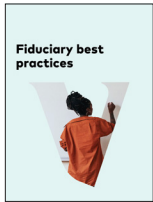


Fulfilling your mission

A guide to best practices for nonprofit fiduciaries



Table of contents



A guide to best practices for nonprofit fiduciaries

Page 3



Sample Investment Committee Charter

Page 42



Sample Investment Policy Statement

Page 46



Investment committee member matrix

Page 50



Nonprofit investment committee member checklist

Page 54



Common investment committee agenda topics

Page 58



Nonprofit investment committee checklist

Page 62

Fiduciary best practices



Contents

Introduction	2
Part I: Defining your role	6
Defining the fiduciary role	
A brief history of U.S. fiduciary law	
Accounting standards and other criteria	
Your fiduciary role	
Laying a strong foundation	12
Investment committee charter	
Investment policy statement	
Investment purpose and strategy	
Part II: Building your structure	16
Building out the framework	
Portfolio construction	
Risk management	
Measuring success	
Spending policy	
Manager selection	
Maintaining the structure	26
Meeting agendas	
Conclusion	30
Part III: Glossary and references	
Glossary of legal, accounting, and tax terms	32
References	35

Introduction

The value of nonprofit service in today's society

Serving on the investment committee of a nonprofit or other charitable organization can be a rewarding way to serve your community and society. Nonprofits provide a large share of services critical to quality of life both domestically and internationally. They are on the front lines of some of the world's greatest challenges: providing food, medicine, and college scholarships for the underprivileged; protecting the environment; and eradicating diseases worldwide.

Such service is not without its share of unique challenges, however. Chief among them is often the limited financial resources available to support

your institution's mission. Financial sustainability, has long been a concern. The pandemic made things even more difficult, according to a 2021 survey from the Urban Institute, which highlighted declines in donations and fee-for-services, as well as staffing.

To the extent that a nonprofit investment portfolio exists, it may not be large enough to attract and retain qualified staff to manage the daily operations of the investment portfolio. These difficulties underscore the importance of establishing strong financial principles and practices within the nonprofit community.

The investment decision-making group for nonprofits

can range from a large, diverse investment committee to a finance committee, board, staff, or other decision-making entity. For the purposes of this reference manual, we will refer to any decision-making entity as the investment committee.

Reflecting the resource challenges of many charitable institutions, this reference manual offers investment committee members and their staff valuable guidance on a number of functions vital to serving a nonprofit in an investment-oriented role, including:

- At the board level, the critical importance of a well-written, thoughtful investment committee

Figure 1. Challenges indicated by nonprofit leaders

Erosion of donations			
Donation trends	2020	2015-2019	
Increased significantly	25%	28%	
Increased moderately	30%	21%	
Stayed more or less the same	32%	17%	
Decreased moderately	6%	14%	
Decreased significantly	5%	24%	
Staffing			
	Urban	Suburban	Rural
Full-time staff	1%	4%	0%
Part-time staff	-1%	-12%	-18%
Regular volunteers	-23%	-24%	-41%
Episodic volunteers	-42%	-35%	-58%
Fee-for-service declines			
<\$100,000 annual spending	-33%		
>\$100,000 to \$499,999	-25%		
>\$500,000 to \$999,999	-38%		
>\$1,000,000 to \$9,999,999	-20%		
>\$10,000,000	0%		

Source: Urban Institute, *Spring 2021 National Survey of Nonprofit Trends and Impacts*, <https://www.urban.org/research/publication/nonprofit-trends-and-impacts-2021>.

charter that clearly defines roles and responsibilities so committees can function efficiently.

- At the committee level, the essential role the investment policy statement plays in specifying your organization's investment strategy, portfolio construction, risk tolerance, spending policy, manager selection, and criteria for success.
- The need to establish an effective communication plan that disseminates information to committee members in a timely manner.
- The importance of maintaining diversity of thought and an orderly decision-making process through effective committee meeting agendas.

- Your responsibility as a fiduciary and key statutes and precedents you need to understand to help avoid legal jeopardy.

Unfamiliar territory for some

Nonprofit boards and investment committees may be different in structure from customary corporate board membership (Figure 2).

- Nonprofit investment committee members often come from more diverse backgrounds with a wider variety of skill levels. Some are extremely knowledgeable and have professional investment experience while others are relative newcomers to the financial world but bring more expertise on their organization's mission.
- Service on a nonprofit investment committee is

generally performed on a volunteer basis, whereas many corporate board members are compensated for their work.

- Spending decisions for nonprofits can be more subjective, particularly for a foundation. By comparison, corporate boards are generally restricted by a variety of constraints, including the need to fund regular pension payments.
- Nonprofits, particularly those with perpetual endowments or foundations, have much longer investment time horizons, which can encourage a focus on long-term asset allocation and investment structure rather than short-term performance. Longer time horizons also place higher priority on managing the entire portfolio, with

Figure 2. Different roles: Nonprofit and corporate boards

Difference	Nonprofit	Corporation
Member backgrounds	Wide variety of investment expertise. Board members tend to come from more diverse backgrounds with a wider variety of investment expertise.	Usually have professional financial backgrounds. Board members are more likely to come from professional financial backgrounds.
Compensation	Volunteer. Investment committee service is usually performed on a volunteer basis.	Paid. Board members are more likely to be compensated financially.
Spending authority	Board members generally have more flexibility.	Restricted by a variety of constraints, including money to fund regular pension payments.
Time horizons	Generally longer, sometimes perpetual. Some nonprofits, particularly those with perpetual endowments or foundations, can have much longer investment time horizons.	Generally shorter. Shorter time horizons because of strict pension funding rules and financial statement impact.

Source: Vanguard.

less attention on the performance of individual asset classes, securities, and sometimes liquidity.

Subtle differences among nonprofits

There is also significant diversity within the nonprofit sector in terms of goals, objectives, and investment management strategies. Private foundations and endowments held by public

charities may appear to share many of the same characteristics, but there are critical differences between the two.

For example, private foundations must distribute at least 5% of the average market value of their investment assets each year or face significant tax penalties. They generally receive few new infusions of

capital to boost operations and must rely almost exclusively on investment income to support obligations. Private foundations must also focus on meeting short-term obligations even at the expense of long-term purchasing power. In contrast, endowments held by public charities do not face the same restrictions and can focus on preserving long-term purchasing power.

A tool kit for your responsibilities

Both seasoned and prospective committee members face new challenges unique to nonprofit investing. Each organization has to tailor its investment practices to fulfill its mission and make adjustments when necessary.

At Vanguard, we adhere to the highest ethical standards and continually strive to help clients achieve their missions. While we provide many services to help our nonprofit clients meet their fiduciary responsibilities, there are other steps investment committees should take on

their own. These are presented in this guide, as well as in a number of companion pieces that can be found online at vanguard.com/nonprofitresourcecenter.

Defining your role



Defining the fiduciary role

Fiduciary: Someone having legal authority for managing another person's or organization's money. The primary duty of a fiduciary is to manage a prudent investment process without which the components of an investment plan cannot be defined, implemented, or evaluated.¹

A brief history of U.S. fiduciary law

To better execute your fiduciary responsibilities, you should first have an understanding of the origins of your legal obligations. While much of the historical context behind the role of a fiduciary pertains to the management of individual trusts, the advances that took place in this area during the second half of the 20th century are also relevant to nonprofits.

Significant events

Fiduciary responsibilities in the United States have evolved over the past half century to the point where modern investment committees have much wider latitude to support their organizations' long-term objectives. This has not always been the case. Until recently, judicially created restrictions based on English common law have mandated that fiduciaries be judged on an individual investment basis rather than on the overall performance of a well-diversified portfolio (Figure 3).²

This perspective reduced potential returns by forcing fiduciaries to rely almost exclusively on conservative investments to meet court approval. Traditional trust law included a number of restrictions on investments, including a prohibition on junior mortgages and new ventures, with some states taking the extreme step of creating legal lists of approved trust investments.³ This restrictive environment not only limited potential returns but also allowed asset values to be eroded by inflation.⁴

In the early 1950s, Harry Markowitz published his landmark paper, *Portfolio Selection*, which has become the generally accepted origin of modern portfolio theory.⁵ This theory combines speculative and safe investments in an effort to generate consistent portfolio returns.⁶ Markowitz developed the concept that a diversified portfolio is considered prudent in most cases because the expected rate of return

¹ Foundation for Fiduciary Studies, 2004.

² Borkus, 2001.

³ National Conference of Commissioners on Uniform State Laws, 1994.

⁴ Borkus, 2001.

⁵ Borkus, 2001.

⁶ Phillips Jr., 1997.

Figure 3. Key events in fiduciary history

Event	Significance
South Sea Company (1720)	<ul style="list-style-type: none">Financial collapse of English company established fiduciary doctrine in England and America of protecting portfolios through conservative bond investments.
Harvard v. Amory (1830)	<ul style="list-style-type: none">Massachusetts Supreme Court ruling established modern prudent man standard.Permitted fiduciaries to incorporate riskier investments into portfolios, provided they used good judgment.
King v. Talbot (1869)	<ul style="list-style-type: none">New York Court of Appeals decision restricts fiduciaries to government- and mortgaged-backed securities.
Modern Portfolio Theory (1952)	<ul style="list-style-type: none">Concept developed by Harry Markowitz that a diversified portfolio is considered prudent in most cases.
Ford Foundation Studies (1969)	<ul style="list-style-type: none">Cary and Bright report argues that traditional trust law does not apply to endowed funds and fiduciaries for such funds balance current and future spending needs, taking into account loss of purchasing power caused by inflation.The Barker study recommends that educational endowments adopt total return strategies and that the management of those funds be delegated to professional money managers.

Sources: Borkus, 2001, Gary, 2007, McElhane, 2010.

increases without substantially increasing the portfolio's overall risk.⁷

Modern portfolio theory stands in sharp contrast to the policy of "safe" investing under traditional fiduciary doctrine. The ultimate goal is to balance portfolio risks and returns through diversification of assets. By using a wide range of investments to build a portfolio that more closely reflects the overall market, higher returns are possible.⁸ A diversified portfolio is considered prudent because it minimizes the specific risk associated with any one investment. Using a broad spectrum of investments, including those once considered speculative, can improve the portfolio's expected rate of return without inherently increasing its exposure to uncompensated risks.⁹

In 1969, the Ford Foundation published two studies that were particularly influential in helping to advance portfolio theory for endowed funds. The first report, *The Law and Lore of Endowment Funds* by William L. Cary and Craig B. Bright, Esq., argued against the traditional trust law concept of prioritizing current income requirements over generating realized gains. Instead, the authors called for

endowments to give equal consideration to capital appreciation needs.¹⁰

The second Ford Foundation report, *Managing Educational Endowments* by Robert R. Barker, analyzed the investment returns of 15 large educational endowments and compared their performance with 21 randomly selected balanced funds, 10 large growth funds, and 1 university endowment from 1959 to 1968. The average annual return for the 15 endowments lagged significantly behind the others during this 10-year period. The report attributed its findings to the endowments' focus on avoiding losses and maximizing present income.¹¹

Markowitz's work and the Ford Foundation studies led to the development of the Uniform Management of Institutional Funds Act (UMIFA), the Uniform Prudent Investor Act (UPIA), and, more recently, the Uniform Prudent Management of Institutional Funds Act (UPMIFA). All of these statutes create a fiduciary standard that essentially warns against exercising extreme conservatism.¹²

⁷ Phillips Jr., 1997.

⁸ Phillips Jr., 1997.

⁹ Phillips Jr., 1997.

¹⁰ Schneider, 2002.

¹¹ Schneider, 2002.

¹² Borkus, 2001.

Statutory breakthroughs—UMIFA, UPMIFA, UPIA

In 1972, the National Conference of Commissioners on Uniform State Laws (NCCUSL) adopted UMIFA. The act is significant because it embraced the concept of total return. In contrast to previous statutes and policies that restricted endowment spending to income investments such as interest and dividends, UMIFA authorizes organizations to spend from capital appreciation on endowment fund assets (Figure 4).

UMIFA also grants investment boards the authority to pursue any investment authorized under law and to delegate investment authority not only within their committees and sponsoring organizations but also to outside advisors and managers.

At the time, UMIFA was seen as groundbreaking legislation for advocates of modernizing fiduciary standards, but its prohibition on endowments from spending below their historical dollar value limited many smaller organizations to investing in cash equivalents, such as certificates of deposit. This strategy forced these institutions to retain sufficient funds and not break the law by dipping into their corpus.

