investment Practices

Fiduciary duties for nonprofit investors are found in state laws that are based on Uniform Acts developed by the Uniform Law Commission. Leading investment practitioners recognize the following principles in their investment practices.

1. The Uniform Prudent Management of Institutional Funds Act ("UPMIFA") and the Uniform Prudent Investor Act ("UPIA") generally govern foundation and endowment investments. Under these two Acts:

   (a) Similar standards for managing institutional funds apply whether a charitable organization is organized as a trust, a nonprofit corporation or another entity.

   (b) Fiduciaries are directed to consider the charitable purposes and mission goals of the institution[2] when making investment decisions.

[1] For example, the following University of Wisconsin - Madison mission statement excerpt is typical for universities. "The primary purpose of the University of Wisconsin–Madison is to provide a learning environment in which faculty, staff and students can discover, examine critically, preserve and transmit the knowledge, wisdom and values that will help ensure the survival of this and future generations and improve the quality of life for all."

[2] The UPMIFA defines "*charitable purpose*" as "the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community." Mission goals involve the specific entity's application of its charitable purposes.

(c) Governing fiduciaries are expected to provide instructions to investment managers that are consistent with the charitable purposes and mission goals of the institutional fund, and must monitor the managers' compliance over time.

2. Fiduciaries must act in good faith to manage investments with the care that an ordinarily prudent person in a similar position would exercise under similar circumstances. However, this also contemplates consideration of each institution's characteristics and precludes mindlessly copying peers.

3. Legal obligations for investment of fund assets must be addressed in governance practices and investment policies. Requirements include, among others, the duties to:

   (a) manage associated risk exposures to the fund and to the endowment's goals;

   (b) diversify investments, except when prudent not to diversify;

   (c) consider economic conditions;

   (d) investigate and verify facts relevant to investments;

   (e) comply with tax requirements;

   (f) incur only reasonable and appropriate costs; and

   (g) consider an asset's special relationship with or value to charitable purposes.

4. Fiduciaries have a duty of loyalty, which requires investments to be managed to serve the entity's charitable purpose and mission, doing so with reasonable impartiality between current and future obligations.

5. Fiduciaries also have a duty of obedience to the endowed institution's mission, which requires use of investment practices that serve its charitable mission and is applied to both program and investment activities.

6. Leaders recognize that prudent investment practices evolve as facts and circumstances change. For example:

   (a) Many investors that used ethics-based investment screens have moved to integration of material ESG factors in their investment and risk management analyses.

   (b) Leaders understand that the prudent investor standard encourages adoption of new investment and risk management knowledge when insights or circumstances change.

   (c) Leading investors are also seeking out and responding to current research findings, which have generally demonstrated that integration of ESG factors into investment practices can be an effective investment strategy which serves charitable purposes and does not require giving up returns.

7. Endowment best practice governance and investment policies should reflect an entity's mission.

    (a) Mission goals can be integrated into investment strategy, investment guidelines, requests for proposals, contracts, compensation, proxy voting, portfolio company engagement and monitoring of investment service providers.

    (b) Investment committee members should include representatives with mission expertise, skill set diversity and sustainable long-term investment practices knowledge.

    (c) Best practice reports to stakeholders should address how the institution's mission is being integrated into its investment practices.

Conclusion

Endowment fiduciary leaders are attentive to evolution of the investment industry knowledge base and to changes in the environment, economy and society which can be material to short- or long-term investment risks and opportunities. There is a growing body of research, with corresponding investment practice options, that offers new opportunities to pursue sustainable and mission-aligned investment without sacrificing results.[3] Fiduciary duty principles and recent regulatory guidance encourage trustees and managers to respond to these developments through a prudent process that focuses on better aligning investment practices with nonprofit charitable purposes and mission goals.[4]

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[3] For additional information, see http://www.intentionalendowments.org/the_business_case_for_esg.

[4] Recent regulatory support of mission-aligned investment practices and the integration of material ESG factors into investment analyses include Federal Department of Labor ERISA Interpretive Bulletins 2015-01 and 2016-01, and IRS Notice 2015-62.