Twenty years later, the Prudent Investor Rule, ratified by the American Bar Association in 1992, built on many of the advances made by Markowitz and UMIFA. This policy recommendation gives fiduciaries greater flexibility to consider any investment to create a

desirable balance between risk and return for a given trust and includes the following features:

- Duty to balance risks against total returns. In contrast to the previous trust doctrine, which characterized return as income yield alone and condemned trustees for speculative investment practices, the Prudent Investor Rule acknowledges that excessive conservatism can prove equally harmful to trust beneficiaries and considers increases in market value as part of the trust's return.¹³
- Duty of impartiality. The Prudent Investor Rule expands the concept of trust preservation to include the protection of trust capital and its purchasing power from the threat of inflation. An investment strategy that seeks maximum income yield may minimize growth of trust capital. Such a strategy may satisfy the income needs of current trust beneficiaries but leaves the trust with diminished purchasing power for future beneficiaries. This approach violates the duty of impartiality by favoring one group's interest over another's.¹⁴
- Authority to delegate. The Prudent Investor Rule builds on UMIFA by encouraging trustees to use outside expertise to identify investment opportunities.
- Investing in a cost-conscious manner. The new policy requires trustees to balance transaction costs associated

¹³ Phillips Jr., 1997.

¹⁴ Phillips Jr., 1997.

with outside advice, investment fees and commissions, and additional capital gains taxation against the prospect that these activities will lead to increased returns.¹⁵

The new rule was codified by the NCCUSL as UPIA in 1994. While UPIA applies primarily to family trusts, the act has served as the foundation for further modernization of fiduciary standards for charitable organizations.

In contrast to UMIFA, which maintains strict prohibitions against spending below endowments' historical dollar value, UPIA grants fiduciaries more flexibility to spend both principal and income for funds held in trust. This flexibility allows trustees to select investments without having to realize a particular portion of the portfolio's total return from traditional income investments.

As the focus of endowment management has shifted from growing assets to preserving long-term security, UMIFA has increasingly been seen as

obsolete by the fiduciary community. For this reason, the NCCUSL approved UPMIFA in July 2006 to update and replace UMIFA.

In addition to further modernizing best practices for nonprofit fiduciaries, UPMIFA differs from its predecessor in the following ways:

- UPMIFA abolishes UMIFA's historical dollar-value limitation and provides better guidance on prudent investing, which makes the need for a floor on spending unnecessary.
- Investment managers are not limited in the kinds of assets they may seek for the portfolio under UPMIFA.
- UPMIFA requires prudence in incurring investment costs, authorizing only costs that are appropriate and reasonable in relation to the nonprofits' assets, the purposes of the institution, and skills available to the institution.

Figure 4. Key model statutes modernizing U.S. fiduciary law

Laws governing charitable trusts	Laws governing nonprofit corporations	Significance
	Uniform Management of Institutional Funds Act (UMIFA) (1972 et seq)	Provided uniform rules for the investment of funds held by charitable institutions and the expenditure of funds donated as "endowments" to those institutions. Embraced concept of total return. Prohibited endowments from spending below their historical dollar value.
Uniform Prudent Investor Act (1994)		Increased the duty to diversify trust assets. Directed the trustee to consider the entire portfolio when making investments by allocating risk across the portfolio rather than on an asset-by-asset basis.
	Uniform Prudent Management of Institutional Funds Act* (UPMIFA) (2006 et seq)	Expands on UMIFA and has replaced it in every state except Pennsylvania as of 2018. Designed to mirror UPIA. Abolishes UMIFA's historical dollar-value limitation on expenditures and provides for diversification of assets, pooling of assets, and total return investment.

Source: Gary, 2007, Langbein, 2004, Uniform Law Commission, 2018.

¹⁵ Phillips Jr., 1997.

Figure 5. Accounting terms and statutes

Accounting standard/law	Timeframe	Description
FAS 116 (1993)	Published in 1993 and updated in 2008	Addresses accounting for contributions received and contributions made.
FAS 117 (1993)	Published in 1993 and updated in 2009	Establishes standards for general-purpose external financial statements provided by nonprofits.
FAS 124 (1993)	Published in 1993 and updated in 2010	Focuses on accounting standards for certain investments held by nonprofits.
Sarbanes-Oxley (2002)		<p>Required publicly traded companies and other entities to adhere to stricter corporate governance standards that broaden board member roles in overseeing financial transactions and auditing procedures.</p> <p>Primarily applies to for-profit corporations but is relevant to the accounting and control standards for nonprofit organizations.</p> <p>Prohibits retaliation against whistleblowers.</p> <p>Prohibits destruction, alteration, or concealment of certain documents or the impediment of investigations.</p>
Revenue Recognition from Contracts with a Customer (ASU 2014-09, topic 606)	Amended in 2014 and effective for fiscal years starting on or after December 15, 2018	Creates a single, principles-based revenue recognition standard under generally accepted accounting principles (GAAP).
Presentation of Financial Statements of Not-for-Profit Entities (ASU 2016-14)	Amended in 2016 and effective for fiscal years starting on or after December 15, 2017	Describes how nonprofits classify net assets, liquidity, and availability of resources, expenses, and investments.
Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made (ASU 2018-08, topic 958)	Amended in 2018 and effective for fiscal years starting on or after December 15, 2018	<p>Provides clarifying guidance on accounting for the grants and contracts of nonprofit organizations as they relate to the new revenue standard (ASU 2014-09 Revenue from Contracts with Customers).</p> <p>Delineates a more detailed framework for nonprofits in defining whether a transaction should be considered a contribution or exchange transaction.</p>

Sources: BoardSource, 2006, Financial Accounting Standards Board (FASB) 2018, 2016, 2014, 2008.

Accounting standards and other criteria

In addition to being informed of the legal statutes affecting nonprofits, investment committee members also must be familiar with other general legal, accounting, and tax terminology impacting their responsibilities. It is beyond the scope of this document to cover all the different laws and rules governing charitable organizations. However, nonprofit fiduciaries at a minimum should be well versed in the following accounting standards, laws, and regulations to protect their sponsoring organizations and themselves from potential difficulties. (Figures 5 and 6).

Figure 6. Key filings and investment regulations

Tax law/Term	Description
Form 990	<p>Annual reporting document that nonprofits file</p> <ul style="list-style-type: none"> • with the IRS. • Provides information on a filing organization’s mission, programs, and finances. • Has several variations including 990PF for private foundations.
Jeopardizing investments	<p>Investment by a private foundation considered</p> <ul style="list-style-type: none"> • to jeopardize the carrying out of the exempt purpose of a private foundation. • Foundation managers who knowingly participate in jeopardizing investments are subject to substantial excise taxes.

Source: Internal Revenue Service, 2018.

Your fiduciary role

The modernization of U.S. fiduciary standards has made it considerably easier for nonprofit investment committees to serve the best interests of their sponsoring organizations.

At Vanguard, we view your fiduciary role as focusing beyond the technical meaning of a statute or regulation and concentrating on how that legal requirement can be used to maximize the welfare of your sponsoring organization in pursuit of its mission. This means applying personal experience, judgment, and knowledge in concert with understanding the regulatory framework. More specifically, nonprofit fiduciaries have an obligation to bring the highest level of ethical conduct and care to the operation and ongoing management of the organization's portfolio.

Investment committee members should meet certain standards of conduct and attention in fulfilling responsibilities to their sponsoring organizations. Under most state laws, nonprofit fiduciaries have three major duties:

1. Duty of care: Nonprofit fiduciaries must use the same degree of care, skill, and diligence that a prudent person would use in handling corporate affairs. Board members can fulfill their responsibility largely by being informed about matters of importance to their sponsoring organization. This means keeping apprised of relevant information before making important decisions or acting on behalf of the nonprofit.

2. Duty of loyalty: Fiduciaries must put any personal or private interests aside and always act in the best interests of their sponsoring organization. Self-dealing, conflicts of interest, and even the appearance of impropriety should

be avoided at all costs. Self-dealing occurs when a fiduciary stands to gain financially from a nonprofit decision.

3. Duty of obedience: Nonprofit fiduciaries must comply with applicable fiduciary law while keeping the organization true to its mission.

We have identified five additional responsibilities essential to good fiduciary conduct:

- **Fiduciary liability.** Investment committee members must understand their fiduciary responsibilities and the potential liabilities of serving on the committee.
- **Investment committee organization.** Committees should be carefully organized and staffed with individuals who understand their organization's mission and what they must do to support it.
- **Investment selection and monitoring.** Fiduciaries must select appropriate investments that are consistent with the unique needs of the organization. They also must decide whether a prospective manager's approach and philosophy fit the portfolio's objective.
- **Portfolio costs.** Costs incurred by the portfolio must be reasonable, paid out by the portfolio, and aligned with your spending policy.
- **Administrative oversight.** Investment committee members must oversee the creation of committee documents to ensure the committee is operating in accordance with those documents. They must also satisfy all legal and regulatory rules issued by relevant agencies.

Laying a strong foundation

Creating an effective committee charter

Many nonprofit investment committees make asset allocation decisions or select investment managers before establishing a charter. Vanguard believes this sequence is ill-advised and that nonprofits should first lay a foundation by having a serious discussion about the structure of an investment committee and the responsibilities of its members.

Given the relatively informal nature of most nonprofit investment committees, which often are composed of volunteers from a wide range of backgrounds and investment skill levels performing multiple tasks, a clear outline of duties is a crucial first step. A nonprofit cannot develop an effective investment strategy without first having identified potential committee members and staff to execute this plan.

To accomplish this, nonprofits should craft a well-written and clearly articulated charter clarifying the role of each committee member. Even the most thoughtful investment plan will have difficulty succeeding without the right people in place to implement it. Therefore, serious discussion of any other issue related to the formation of the investment committee is somewhat irrelevant until a committee has determined who is going to serve on its board and in what capacity.

An effective charter helps investment committees avoid the following common mistakes:

- Conferring committee membership as a reward.
 - Relying too heavily on a single committee member for either financial support or investment expertise.
 - Allowing potential conflicts of interest.
 - Making portfolio decisions based solely on industry peers.¹⁶
- A charter should identify the length of time members are expected to serve and be clear about which ex-officio positions are permanent (e.g., CFO) and which should rotate. We recommend that nonprofits consider a minimum of five years of service by members and be wary of rotating more than one-third of the committee members in any one term. Gradual shifts in committee composition are one of the most effective ways to balance the need for continuity and institutional memory with the importance of fresh perspectives.
- The charter must also familiarize new committee members with the organization's investment goals and approach while educating them on their fiduciary responsibilities. Other important components of an effective charter include:
- Eligibility requirements for serving on the committee.
 - Committee size.
 - The process for appointing a committee chair.
 - Member guidelines for establishing and monitoring the portfolio.

- The roles and responsibilities of permanent staff and outside consultants.
- The frequency with which the committee meets to review the investment policy statement (IPS), investment manager and fund performance, and financial statements.

A well-formulated investment committee charter not only defines roles and responsibilities but also serves as a useful tool for uniting committee members behind the purpose and mission of your organization. By having members agree up front to the principles detailed in this document, your charter will encourage the committee to unify behind the organization's purpose and policies for achieving its goals.¹⁷

Developing a strong investment policy statement

Once your organization has clarified roles and responsibilities, your next step is to develop a well-written IPS that outlines a financial strategy that will support the mission of your nonprofit. An IPS defines the purpose, objectives, and measures of success for your portfolio. It also summarizes the portfolio's investment strategy and outlines the process for evaluating investment managers.

A clearly articulated, realistic IPS is arguably the most effective way to define a portfolio's purpose

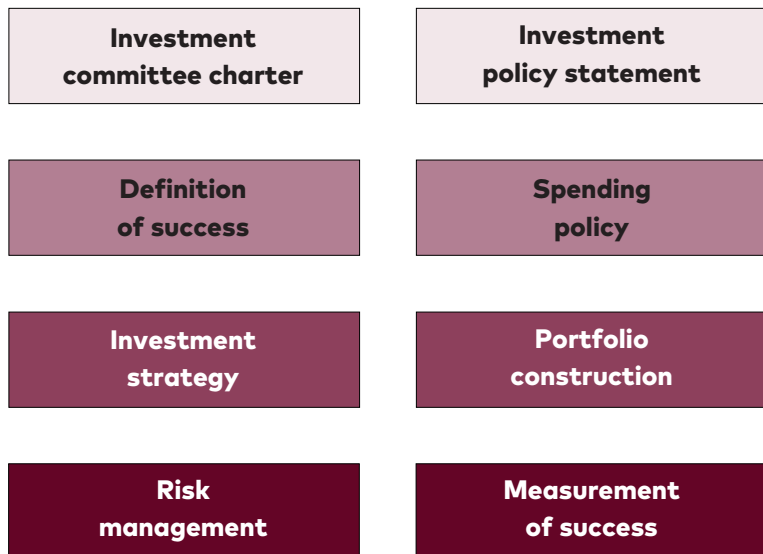
and measure a committee's success at fulfilling its goals. It also can help establish productive communications and expectations with outside investment managers and other fiduciaries.

Finally, a well-crafted IPS can protect a nonprofit from the emotional element that often inhibits a committee's decision-making process. Nonprofits are too often tempted to follow the investment strategies and practices of top-performing organizations.

This approach is ill-advised in most cases because larger institutions may have expertise, staff, and other resources beyond those of most nonprofits.

Investment policy statements should always address the organization's investment purpose and strategy.

Figure 7. Laying a strong foundation



Investment policy statement: Clearly defining your investment plan and how it will be executed

Investment purpose and strategy

An investment committee should have an explicit understanding of its portfolio's purpose and a clear definition of success for fulfilling its objectives. An example of such a strategy would be investing your organization's assets with the goal of preserving their long-term, real purchasing power while providing a relatively predictable and increasing stream of annual distributions in support of the sponsoring organization.¹⁸ Committee members must agree on a common purpose for the assets they oversee and articulate that objective as explicitly as possible. A goal without a definition can be difficult to understand and can make it challenging for committee members to evaluate their progress.¹⁹

In developing an investment purpose, board members must be wary of the trade-off between the competing goals of supporting short-term operations and preserving long-term assets. Committees that emphasize the former run the risk of losing long-term purchasing power, while those that focus on the latter may not have the resources to support their organization's short-term operating budgets.

There are three main investment strategies for nonprofits:

Preservation. The goal of a preservation strategy is to maintain enough growth to preserve equity and purchasing power across generations. This strategy, known as intergenerational equity, establishes a sustainable rate of consumption.

Growth. Nonprofits with unlimited time horizons, such as many university endowments, often pursue a growth strategy or a target rate of return greater than spending, inflation, and expenses. These organizations are invested in perpetuity and need to grow their corpus to adequately prepare for future responsibilities.

Consistency. A consistency strategy provides funding for spending needs in real terms. This approach tends to be a more suitable option for nonprofits with shorter time horizons that place higher priority on meeting pending obligations.

Fiduciaries should consider the diversification of portfolio assets, portfolio liquidity, donor requirements, and short-term income needs before formulating a strategy. Investments should be based on fully funding intended obligations, while various factors—including liquidity, risk, return, and funding status—should be used as metrics for success.

These considerations need to be revisited from time to time to ensure that new circumstances within the organization, the markets, or the broader economy haven't altered the portfolio's objectives. Fiduciaries should also review the portfolio as a whole and recognize that some assets will outperform while others will lag.

Building your structure



Building out the framework

Portfolio construction

Developing and maintaining an asset allocation strategy that meets your organization's short- and long-term goals is one of the most important responsibilities of a nonprofit investment committee and should be reflected in the investment policy statement.

In a landmark paper published in 1986, *Determinants of Portfolio Performance*, Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower concluded that asset allocation is the primary determinant of a portfolio's performance, with security selection and market-timing playing minor roles.²⁰ The research of Brinson et al. was confirmed by Brian J. Scott, James Balsamo, Kelly N. McShane, and Christos Tasopoulos in the 2016 Vanguard study, *The Global Case for Strategic Asset Allocation and an Examination of Home Bias*. Vanguard believes that asset allocation is indeed the most important determinant of return volatility and long-term total return in a broadly diversified portfolio with limited market-timing.

The 1986 Brinson et al. study represents a time-series analysis of the effect of asset allocation on performance. The methodology compared the performance of a policy, or long-term asset allocation represented by appropriate market indexes, with the actual performance of a portfolio over time. The findings indicated that, on average, most of a portfolio's return variability was attributed to its policy of asset allocation return variability. Active

investment decisions—market-timing and security selection—had relatively little impact on return variation.²¹

Forecasting returns is an inexact science requiring experience, intuition, and judgment. For this reason, committees should use conservative assumptions and consider a portfolio's performance history as a guide but not a predictor of future returns.²² This is especially true for committees responsible for assets that an organization needs to meet near-term expectations. If expected returns and spending assumptions aren't considered together, committees run the risk of having insufficient assets when they are needed to fulfill a spending obligation.

Within the nonprofit world, there is great diversity in the approach to asset allocation strategies. Institutions with urgent distribution commitments and shorter time horizons usually opt for lower-risk investments such as short-duration, high-liquidity fixed income products. For example, the IRS guidelines stating that private foundations must in general achieve a minimum annual payout of 5% of investment assets can impact the asset allocation and liquidity requirements for these portfolios.

Organizations with long time horizons, incremental gifts, and rising payout pressures may opt to take on greater risk through more aggressive portfolio strategies such as hedge funds and other absolute return investments, which may achieve higher long-term returns.

²⁰Vanguard, 2007.

²¹Vanguard, 2007.

²²Vanguard, 2004.

Risk management

Investment committees should adopt a clear investment strategy that includes a reasonable set of assumptions about the organization's risk tolerance and the portfolio's expected returns. It could be based on a traditional measure such as volatility, a loss of principal, or donor opinions of how the committee is managing its assets. The committee should attempt to identify all possibilities for failure based on the likelihood of their occurring and their potential impact.

Committees should discuss risk before setting standards and ask the following questions (Figure 8):

- What are the risks involved?
- Which risks are most likely to happen, and which ones will have the greatest impact?
- How much risk is manageable?

Best practices dictate that your organization's IPS should clearly develop a risk control framework that includes asset allocation and rebalancing as key strategies. Committee members

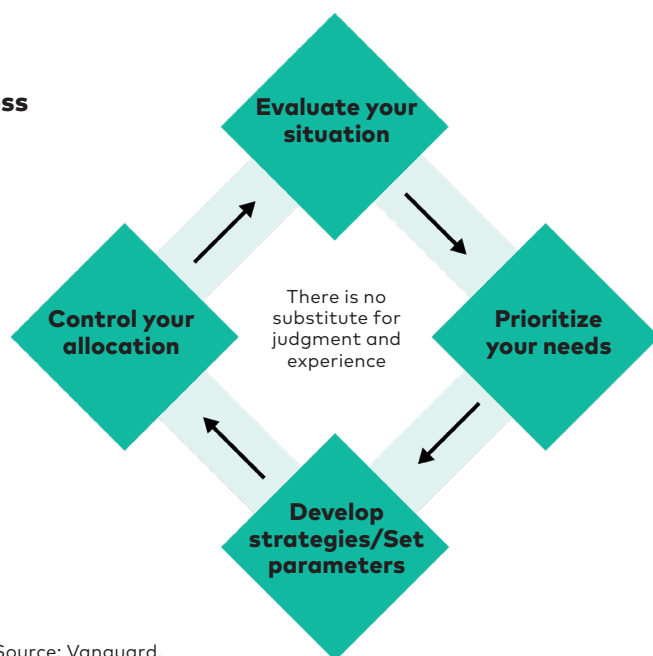
should specifically avoid rebalancing as a market-timing exercise.²³ Rebalancing requires buying and selling securities on a regular or systematic basis to return your portfolio to its target allocations. Without a disciplined approach, portfolio weightings may quickly become inconsistent with policy targets and undermine your organization's funding needs.

Generally, investment committees should review asset allocation targets no more than once a year. However, if there is a fundamental change to your organization's unique situation, you may need to meet more frequently to discuss this subject.

Annual reviews allow managers to make the changes necessary to move their portfolio in a desired direction. At the same time, limiting such discussions to regularly scheduled intervals diminishes the possibility of ill-advised decisions made in response to short-term market conditions.

Once you have defined risk, it is easier to discuss how much you are willing to take

Figure 8. Risk management process



Source: Vanguard.

on to achieve your return objectives. Committees should establish return expectations that are commensurate with their organization's risk/reward profile. Some may decide to assume

more risk with the potential reward of higher returns. Other committees may be willing to forgo the potential for large gains in return for a more secure return.

Measuring success

Nonprofit investment committees can measure success in a variety of ways, such as:

- In absolute terms.
- Against a market benchmark.
- Relative to a policy portfolio or competitive group.

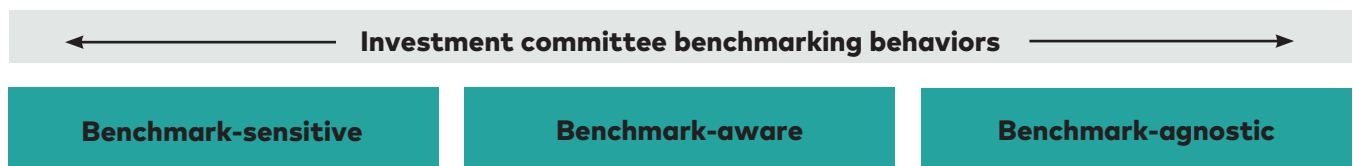
Each measure has its potential drawbacks. For example, committees often measure manager performance relative to a market benchmark because of the wide availability of this information. Under this approach, outperformance relative to the benchmark is considered a success, while underperformance causes consternation among investment committee members.²⁴

Measuring success via a competitive group can also be an artificial measure of portfolio success unrelated to the portfolio objective, given the difficulty smaller institutions may have competing with larger nonprofits because of a lack of scale, staffing, and expertise.

In general, nonprofit investment committees should measure the success of their portfolios relative to their ability to meet the goals of the organizations they serve rather than on how their investments compare with a benchmark of portfolios from their peers. Committees should recognize that there might be differences between conventional measurements of performance and those the committee is using to assess the portfolio's progress.

An example of an appropriate benchmark would be whether your investment strategy meets a specific payout percentage necessary to fund the critical needs of your sponsoring organization. This approach increases the likelihood that your investment strategy will remain consistent over time with your organization's objectives and goals.²⁵

Figure 9. Measuring success against benchmarks



²³ Vanguard, 2004.
²⁴ Vanguard, 2006a.
²⁵ Vanguard, 2004.

Spending policy

Selecting a spending policy that best supports your organization's mission is a major challenge for nonprofit investment committees. Nonprofit fiduciaries generally develop an approach that balances two fundamentally different goals:

- Maintaining the level of current spending.
- Growing the size of current investments to keep pace with inflation and support future obligations.

At a minimum, your organization's spending policy should support the needs of both current and future obligations. Which goal takes on a higher priority will vary depending on the objectives of your organization. A private foundation, required by law to spend 5% of its assets or face significant tax consequences, will generally emphasize short-term spending needs ahead of preserving long-term purchasing power. In contrast, a university endowment invested in perpetuity is likely to assume additional risk to grow current investments and achieve intergenerational equity.

This decision is an important one. An overly aggressive spending policy could force future cutbacks at critical times, while underspending to preserve future assets potentially deprives an institution of funds that could be put to productive use. A clearly defined spending policy helps to resolve these conflicts.

We have identified the following four spending policies that are most frequently adopted by nonprofits:²⁶

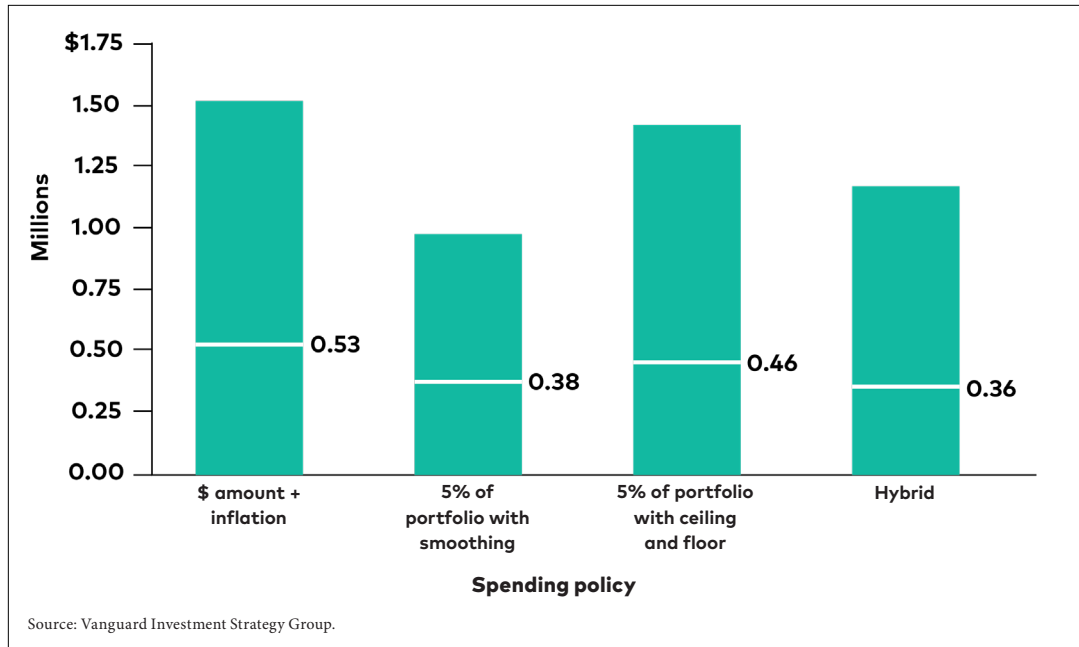
Dollar amount grown by inflation. A dollar amount of spending is calculated in the organization's first year on the basis of need or other criteria, usually expressed as a percentage of initial portfolio value. The spending amount for each subsequent year is then determined by multiplying the prior year's spending by an inflation factor. While this policy typically produces stable annual spending in the short term, it makes no adjustments for spending reductions during periods of poor market performance.

Percentage of portfolio with smoothing term. This policy bases annual spending on a stated portion of the portfolio value at the end of the prior year. A smoothing term modifies this to a percentage of the average ending balance over a period of time. For example, each year's spending level could be equal to a percentage of the average ending balance for the prior three years. Spending is automatically reduced when markets have been doing poorly and increased after periods of strong market performance. Poor investment returns are at least partially offset by reductions in current spending, helping to preserve the portfolio's value, and sustain future spending.

This approach makes budgeting more difficult in the short run because spending levels vary based on investment returns. On the positive side, the smoothing portion of this policy helps to dampen volatility. For this reason, this approach provides the most consistent spending levels over the long term.

²⁶ Vanguard, 2006b.

Figure 10. Deviation below target spending



Percentage of portfolio with ceiling and floor. Instead of using a smoothing term, the amount of spending is held within a fixed range using a ceiling and a floor. If an investment committee selected a 15% ceiling and a 15% floor, the annual spending level would always be between 85% and 115% of the initial dollar amount adjusted for inflation.

The ceiling-and-floor approach can be an effective tool for budgeting purposes because it prohibits market-based spending variations from moving outside a set range. This can result in surplus returns in strong market years that can be reinvested and spent in future years. Its limitation is that while it provides for some downward adjustment to spending in poor markets, these corrections may not significantly reduce the potential for a material decline in principal, necessitating reductions in future spending levels below the spending "floor."

Hybrid combination of dollar amount grown by inflation and percentage of portfolio. The level of annual spending under this policy is determined by

combining a fixed percentage of the dollar amount grown by inflation with a fixed percentage of portfolio spending. The approach, which has increased in popularity recently, may, for example, combine 40% of the prior year's spending amount adjusted for inflation with 60% of an amount determined by calculating a percentage of the portfolio with a three-year smoothing term.

A portion of spending varies, based on market performance, and a portion is predictable, which eases budget concerns. The existence of a hard floor on spending again does not protect a nonprofit's corpus from being exhausted under extreme market conditions.

Vanguard analyzed which of these four spending policies provides the best long-term spending stability and asset growth using 45 variations of return data from 1960 through 2004. The study findings include:²⁷

- The 5% of portfolio assets with smoothing term strategy provides the most consistent spending levels with the tightest range of deviations below target and the second lowest

level of average shortfalls (Figure 10). In addition, this approach was the only one of the four spending policies to maintain some level of spending throughout the entire 45-year period under our “worst case” scenario (Figure 11).

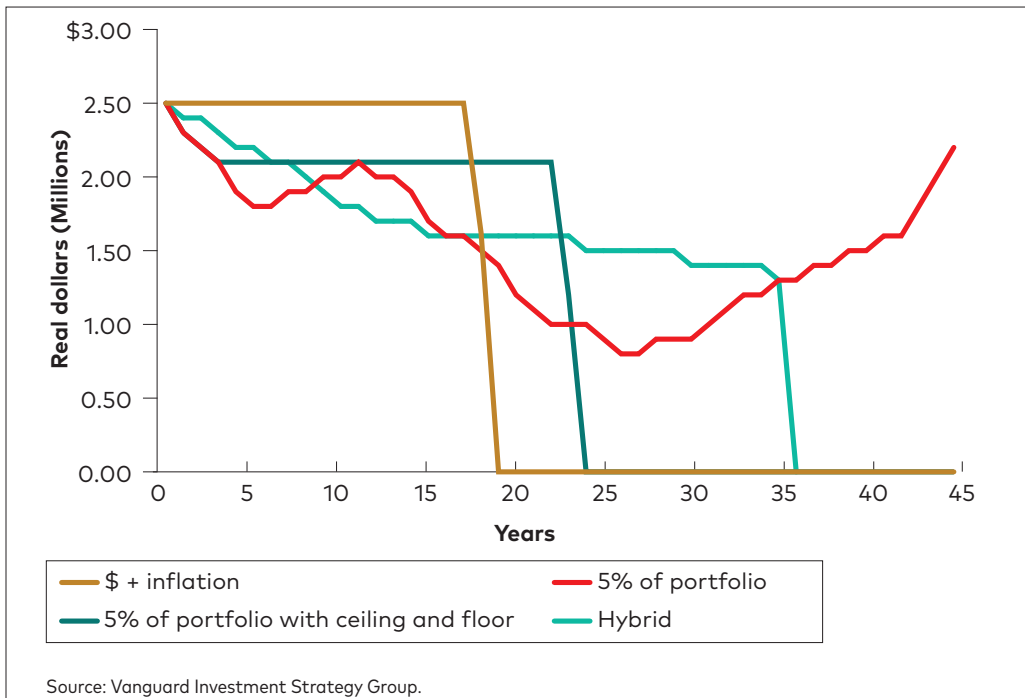
- In contrast, relatively high levels of downside volatility make the 5% of portfolio assets with a ceiling-and-floor strategy (second highest range in deviation below spending target, as well as average shortfalls) better suited for institutions with longer time horizons.
- The dollar amount grown by inflation policy shows the highest range of downside volatility with spending dropping to zero within 20 years. However, this approach also provided the greatest short-term spending stability and could be the most suitable option for foundations with limited time horizons.

Nonprofit fiduciaries should keep the following considerations in mind before deciding on the spending policy that

best fulfills the organization’s mission:²⁸

- Determine the extent to which your institution can accept volatility in near-term spending. This decision should consider a number of factors including your institution’s level of annual contributions, access to additional funding sources, degree of flexibility in annual spending, and overall risk tolerance.
- Periodically evaluate your spending policies. Rigid spending rules cannot eliminate investment volatility. Spending policies that disregard returns are risky. Assuming that the portfolio will recover before levels reach a crisis point may lead to more dramatic reductions in spending later.
- Determine if your organization can tolerate short-term fluctuations in spending. The more a nonprofit can tolerate some short-term fluctuations in spending, the more likely it is to achieve its long-term goals. If the portfolio includes volatile investments likely to produce high average returns, you must accept

Figure 11. Most volatile spending paths



²⁷ Vanguard, 2006b.

²⁸ Vanguard, 2006b.

regular, relatively small changes in spending or run the risk of having to make more abrupt and significantly larger adjustments later.

- Because returns frequently fall below 5%, private foundations should consider reinvesting excess funds during periods of strong market performance to help offset poor investment returns in the future. This

helps to protect the portfolio during periods of severe underperformance.

- Understand how the portfolio assets are priced, and ensure that the portfolio can support your organization's spending requirements.

Manager selection

Virtually all nonprofit investment committees hire at least one outside investment advisor to manage their assets, with a majority hiring multiple managers. Many committees don't make this decision on their own. In general, there are three different approaches for manager selection: 1) hiring an outside consultant to make the decision for you, 2) hiring a consultant to identify several candidates and letting your committee make the final decision, and 3) hiring a manager directly.

Before hiring a manager, you should be convinced that his or her investment philosophy fits within the role you expect it to play in your portfolio. Selecting someone whose investment approach is inconsistent with your portfolio requirements can jeopardize the ultimate success of your organization.

Fiduciaries face a number of challenges during the manager selection process. Investment committees should clearly spell out guidelines in the IPS governing the selection, compensation, evaluation, and termination of their managers. Fiduciaries also should identify mandates that prospective managers will be expected to fulfill in administering various portions of their portfolio.

Nonprofits should base their selection of investment managers on multidimensional criteria rather than on a single factor.²⁹ Investment committees too often overemphasize past performance at the exclusion of other important criteria. This approach can be problematic because past performance is often time-period-dependent and has little to do with investor skill.

The most widely used data for evaluating manager performance is generally short-term returns, which may not be meaningful. Because of the wide availability of this return data, it is not unusual for an investment committee to have a bias toward using it to frame its view of a manager.

However, Figure 12 demonstrates the challenge of using past success as a predictor of future success. Our evaluation of fund performance since 2009 showed that only a substantial minority of funds managed to outperform their benchmarks in consecutive five-year periods. This inconsistency in performance is also a reason why abandoning managers simply because their results have lagged can lead to disappointment. In many cases, the most appropriate response is to stick with your original strategy.³⁰

²⁹ Vanguard, 2004.

³⁰ Vanguard, 2013.

Regular review of short-term data, which increases the likelihood that investors will be confronting underperformance, may put pressure on investment committees to take dramatic action such as changing managers or strategies in response to the bad news. The best committees look beyond statistics and test manager credibility by speaking with both current and former clients.³¹

Other aspects of a manager's record that should be assessed include his or her compliance history with regulators and any potential conflicts of interest, such as prior relationships with members of the investment committee.

We recommend the following best practices in evaluating a potential investment advisor (Figure 13):

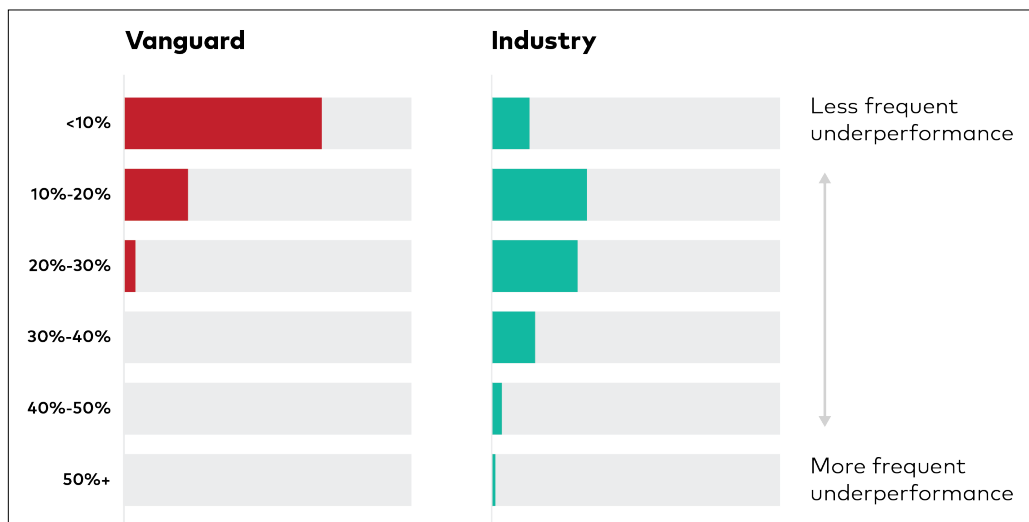
Understand each investment manager's investment process, which should be consistent over time and reflect your organization's philosophy. A nonprofit that places top priority on preserving long-term purchasing power and asset growth should be targeting its search for prospective managers willing to take

on greater risk in return for higher long-term returns. In contrast, a foundation more concerned about short-term spending stability will be much more focused on finding risk-averse advisors.

Analyze the nature of a manager's investment team and firm. Assessing the stability of a potential outside advisor's investment team and firm is an important step because managers can easily be distracted if they operate under uncertain conditions.³²

Fiduciaries should, therefore, ask the following questions before hiring an outside manager:³³

- Does the investment manager's team have an individual or collective approach to making recommendations?
- If a single individual manages the portfolio, does that individual have strong relationships with the firm's analytical group and trading professionals?
- How long has the team worked together?



◀ **Figure 12. Percentage of years outperforming funds falling into bottom quartile versus peers**

Note: We screened all actively managed U.S. and international funds with a minimum of 10 years of performance data during 1995 through 2019 and identified all net outperforming funds relative to their style benchmark. We calculated funds' rolling one-year performance and measured it relative to their 25th percentile peer returns over the same time period. The data presented is the percentage of years over a 10-year period that funds underperformed. Sources: Vanguard and Morningstar, Inc., as of December 31, 2019.

³¹ Vanguard, 2004.

³² Swensen, 2000.

³³ Vanguard, 2004.

Review the firm’s long-term performance in light of its philosophy and process. Past performance should be considered part of the selection process but should never drive your decision. Investment committees must recognize that markets are cyclical and there will be periods when a manager or group of managers will perform well and periods when they will perform poorly. A keen understanding of what drives results helps committees maintain the proper perspective. This requires a sound understanding of the markets and a manager’s investment approach. For example, one should not expect a value-oriented manager to outperform in a market environment that favors growth investing.

Align manager’s fees to your organization’s goals. Committees must pay close attention to manager fees. Under UPMIFA, investment committees are required to manage expenses prudently in relation to the nonprofit’s assets, the purposes of the institution, and the skills available to the committee.

Excessive investment advisor fees can eat into a nonprofit’s investment return over time. According to industry averages, an organization with a \$6 million annual distribution can lose more than 1% of a nonprofit’s value to manager expenses (Figure 14). This can seriously damage an institution’s ability to fulfill its mission. Over a period of several decades, the inability to control manager fees and expenses can mean inadequate funding for dozens of scholarships at a university, a multiyear delay or even cancellation of a new hospital wing, or insufficient resources to provide enough vaccines to cure an infectious disease in the underdeveloped world.

Fiduciaries also should ensure that a manager’s fee structure is aligned with their portfolio’s goals and time horizon. Applying a short time frame to analyze a portfolio positioned for long-term results can end in poor investment decisions that compromise the ability to meet established objectives. Fees for an active equity manager whose investment returns can vary significantly over short periods should be based on performance of at least three years.³⁴

Figure 13. Manager selection criteria

Firm	People	Philosophy	Process	Portfolio	Performance
<ul style="list-style-type: none"> Ethics Stability Ownership Account and asset trends Client list Incentives 	<ul style="list-style-type: none"> Deep investment team Succession/contingency Limited turnover of key professionals Tenure and experience Proven expertise in subject matter Demonstrated ability to handle large mandates 	<ul style="list-style-type: none"> Shared by investment professionals Enduring Easily articulated 	<ul style="list-style-type: none"> Understandable Stable/proven Generates a portfolio consistent with philosophy 	<ul style="list-style-type: none"> Clear reflection of philosophy and process Consistent characteristics over time Indication of willingness to take risks 	<ul style="list-style-type: none"> History of competitive results versus benchmarks and peers Demonstrated success in different environments

Source: Vanguard.

³⁴ Swensen, 2004.

Conduct manager reviews

The appropriate time frame for performance review depends on the asset classes involved. While assets in particularly efficient markets, such as certain money market and fixed income products, may require less time to assess investor skill, performance of assets in less efficient markets, such as equities and various alternatives, should be evaluated over a longer time frame—a three- to five-year period, for example.³⁵

More frequent evaluations or a termination may be necessary should a substantial change occur in the mission of the manager's firm, its people, or philosophy.³⁶ A manager change may be warranted if the committee determines, over a sufficient time frame, that manager performance is lagging and unlikely to improve in the foreseeable future.

Once you have hired a manager, Vanguard recommends establishing an ongoing managerial review process. Fiduciaries should regularly revisit the premises on which their original hiring decisions rest, periodically reviewing initial assumptions and subsequent behavior.

Figure 14. Manager expenses can impact nonprofit funding

Initial portfolio value	\$150,000,000
Spending/Distribution (4.0%)	\$-6,000,000
Investment management/Custody fees (0.3%–2.0%)	\$-450,000 to \$-3,000,000
Total expenses	\$-6,450,000 to \$-9,000,000
Residual portfolio value (accounting for spending and expenses)	\$143,450,000 to \$141,000,000
Difference of residual portfolio values	\$2,550,000

Source: Vanguard.

This hypothetical illustration does not represent any specific investment and holds true only if the returns delivered by different managers are identical.

³⁵ Swensen, 2000.

³⁶ Swensen, 2000.

Maintaining the structure

Maintaining diversity of thought and open communication

Once you have clearly established roles, investment policies, and fiduciary responsibilities, your organization must remain vigilant in adhering to its fiduciary duties. Unlike corporate retirement plan investment committees where the organization plays a more hands-on role, nonprofit investment committees tend to regulate themselves or report to a self-regulated board. While this more ad hoc arrangement can foster an atmosphere of creativity that benefits the institution, it can also lead to a lack of discipline and focus if not carefully monitored.

This unique environment makes it even more critical for committee members to establish strong working relationships and discussions with one another. A group's size, expertise among its members, and approach to conflict resolution are all critical components to productivity and the overall performance of the institution.

There are three basic strategies for protecting a committee from the risk of losing focus:

Establish an effective communications plan

Keeping your fiduciaries apprised of key events and milestones concerning the institution is crucial, given the part-time nature of service on a nonprofit investment committee. Events and milestones about which you should be in regular contact with your committee members include:

- Your organization's overall investment strategy.
- The performance of your portfolio.
- The overall effectiveness of your investment strategy.

Ensure that your committee includes members from diverse backgrounds

Heterogeneity is vital for fostering an atmosphere in which unconventional and independent thinking will flourish. Diverse investment boards also are less likely to fall into bad habits, including allowing one person's opinion to dominate the discussions even if that person is an investment professional or a major donor.

Maintain an orderly decision-making process within your committee through effective meeting agendas.

Common investment committee agenda topics

Topics of discussion and frequency of meetings will vary depending on the investment committee's charter, the complexity of the portfolio, and the size and capabilities of the staff.

At a minimum, committees should meet semiannually to evaluate the performance of the portfolio and at least annually to review asset allocation characteristics. Other committees may choose to meet on a quarterly basis with at least one of the

meetings focusing on education, such as reviewing a particular asset class or investment strategy.³⁷

New committee members in particular should review prior meeting minutes and committee materials from the past one or two years to gain a better historical perspective.

Below is a summary of items that your committee should consider including in its meeting agendas.

At each meeting:

Approve minutes.

Approval of the prior meeting's minutes serves as a helpful reminder for members to review recently discussed topics and allows for a common starting ground at each meeting. This step is usually mandated by charter or statute.

Portfolio review

Review investment performance.

While total portfolio and component performance should be reviewed at each meeting, committees should evaluate them with a longer-term perspective. Best practices dictate that committees evaluate investment performance in the context of overall capital market conditions/returns to provide an attribution and understanding of portfolio returns.

Review asset allocation for rebalancing as necessary.

Asset allocation decisions should be long-term in nature. Rebalancing should be considered at least every one to two years unless there is a major change in strategy or manager investment philosophy. However, a small component of the portfolio may be more tactical and opportunistic based on capital market conditions. In such cases, more frequent reviews of asset allocation may be necessary.

Identify agenda items for subsequent committee meetings

Discussion at a meeting often leads to agenda items for subsequent meetings. At each meeting, committees should present a schedule of future meeting dates and proposed agenda items.

³⁷ Swensen, 2000.

Annually:

Approve investment committee members

Generally, committee members are reviewed and appointed annually. Board members should rotate on a continuous cycle, typically after five years of service, with no more than one-third of the membership rotating off the committee at a given time.

Reaffirm objectives

It is important for the committee to review and reaffirm the portfolio in light of the organization's mission statement and goals. Should any of the above mentioned change, the committee should modify its investment strategy as necessary.

Investment policy statement (IPS)

The committee should formally review the IPS. Changes in the asset pool and board constituencies may necessitate modest modifications to the IPS over time. Such a review also creates a shared understanding of the objectives for each asset pool and is particularly useful following turnover among committee members.

Spending policy

Similar to the IPS, it is useful to have a regular discussion about spending policy. Many committees need to approve the spending policy annually by charter. While it is unlikely to change often, setting the spending policy is a key role of the investment committee and should be reviewed periodically.

Asset allocation

Committees should discuss their asset allocation annually, addressing the risk level, the likelihood of meeting spending and growth objectives, and the impact of changing strategic asset allocation. Major strategic changes to asset allocations should be made infrequently and only after careful consideration. However, conducting an asset allocation assessment in conjunction with a spending policy review helps committees evaluate and validate their assumptions.

Major asset classes

Committees should review each major asset class throughout the year to analyze the objective of the asset classes, their construction, and success to date in meeting their stated objectives.

Risk management review

Some committees find it useful to assess portfolio risk annually, either as part of an asset allocation study or separately. A regular review process should be implemented to help committees develop a shared understanding of portfolio risks—from asset class to operational risks—in the portfolio.

Review costs associated with the portfolio

Because costs diminish a portfolio's net return, it is always important to keep a close eye on fees and expenses. A regular cost review should include custodian, consultant, accounting, legal, and asset management fees.

Periodically:

Review investment managers

Managers should not be evaluated solely on performance but also on criteria such as consistency of investment philosophy, fees and expenses, and stability of the investment team and firm.

Discuss relevant regulatory changes

Because regulatory changes may impact the management of the portfolio, it is important for the committee to discuss such changes.

Review other contractual vendor agreements (custodians, consultants, etc.)

Typically, these agreements are reviewed every five years. While this responsibility is often delegated to the staff, the committee may be required to review and approve any changes. All insurance policies, including Directors and Officers Liability Insurance and Errors and Omissions Insurance, should be reviewed to ensure they are in good standing and up to date. The committee also should discuss its satisfaction with the quality of the service and responsiveness provided by all vendors, including trustees.

Review ancillary pools of assets

Nonprofit organizations sometimes receive unique gifts or have pools of assets outside of the endowment/foundation. A review of outside asset pools should be conducted when they require board approval or when the committee feels it is warranted.

Conclusion

We hope this reference manual has provided insights into what it means to be an investment committee member for a nonprofit organization, including critical information on the following key subject matters:

- Your role as a fiduciary. Keeping abreast of important legal statutes, accounting practices, and other policies affecting nonprofit fiduciaries.
- Investment committee charter. Identifying and clearly establishing roles and responsibilities of investment committee members through a clearly articulated investment committee charter.
- Investment policy statement. How an effective, multifaceted IPS can lead to nonprofit investment committee success by clearly stating an organization's investment strategy, asset allocation, manager selection and evaluation criteria, risk management, spending policy, and performance assessment.
- Meeting agendas and communication strategies. The importance of keeping members of your committee apprised of significant events related

to their responsibilities through well-defined meeting agendas and effective communications strategies.

The importance of ensuring that nonprofit organizations have sufficient funds cannot be overstated given the crucial role they are playing in solving many of society's greatest social, cultural, educational, and health-related challenges.

To this end, nonprofit committee members must fully understand their organization's mission and the investment strategy necessary for achieving success. Nonprofit fiduciaries also must develop an effective organizational structure for meeting goals and achieving successful outcomes.

While there are many unique requirements and practices within the nonprofit market, your main goal should be to promote the success of your charitable organization through sound investment decisions and practices. In Vanguard's view, the fiduciary standards for nonprofit investment committees can be summarized in a single phrase:

"Providing the financial resources necessary to maximize the welfare of your sponsoring organization's mission."

This brochure is provided for informational purposes only and is subject to change. It is not legal advice. Consult a nonprofit attorney or other legal or tax counsel for application of the laws referenced herein to your organization and its specific circumstances. For additional information and access to other valuable resources, please visit vanguard.com/nonprofitresourcecenter.

Glossary and references



Glossary

Financial Accounting Standards Board (FASB). The Financial Accounting Standards Board is the designated organization in the private sector for establishing standards of financial accounting and reporting, which govern the preparation of financial reports. Organizations, including nonprofits, comply with these accounting standards to help ensure their financial reports are credible, transparent, and comparable by the users of the financial information presented. FAS 116, 117, and 124 are particularly foundational and relevant for these organizations.

- FAS 116 addresses accounting for contributions received and contributions made. In general, this statement requires investment committees to recognize contributions received, including unconditional promises to give, as revenue at their fair values in the period made. The standard also requires recognition of the expiration of donor-imposed restrictions in the period in which the restrictions expire.

- FAS 117 establishes standards for general-purpose external financial statements provided by nonprofits. This statement requires nonprofits to provide a statement of financial position, a statement of activities, and a statement of cash flows. In accordance with FAS 117, nonprofits also must report accounts for the organization's total assets, liabilities, and net assets in a statement of financial position.

The standard extends provisions of FAS 95 (Statement of Cash Flows) to nonprofit organizations and expands its description of cash flows from financing activities to include certain donor-restricted cash that must be used for long-term purposes. It also requires that voluntary health-and-welfare organizations provide a statement of expenses by both functional and natural classifications.

- FAS 124 focuses on accounting standards for certain investments held by nonprofits. It requires that investments in equity

securities with readily determinable fair values and all investments in debt securities be reported at fair value with gains and losses included in the statement of activities. FAS 124 also establishes standards for reporting losses caused by a donor's stipulation to invest a gift in perpetuity or for a specified term.³⁸

In July 2009, FASB released their Accounting Standards Codification, which aimed to capture and codify essential standards and provide implementation guidance. In the years following the Codification, three accounting standards updates were issued that are relevant to nonprofit organizations.

- Accounting Standards Update 2014-09, Topic 606 (Revenue Recognition from Contracts with a Customer) highlights that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that

³⁸FAS, 1993.

directive, an entity should: identify the contract(s) with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the entity satisfies a performance obligation.

- Accounting Standards Update 2016-14 (Presentation of Financial Statements of Not-for-Profit Entities) addresses several issues including complexities relating to the use of the previously required three classes of net assets, deficiencies in the transparency and utility of information used to assess an entity's liquidity, inconsistencies in the type of information provided about expenses of the period, and the impediment of preparing an indirect method reconciliation if the direct method is already being used to present operating cash flows.
- Accounting Standards Update 2018-08, Topic 958 (Clarifying the Scope

and Accounting Guidance for Contributions Received and Contributions Made) provides a more robust framework to determine when a transaction should be accounted for as a contribution under Subtopic 958-605 or as an exchange transaction accounted for under other guidance (i.e., Topic 606). The update also provides additional guidance about how to determine whether a contribution is conditional.

- IRS Form 990. Form 990 is the annual reporting document that nonprofits file with the IRS.
- Sarbanes–Oxley. In 2002, Congress passed and President Bush signed into law the Sarbanes–Oxley Act. Passed in response to accounting scandals and other corporate malfeasance, the law requires that publicly traded companies and other entities adhere to stricter corporate governance standards that broaden board member roles in overseeing financial transactions and auditing procedures.³⁹

Most of Sarbanes–Oxley's provisions apply directly to publicly traded companies. Two, however, are directly relevant to all organizations, including nonprofits:

- Whistle-blower protection. Sarbanes–Oxley provides protections for whistle-blowers and imposes criminal penalties for actions taken in retaliation against those who risk their careers by reporting suspected illegal activities in the organization. It is illegal for any organization— for-profit and nonprofit alike—to punish a whistle-blower in any manner.⁴⁰
- Document destruction. The act makes it a crime to alter, conceal, falsify, or destroy any document to prevent its use in an official proceeding such as a federal investigation or bankruptcy proceeding.⁴¹

Jeopardizing investments by private foundations. An investment is considered to jeopardize the carrying out of a private foundation's exempt purpose if it is determined that the foundation managers have failed to exercise ordinary

³⁹ BoardSource and Independent Sector, 2003.

⁴⁰ BoardSource and Independent Sector, 2003.

⁴¹ BoardSource and Independent Sector, 2003.

business care and prudence in providing for the long- and short-term financial needs of the foundation. In exercising the necessary standard of care and prudence, foundation managers may take into account the expected return on the investment, the risks of rising and falling price levels, and the need for diversification within the investment portfolio.

An excise tax equal to 10% of the amount of the investment is imposed on the private foundation for each jeopardizing investment. Foundation managers who knowingly participate in jeopardizing investments also are subject to a 10% excise tax on the amount of the investment, capped at \$10,000 per investment. An additional excise tax equal to 25% is imposed on the private foundation if it does not remove the investment from jeopardy, and an additional excise tax equal to 5% is imposed on any foundation manager who refuses to agree to the removal of the investment from jeopardy, capped at \$20,000.

Determinations whether the investment of a particular amount jeopardizes the carrying out of the foundation's exempt purposes must be made on an investment-by-investment basis, and in each case, the foundation managers must take into account the foundation's portfolio as a whole.

The following investments and practices, while not prohibited, are closely scrutinized by the IRS:

- Trading on margin.
- Commodity futures.
- Working interests in oil and gas wells.
- Puts, calls, and straddles.
- Warrants.
- Selling short.

Foundation managers must be diligent in monitoring the types of investments in their organization's portfolio and must be willing to meet with their respective portfolio managers and periodically review asset allocation decisions to avoid potential harm.

References

- Barker, Robert R., 1969. *Managing Educational Endowments*, The Ford Foundation, New York, NY.
- BoardSource and Independent Sector, 2003. *The Sarbanes–Oxley Act and Implications for Nonprofit Organizations*, BoardSource and Independent Sector.
- Borkus, Randall H., 2001. "A Trust Fiduciary's Duty to Implement Capital Preservation Strategies Using Financial Derivatives Techniques," 36 *Real Property, Probate & Trust Journal*. Chicago, IL.
- Cary, William L. and Bright, Craig B., 1969. *The Law and Lore of Endowment Funds*, The Ford Foundation, New York, NY.
- Coffman, Suzanne E., 2005. *Nonprofits' Three Greatest Challenges*, Philanthropic Research, Inc., Williamsburg, VA.
- Financial Accounting Standards Board of the Financial Accounting Foundation, 1993. Norwalk, CT.
- Foundation for Fiduciary Studies, 2004. *Prudent Investment Practices*, Center for Fiduciary Studies, Pittsburgh, PA.
- Gary, Susan N., 2007. *Charities, Endowments, and Donor Intent: The Uniform Prudent Management of Institutional Funds*.
- Internal Revenue Service, 2008. *IRS Completed 2008 Form 990 Instructions and Background Documents and Instructions for Form 4720*. Internal Revenue Service, Washington, D.C.
- Langbein, John, 2004. *Mandatory Rules in the Law of Trusts*.
- McElhaney, Robert Louie Stanton, 2010. *The Effects of Higher Education Endowment Management Practices on Endowment Performance*.
- National Conference of Commissioners on Uniform State Laws, 1994. *Uniform Prudent Investor Act*. Approved by the American Bar Association.
- Phillips, W. Brantley Jr., 1997. "Chasing Down the Devil: Standards of Prudent Investment Under the Restatement (Third) of Trusts," *Washington & Lee Law Review* 54. <https://scholarlycommons.law.wlu.edu/wlulr/vol54/iss1/8>
- Schneider, William, 2002. *The Total Return Approach to Trust Investment Management*.
- Swensen, David F., 2000. *Pioneering Portfolio Management*, The Free Press, New York, NY.
- Uniform Law Commission (ULC), 2019. *2018-2019 Guide to Uniform and Model Acts*.
- Vanguard, 2004. *Investment Committees: Vanguard's View of Best Practices*. Vanguard Investment Strategy Group.
- Vanguard, 2006a. *Evaluating Managers: Are We Sending the Right Messages?* Vanguard Investment Strategy Group.
- Vanguard, 2006b. *Endowment and Foundation Spending Guidelines*. Vanguard Investment Strategy Group.
- Vanguard, 2007. *The Asset Allocation Debate: Provocative Questions, Enduring Realities*. Vanguard Investment Strategy Group.
- Vanguard, 2013. *Vanguard's principles for investing success*, Vanguard Investment Strategy Group.

Fulfilling your mission





Institutional Investor Group

P.O. Box 2900
Valley Forge, PA 19482-2900

Connect with Vanguard® > institutional.vanguard.com > 888-888-7064

All investing is subject to risk, including the possible loss of money you invest. There is no guarantee that any particular asset allocation or mix of funds will meet your investment objectives or provide you with a given level of income.

Diversification does not ensure a profit or protect against a loss.

Past performance is not a guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

For additional information and one-stop access to other valuable resources, please visit vanguard.com/nonprofitresourcecenter.

© 2022 The Vanguard Group, Inc.
All rights reserved.

IAMNBPR052022

Sample Investment Committee Charter

This document will help you, as a fiduciary, develop a charter for the committee that oversees investments for your nonprofit organization.

Committee charters outline the roles, responsibilities, and authority of the investment committee, support staff, outside consultants, and investment managers. Vanguard's experience working with nonprofits indicates that a committee charter is a key component of a successful investment board and a crucial first step in forming a committee.

Drafting the committee charter will clarify the scope and range of roles, eliminating overlap and duplication. Most importantly, this process will help you meet the fiduciary responsibilities you are required to fulfill on behalf of your organization's mission.

We think the attached sample charter will serve as a valuable tool to help you create your own committee blueprint that meets your nonprofit's specific needs. However, this document is not a one-size-fits-all template. The sample charter was drafted broadly to address the needs of a variety of nonprofit organizations

from foundations with mandatory spend-out rates and short-term missions to university endowments with unlimited time horizons.

Although we include some specific suggestions, you will need to customize the charter's final version based on your organization's specific goals. We strongly recommend that you review your charter with your organization's legal counsel before formal adoption. This sample document is for informational purposes only; it is not legal advice.

CHARTER OF THE INVESTMENT COMMITTEE OF XYZ NONPROFIT (insert formal name of organization)

Introduction

The Investment Committee is a standing committee of XYZ Nonprofit Organization [insert formal name of nonprofit].

This Charter outlines the responsibilities of the Committee with respect to the duties of individual members. The Committee is responsible for the investments of XYZ Nonprofit Organization and those investments shall collectively be referred to as the Portfolio.

Purpose of the Investment Committee

The Investment Committee has overall responsibility for the operation and administration of the Portfolio. The members of the Investment Committee are fiduciaries of the Portfolio with respect to all responsibilities allocated to them. The members will discharge their duties solely on behalf of the sponsoring organization's mission in accordance with its specific terms.

Committee membership

The Committee shall consist of 10 members. *[The smaller the portfolio and the narrower the scope of duties, the smaller the committee can be. Most investment committees have both administrative and investment duties. The members' competencies should reflect the responsibilities that they will undertake.]* Each member shall be appointed by the Committee for a term of five years. The terms of the members shall be staggered to the extent practicable. The Committee shall designate one member to serve

as Chair. Each member shall acknowledge his or her membership in writing. Members shall serve at the pleasure of the sponsoring organization.

The Committee may form subcommittees as it deems appropriate. Subcommittees may be formed to address special projects for a limited period or may become standing subcommittees for a particular purpose. [Some investment committees have an investment subcommittee and an administrative subcommittee, which allows members to allocate their duties efficiently while retaining the ability to set policy and make major decisions as a single body. Some committees convene a subcommittee for a special project, such as the evaluation of a particular asset class or investment strategy.]

Organization

The Committee shall hold regular (semi-annual/quarterly) meetings and shall meet more frequently as circumstances require. The Committee shall keep minutes of the meetings and provide quarterly [set frequency here to at least annually or use "periodic"] reports to the organization. The Chair shall, in consultation with other Committee members, set the agenda for and preside at the meetings. A quorum for the transaction of business at any meeting of the Committee shall consist of a majority of Committee members. Decisions shall be made by a majority of those present at the meeting.

The Committee shall have direct access to and complete and open communications with senior

leaders of the sponsoring organization and may obtain advice and assistance from internal staff. The Committee may also retain independent consultants to assist it and determine the compensation for such consultants.

Authority and responsibilities

[In this section, it is particularly important to tailor the duties to those set forth in the portfolio document, committee resolutions, and other delegations of authority. The duties can be articulated more specifically here than in the portfolio documents. The suggested language is representative of an investment committee's duties.]

A. Investment duties

1. Understanding the sponsoring organization's investment goals and how these objectives support the nonprofit's mission.
2. Adopting, periodically reviewing, and revising an Investment Policy Statement.
3. Monitoring the performance of investment funds and investment managers in accordance with the Investment Policy Statement.
4. Retaining or replacing investment managers and/or investment funds for the Portfolio.
5. Reviewing the backgrounds of Investment Committee members and staff to ensure no conflicts of interest exist.

B. Administrative duties

1. Resolving all questions of interpretation of policy under the Portfolio.
2. Determining the amount of contributions necessary for the Portfolio.
3. Furnishing notices and reports to Investment Committee members and others affiliated with the nonprofit.
4. Reviewing all fees incurred by or on behalf of the Portfolio for reasonableness.
5. Preparing and filing such forms as may be required by government entities.

6. Reviewing the audited and unaudited financial statements of the Portfolio and audit reports of the Portfolio's service providers.
7. Maintaining records for the administration of the Portfolio and the actions of the Committee.
8. Selecting, monitoring, and replacing third-party advisors of the Portfolio, such as consultants and other providers of Portfolio services.
9. Making adjustments or correcting defects under the Portfolio in a uniform and nondiscriminatory manner.
10. Preparing amendments to the Portfolio for changes in design or applicable laws and regulations.

Compensation

All members receiving full-time compensation from the nonprofit shall serve without additional compensation for the performance of their duties as members of the Committee. The Committee shall reimburse the members for all expenses properly and actually incurred.

Representations by the nonprofit

The sponsoring organization shall provide the Committee with such information as is necessary or desirable to fulfill its responsibilities. The nonprofit may furnish the Committee with such clerical and other assistance as the Committee may need to perform its duties. The sponsoring organization shall be responsible for any reasonable costs or expenses incurred in the Portfolio's operation or administration. However, any duly authorized Portfolio expenses may be paid by or reimbursed from the Portfolio.

For additional information and one-stop access to other valuable resources, please visit Vanguard's Investment Committee Resource Center at [vanguard.com/nonprofitresourcecenter](https://www.vanguard.com/nonprofitresourcecenter).

Connect with Vanguard® > institutional.vanguard.com > 888-888-7064

All investing is subject to risk, including the possible loss of the money you invest.

Vanguard®

P.O. Box 2900
Valley Forge, PA 19482-2900

© 2022 The Vanguard Group, Inc.
All rights reserved.

IAMSBC 052022

Sample Investment Policy Statement

I. Introduction

The XYZ Institution Nonprofit Fund (hereinafter referred to as the "Fund") was created to provide perpetual financial support to XYZ Institution (the "Institution"). The purpose of this investment policy statement is to establish guidelines for the Fund's investment portfolio (the "Portfolio"). The statement also incorporates accountability standards that will be used for monitoring the progress of the Portfolio's investment program and for evaluating the contributions of the manager(s) hired on behalf of the Fund and its beneficiaries.

II. Role of the investment committee

The investment committee (the "Committee") is acting in a fiduciary capacity with respect to the Portfolio, and is accountable to the Board of XYZ and to the executive committee, for overseeing the investment of all assets owned by, or held in trust for, the Portfolio.

- A. This investment policy statement sets forth the investment objectives, distribution policies, and investment guidelines that govern the activities of the Committee and any other parties to whom the Committee has delegated investment management responsibility for Portfolio assets.
- B. The investment policies for the Fund contained herein have been formulated consistent with the institution's anticipated financial needs and in consideration of the institution's tolerance for assuming investment and financial risk, as reflected in the majority opinion of the Committee.
- C. Policies contained in this statement are intended to provide guidelines, where necessary, for ensuring that the Portfolio's investments are managed consistent with the short-term and long-term financial goals of the Fund. At the same time, they are intended to provide for sufficient investment flexibility in the face of changes in capital market conditions and in the financial circumstances of the Institution.
- D. The Committee will review this investment policy statement at least once per year. Changes to this investment policy statement can be made only by affirmation of a majority of the Committee, and written confirmation of the changes will be provided to all Committee members and to any other parties hired on behalf of the Portfolio as soon thereafter as is practical.

III. Investment objective and spending policy

- A. The Fund is to be invested with the objective of preserving the long-term, real purchasing power of assets while providing a relatively predictable and growing stream of annual distributions in support of the Institution.
- B. For the purpose of making distributions, the Fund shall make use of a total-return-based spending policy, meaning that it will fund distributions from net investment income, net realized capital gains, and proceeds from the sale of investments.
- C. The distribution of Fund assets will be permitted to the extent that such distributions do not exceed a level that would erode the Fund's real assets over time. The Committee will seek to reduce the variability of annual Fund distributions by factoring past spending and Portfolio asset values into its current spending decisions. The Committee will review its spending assumptions annually for the purpose of deciding whether any changes therein necessitate amending the Fund's spending policy, its target asset allocation, or both.
- D. Periodic cash flow, either into or out of the Portfolio, will be used to better align the investment portfolio to the target asset allocation outlined in the asset allocation policy in Section IV. A. herein.

IV. Portfolio investment policies

- A. Asset allocation policy
 1. The Committee recognizes that the strategic allocation of Portfolio assets across broadly defined financial asset and subasset categories with varying degrees of risk, return, and return correlation will be the most significant determinant of long-term investment returns and Portfolio asset value stability.
 2. The Committee expects that actual returns and return volatility may vary from expectations and return objectives across short periods of time. While the Committee wishes to retain flexibility with respect to making periodic changes to the Portfolio's

asset allocation, it expects to do so only in the event of material changes to the Fund, to the assumptions underlying Fund spending policies, and/or to the capital markets and asset classes in which the Portfolio invests.

3. Fund assets will be managed as a balanced portfolio composed of two major components: an equity portion and a fixed income portion. The expected role of equity investments will be to maximize the long-term real growth of Portfolio assets, while the role of fixed income investments will be to generate current income, provide for more stable periodic returns, and provide some protection against a prolonged decline in the market value of equity investments.
4. Cash investments will, under normal circumstances, only be considered as temporary Portfolio holdings and will be used for Fund liquidity needs or to facilitate a planned program of dollar-cost averaging into investments in either or both of the equity and fixed income asset classes.
5. Outlined below are the long-term strategic asset allocation guidelines determined by the Committee to be the most appropriate, given the Fund's long-term objectives and short-term constraints. Portfolio assets will, under normal circumstances, be allocated across broad asset and subasset classes in accordance with the following guidelines:

Asset class	Subasset class	Target allocation
Equity		70%
	U.S.	60%
	Non-U.S.	10%
Fixed income		30%
	Investment grade	25%
	Below investment grade	5%
Cash		0%

6. To the extent the Portfolio holds investments in nontraditional, illiquid, and/or nonmarketable securities including (but not limited to) venture capital, hedge funds, and real estate investments, these assets will be treated collectively as alternative

investments for purposes of measuring the Portfolio's asset allocation. While not specifically considered within this policy, alternative investments may comprise no more than 15% of total Portfolio assets and, to the extent they are owned, will proportionately reduce target allocations to the three primary asset classes itemized above.

B. Diversification policy

1. Diversification across and within asset classes is the primary means by which the Committee expects the Portfolio to avoid undue risk of large losses over long time periods. To protect the Portfolio against unfavorable outcomes within an asset class due to the assumption of large risks, the Committee will take reasonable precautions to avoid excessive investment concentrations. Specifically, the following guidelines will be in place:
 - a) With the exception of fixed income investments explicitly guaranteed by the U.S. government, no single investment security shall represent more than 5% of total Portfolio assets.
 - b) With the exception of passively managed investment vehicles seeking to match the returns on a broadly diversified market index, no single investment pool or investment company (mutual fund) shall comprise more than 20% of total Portfolio assets.
 - c) With respect to fixed income investments, the Portfolio may not allocate more than 10% to investments that are below investment grade (Standard & Poor's BBB or Moody's Baa or higher).

C. Rebalancing

It is expected that the Portfolio's actual asset allocation will vary from its target asset allocation as a result of the varying periodic returns earned on its investments in different asset and sub-asset classes. The Portfolio will be rebalanced to its target normal asset allocation under the following procedures:

1. The investment manager will use incoming cash flow (contributions) or outgoing money movements (disbursements) of the Portfolio to realign the current weightings closer to the target weightings for the Portfolio.
2. The investment manager will review the Portfolio semiannually (June 30 and December 31) to determine the deviation from target weightings. During each semiannual review, the following parameter will be applied:
 - If any asset class (equity or fixed income) within the Portfolio is +/-5 percentage points from its target weighting, the Portfolio will be rebalanced.
3. The investment manager may provide a rebalancing recommendation at any time.
4. The investment manager shall act within a reasonable period of time to evaluate deviation from these ranges.

D. Other investment policies

Unless expressly authorized by the Committee, the Portfolio and its investment managers are prohibited from:

1. Purchasing securities on margin or executing short sales.
2. Pledging or hypothecating securities, except for loans of securities that are fully collateralized.
3. Purchasing or selling derivative securities for speculation or leverage.
4. Engaging in investment strategies that have the potential to amplify or distort the risk of loss beyond a level that is reasonably expected, given the objectives of their Portfolio.

V. Monitoring portfolio investments and performance

The Committee will monitor the Portfolio's investment performance against the Portfolio's stated investment objectives. At a frequency to be decided by the Committee, it will formally assess the Portfolio and the performance of its underlying investments as follows:

A. The Portfolio's composite investment performance (net of fees) will be judged against the following standards:

1. The Portfolio's absolute long-term real return objective.
2. A composite benchmark consisting of the following unmanaged market indexes weighted according to the expected target asset allocations stipulated by the Portfolio's investment guidelines:
 - a) U.S. equity: CRSP US Total Market TR USD
 - b) Non-U.S. equity: FTSE Global All-Cap ex-US Index
 - c) Investment Grade fixed income: Bloomberg US Aggregate Float Adjusted Total Return Index.
 - d) Non-Investment Grade fixed income: Bloomberg US Corporate High Yield Total Return Index.
 - e) Cash: Citigroup 3-Month U.S. Treasury Bill Index

B. The performance of professional investment managers hired on behalf of the Portfolio will be judged against the following standards:

1. A market-based index appropriately selected or tailored to the manager's agreed-upon investment objective and the normal investment characteristics of the manager's portfolio.
2. The performance of other investment managers having similar investment objectives.

C. In keeping with the Portfolio's overall long-term financial objective, the Committee will evaluate Portfolio and manager performance over a suitably long-term investment horizon, generally across full market cycles or, at a minimum, on a rolling five-year basis.

D. Investment reports shall be provided by the investment manager(s) on a (calendar) quarterly basis or as more frequently requested by the Committee. Each investment manager is expected to be available to meet with the Investment Committee once per year to review portfolio structure, strategy, and investment performance.

For additional information and one-stop access to other valuable resources, please visit Vanguard's Investment Committee Resource Center at [vanguard.com/nonprofitresourcecenter](https://www.vanguard.com/nonprofitresourcecenter).

Connect with Vanguard® > institutional.vanguard.com > 888-888-7064

All investing is subject to risk, including the possible loss of the money you invest.

Vanguard®

P.O. Box 2900
Valley Forge, PA 19482-2900

© 2022 The Vanguard Group, Inc.
All rights reserved.

IAMSBCC 052022

Investment committee member matrix

Creating the right mix

Investment committees need to have the right blend of capabilities and attributes to be effective. It's not that everyone needs to be an expert in everything, but roles have to be clear. A diverse group can examine issues from a variety of perspectives to help ensure that decisions reflect the organization's mission, finances, and culture. By assessing your existing members' backgrounds, experience, and interests, you can identify any gaps on the committee, and that's what this tool is designed to help you do.

Taking stock of your committee

Some investment committees excel, while others struggle. What accounts for the difference? In large part, it comes down to the knowledge, skills, abilities, personalities, and attitudes of your committee members. By assessing the backgrounds and qualitative aspects of your members, you'll be better positioned to identify strengths and weaknesses, assess the overall balance of the committee, and develop a strategy to improve its overall effectiveness.

Benefits of a well-constructed committee

A diverse, well-constructed committee is greater than the sum of its parts. The members know each other well and work together effectively. Healthy debate is the rule rather than the exception because there is a high level of trust. And most importantly, members feel personally responsible for the group's decisions and for maintaining a harmonious working environment.

In terms of the overall size of your committee, some research suggests that a 6 to 10 member group benefits from being diverse without suffering the coordination problems associated with larger groups.

Using the committee member matrix

This tool will help you catalog committee members' experience, education, and expertise, and allow you to identify any gaps.

Pay special attention to the blue columns, which cover investment, finance, legal, and risk management areas—all key to successful investment committees. We've also provided columns for qualitative aspects, such as potential conflicts of interest or donor status. You can also note any fields of interest or backgrounds that may fill gaps on your committee. Remember that the qualitative aspects (such as commitment to the organization's mission) are just as important to get right as making sure members have the appropriate background or experience.

Finally, because each organization is unique, there are a couple of blank columns where you can list other categories.

Investment committee member matrix

Member name/position	Joining year	Career field/degrees/designations	Qualitative aspects	Equity	Fixed income	Alternatives	Accounting/finance	Economics	Regulatory/legal	Risk management	Government relations	Media relations	Fund-raising						

Notes:



P.O. Box 2900
Valley Forge, PA 19482-2900

Connect with Vanguard® > institutional.vanguard.com > **888-888-7064**

For additional information and one-stop access to other valuable resources for nonprofits, please visit vanguard.com/nonprofitresourcecenter.

All investing is subject to risk, including the possible loss of the money you invest.

© 2022 The Vanguard Group, Inc.
All rights reserved.

IAMMAT 052022

Nonprofit investment committee member checklist

Well-informed fiduciaries are critical to the financial strength and ultimate success of your organization's mission.

Checklist for committee members

The following checklist highlights best practices for individual members of nonprofit investment committees. For more information, please reference our guidebook, *Fulfilling Your Mission: A Guide to Best Practices for Nonprofit Fiduciaries*, or feel free to visit our website at vanguard.com/nonprofitresourcecenter.

Your principal fiduciary duties

Organization of committees

Do you:

- Read and fully understand the committee charter?
- Understand your sponsoring organization's mission and have the investment skills required to implement a strategy that fulfills its mission?
- Understand the portfolio's investment objectives in terms of organizational goals and spending objectives?
- Have the investment skills required to perform your responsibilities on the committee?
- Understand your fiduciary responsibilities and the potential financial liabilities of serving on the committee?

Notes:

Manager selection and evaluation

Do you:

- Analyze whether a prospective manager's style and philosophy fit the portfolio's objective?
- Select and evaluate managers based on multidimensional criteria, rather than exclusively on past performance?

Notes:

Investment selection and monitoring

Do you:

- Review the committee investment policy statement before regularly scheduled meetings?
- Have a clear understanding of why the portfolio holds each of its particular investments?
- Periodically review whether the portfolio investments are consistent with the goals of your sponsoring organization?

Notes:

Investment costs

Do you:

- Understand what investment costs are being charged and if they are reasonable for the portfolio and your committee standards?

Notes:

Additional fiduciary duties

Administrative oversight

Do you:

- Prepare and file forms as required by government entities?
- Maintain current portfolio documents and review these documents and processes on a regular basis to ensure their compliance with all relevant laws and regulations?
- Ensure that the processes used to manage the portfolio conform in all details with the written portfolio documents?
- Make sure the portfolio is operating according to committee documents?

Notes:

Fiduciary education

Do you:

- Attend institutional industry conferences?
- Regularly visit or reference nonprofit websites and industry publications?

Notes:

Meeting agenda

Do you:

- Attend all scheduled meetings?
- Review meeting materials before investment review?
- Feel comfortable challenging conventional wisdom by providing opposing opinions during committee sessions?

Notes:

In Vanguard's view, the fiduciary standards for nonprofit investment committees can be summarized in a single phrase: "Providing the financial resources necessary to maximize the welfare of your sponsoring organization's mission."

For additional information and one-stop access to other valuable resources, please visit Vanguard's Investment Committee Resource Center at vanguard.com/nonprofitresourcecenter.

Connect with Vanguard® > institutional.vanguard.com > 888-888-7064

All investing is subject to risk, including the possible loss of the money you invest.

Vanguard®

P.O. Box 2900
Valley Forge, PA 19482-2900

© 2022 The Vanguard Group, Inc.
All rights reserved.

IAMSBC 052022

Common investment committee agenda topics

Topics of discussion and frequency of meetings will vary depending on each investment committee's charter, the portfolio's complexity, and the staff's size and capabilities.

At a minimum, committees should meet semiannually to evaluate the portfolio's performance and at least annually to review asset allocation characteristics. Other committees may choose to meet on a quarterly basis with at least one meeting taking an educational focus, such as reviewing a particular asset class or investment strategy.

New committee members in particular should review meeting minutes and committee materials from the past one or two years to have a better awareness of the committee's activities.

A summary of some items that investment committees of Vanguard's institutional clients often include in their agendas follows.

At each meeting

- Approve minutes: Approval of the prior meeting's minutes serves as a helpful reminder for committee members to review recently discussed topics and allows for a common starting point at each meeting. This is usually mandated by charter or statute.
- Portfolio review:
 - Review investment performance: While total portfolio and component performance should be reviewed at each meeting, committees should evaluate them with a longer-term perspective. Best practices dictate that committees evaluate investment performance in the context of overall capital market conditions/returns to provide an attribution and understanding of portfolio returns.
 - Review portfolio for rebalancing as necessary: Rebalancing should be examined at least every year unless there is a major change in strategy or manager investment philosophy.
 - Review asset allocation as necessary: Asset allocation decisions should be long term in nature and reviewed at least every one to two years. However a small component of the portfolio may be more tactical and opportunistic based on capital market conditions. In such cases, more frequent reviews of asset allocation may be necessary.
- Identify agenda items for subsequent committee meetings: Discussion at a meeting often leads to agenda items for subsequent meetings. At each meeting, committees should present a schedule of future meeting dates and proposed agenda items.

Annually

- Approve investment committee members: Generally, committee members (and committee officers) are reviewed and appointed annually. Board and investment committee members should rotate on a continuous cycle, with the board determining the appropriate rotation schedule based on the organization's specific needs and circumstances. Gradual shifts in committee composition are one of the most effective ways to balance the need for continuity with the importance of fresh perspectives.
- Reaffirm objectives: It is important for the investment committee to review and reaffirm the portfolio in light of the organization's mission statement and goals. The board should also discuss if any part of the objectives has changed, how and whether any changes reasonably fit in with or alter the mission and goals, and the appropriate response to them.
- Investment policy statement (IPS): The committee should formally review the IPS. Changes in the asset pool and board constituencies may necessitate modest modifications to the IPS over time. Such a review also creates a shared understanding of the asset pool's objectives and would be particularly useful following turnover of committee members.
- Spending policy: Similar to the IPS, it is useful to have a regular discussion about the spending policy. Many committees need to approve the spending policy annually by charter. While the policy is unlikely to change often, formally reviewing it is a key role of the investment committee.

- **Asset allocation:** Committees should discuss their asset allocation annually; addressing the level of risk, the likelihood of meeting spending and growth objectives, and the impact of changing strategic asset allocation. Major strategic changes to asset allocations should be made infrequently and only after careful consideration. However, conducting an asset allocation assessment in conjunction with a spending policy review helps committees evaluate and validate their assumptions.
- **Major asset classes:** Committees should review each major asset class throughout the year to analyze the objective of the asset classes, their construction, and success to date in meeting their stated objectives.
- **Risk management review:** Some committees find it useful to assess portfolio risk annually, either as part of an asset allocation study or separately. A regular review process should be implemented to help committees develop a shared understanding of portfolio risks—from asset class to operational risks—that exist in their portfolio.
- **Review costs associated with the portfolio:** Because costs diminish a portfolio's net return, it is always important to keep a close eye on fees and expenses. A regular cost review should include custodian, consultant, accounting, legal, and asset management fees. For purposes of Form 990, asset management fees are amounts paid for investment counseling and portfolio management; monthly account service fees are considered portfolio management expenses; and transaction costs, such as brokerage fees and commissions, are treated as sales expenses and not as investment management fees.

Periodically

- **Review investment managers:** Managers should not be evaluated solely on performance but also on criteria such as consistency of investment philosophy, fees and expenses, and stability of the investment team and firm.
- **Discuss relevant regulatory changes:** Periodically, regulatory changes may impact the management of your portfolio, and therefore, such changes are important to bring up for committee discussion.
- **Review other contractual vendor agreements (custodians, consultants, etc.):** These agreements are typically reviewed every three years. While these responsibilities are often delegated to the staff, there may be review and approval required by the committee to execute material charges or engage a new investment manager or a consultant. All insurance policies, including Directors and Officers Liability Insurance and Errors and Omissions Insurance, should be reviewed by the committee as well as the full board to ensure they are in good standing and current. The committee should also discuss its satisfaction with the quality of the service and responsiveness provided by applicable vendors, including trustees.
- **Review ancillary pools of assets:** Nonprofit organizations often have ancillary asset pools outside of the endowment/foundation or receive unique gifts. A review of outside asset pools should be conducted when they require board approval or when the committee feels it is warranted.

For additional information and one-stop access to other valuable resources, please visit Vanguard's Investment Committee Resource Center at [vanguard.com/nonprofitresourcecenter](https://www.vanguard.com/nonprofitresourcecenter).

Connect with Vanguard® > institutional.vanguard.com > 888-888-7064

All investing is subject to risk, including the possible loss of the money you invest.

Vanguard®

P.O. Box 2900
Valley Forge, PA 19482-2900

© 2022 The Vanguard Group, Inc.
All rights reserved.

IAMSBC 042022

Committee assessment tool

Committees play an important role in many organizations. They can set strategy, determine budgets, and create succession plans. Committees also frequently oversee the organization's investment portfolio. Any decision-making group faces its own challenges, but groups making investment-related decisions should be particularly aware of some behavioral dynamics that can influence the quality of those decisions.

This assessment tool is designed to help you:

- Identify behaviors that can negatively affect group performance—the first step toward improving a group's overall quality of performance and decision-making.
- Understand and apply some possible techniques for addressing opportunity areas.

Definitions and examples of suboptimal behavior

Attitudes and behaviors that get in the way of effective decision-making among committee members can take a variety of forms. This section will help you determine the current state of your investment committee in terms of recognized group behaviors.

Groupthink

A style of thinking in which the desire for group harmony discourages healthy dissent, leading to ineffective decision-making.

Symptoms include:

- Being close-minded; committee refuses to discuss alternative ideas (e.g., real estate, passive management).
- Pressures toward uniformity; an environment where dissent is unwelcome and self-censorship may occur.

Assessing the risk of groupthink

- Do committee members speak their minds?
- Do committee members feel free to question group decisions?

Confirmation bias

A tendency among groups to acquire information that confirms preconceived ideas and to disregard contrary views or data.

Symptoms include:

- Seeking more information that supports—rather than challenges—preconceived beliefs.
- Withholding or ignoring evidence that conflicts with prevailing group views.

Assessing the risk of confirmation bias

- Does your committee aggressively seek information supporting ideas it likes?
- Does your committee seek information that conflicts with prevailing views on the committee?

Group polarization

A situation that occurs when groups as a whole make decisions that are either riskier or more conservative than the leanings of their individual members.

Symptoms include:

- Arriving at a final outcome that is more extreme than would have been expected, given group members' individual views.

Assessing the risk of group polarization

- Does your committee make riskier decisions than you would make on your own?
- Does your committee make more conservative decisions than you would make on your own?

Shared-information bias

A phenomenon that occurs when information is shared before the discussion but not considered during the discussion.

Symptoms include:

- The perceived expert doesn't feel it's appropriate to add opinions because not everyone else is an expert.
- Someone shares information, but it's discounted because others don't know about it.

Assessing the risk of shared-information bias

- Do committee members welcome fresh insights during meetings, beyond the information that is shared in advance?

- Do committee members withhold information if it hasn't been previously circulated?

Herding

The tendency for groups as a whole or group members as individuals to resist being outliers and to make decisions based on what others do.

Symptoms include:

- Constantly benchmarking against others in the industry.
- Frequently overriding the investment policy on such issues as rebalancing to conform to what others are doing.

Assessing the risk of herding

- Does your committee benchmark investment decisions against others in the industry?
- Does your committee override its investment policy if others in the industry are following another direction?

Social loafing

The tendency of individual group members to put forth minimal effort in a group setting.

Symptoms include:

- Members who attend meetings but do not make meaningful contributions.
- Members who skip the majority of meetings but remain on the committee.

Assessing the risk of social loafing

- Do all committee members attend scheduled meetings?
- Do all committee members make significant contributions to the group?

Techniques to address suboptimal behaviors on committees

If you suspect that your committee is not operating effectively, see below to discover which strategies could potentially address these group behaviors. We have grouped these techniques into three categories—structure, process, and information access and review—and identified the relative value of each strategy in addressing the behaviors that may impede committee effectiveness.

- Read through the examples to determine whether your committee exhibits any suboptimal behaviors.
- If so, explore the suggested techniques to identify those best suited to your committee.

Structure

Diverse members—Ensuring the group has diverse members in terms of knowledge, skills, abilities, personalities, attitudes, and backgrounds. Ethnicity, race, and age can also be considered. Diverse groups can draw on a wider range of knowledge and skills, which improves flexibility and innovativeness and may encourage productive debate.

Group size—A group should be large enough to include diverse insights and experiences but small enough to keep organization and coordination manageable and to keep members motivated. Research indicates committees typically benefit from having six to nine members (Duty, opportunity, mastery: Investment committee best practices, Vanguard, 2017).

Process

Decision-making tactics—The process of how a group goes about making decisions. Are decisions made before the meetings? Useful techniques include cataloging pros and cons or reviewing “what if” scenarios.

Devil's advocate—A devil's advocate can challenge inherited wisdom and the voice of the crowd. The role of devil's advocate should be assigned to a committee member. This role should rotate and should not always be the same person. Note that an institutional consultant or advisor may also play this role.

Leadership style—Techniques leaders can use to help avoid suboptimal group behaviors include basic meeting management practices: Set a regular meeting schedule, distribute an agenda in advance, recognize member preferences about how they want to interact, and encourage attendance.

It's the leader's job to make sure the group's tasks are executed. This may be accomplished through a democratic leadership style, which allows members to vote on decisions and promotes an egalitarian atmosphere.

Decision-making can also follow autocratic or laissez-faire models.

Some techniques leaders can use to help promote effective group behaviors include:

- Not stating an opinion before opening up discussion to the group.
- Encouraging the sharing of information and healthy debate.

Information access and review

Leveraging member expertise—Identifying

and using the knowledge, skills, and abilities of group members. A best practice is making sure all group members have information about the backgrounds of other members to ensure each member's abilities are known and formally acknowledged by the group.

Outside expert—A consultant or other expert who brings in expertise or a different perspective that doesn't exist within the group. This individual can serve as a devil's advocate, as the bearer of bad news, or as a creative antidote to stale thinking.

Techniques to address suboptimal behaviors

		Structure		Process			Information	
		Diverse members	Group size	Decision-making tactics	Devil's advocate	Leadership style	Leveraging member expertise	Outside expert
Potential negative impact of behavior on decisions ↑ higher ↓ lower	Suboptimal behaviors							
	Groupthink	•		•	•••	••		••
	Confirmation bias	•••		•	••	•		•
	Group polarization	•••		•	••			•
	Shared-information bias	•	•••			•	••	
	Herding	•		•	••			•••
	Social loafing		••			•	•••	

Technique effectiveness in addressing behavior: • Good •• Better ••• Best

For additional information and one-stop access to other valuable resources, please visit Vanguard's Investment Committee Resource Center at vanguard.com/nonprofitresourcecenter.

Connect with Vanguard® > institutional.vanguard.com > 888-888-7064

All investing is subject to risk, including the possible loss of the money you invest.

Vanguard®

P.O. Box 2900
Valley Forge, PA 19482-2900

© 2022 The Vanguard Group, Inc.
All rights reserved.

IAMSBC 052022