# The value of an Investment Policy Statement to you and your organization

Over the past 10 years, the percentage of small-staffed endowments and foundations with a formal Investment Policy Statement (IPS) has grown remarkably—from 52% in 2005 to 76% in 2014.[1] And no wonder. Having an IPS in place for your organization is a critical step in assuring that it can move steadily toward its financial and investing goals.

## The benefits of formal documentation

Whatever the size of your nonprofit, a well-constructed IPS can benefit you and your organization by:

1. Creating a formal road map for the management of investments over time and
2. Giving board members a set of guidelines that can help them fulfill their fiduciary responsibilities

## A framework for making strategic investing and spending decisions

The primary purpose of the IPS is to establish a set of guidelines to be followed by the board over a specific period of time. It typically provides a blueprint for an organization's spending policies, liquidity needs, asset allocation ranges, investment objectives and benchmarks, risk tolerance, manager selection, performance reporting and ongoing portfolio management. (See *What's in the Investment Policy Statement on page 2*.) It also brings continuity and consistency to investment decisions and helps new board members get up to speed more quickly on the organization's investment strategy.

A formal IPS encourages an organization to consider risks in a deliberate and thoughtful manner as it manages investments in good and bad markets. In the years leading up to the market crash of 2008, for example, many small and mid-sized university endowments began to emulate large endowment investment policies by increasing their allocations to alternative investments. Unfortunately, some institutions did not fully account for the lack of liquidity and other risks related to these investments. When the financial markets fell precipitously, universities lost, on average, 23% of their endowment funds.[2] Although having an IPS will not automatically lead to less volatility in a portfolio, it can provide important guardrails that help keep an organization on track in both rising and falling market scenarios.

An IPS also can articulate an endowment's short- and long-term spending objectives to help guide decision making when spending discussions arise. If changing spending needs trigger a desire to adjust the organization's investment strategy, an IPS can describe the process that the board must follow and factors it needs to consider in making such a change. This process can protect the integrity of the organization's portfolio by keeping reactions to short-term market conditions from derailing long-term investing plans.

An IPS also provides guidelines for reviewing and rebalancing an investment portfolio to maintain its stated asset allocation, which is one of the best ways to help keep a portfolio on a steady course. The guidelines in an IPS can specify how and when rebalancing should occur as a routine part of the portfolio management process.

### What's in the Investment Policy Statement?

The majority of nonprofits have an existing Investment Policy Statement[3] to guide them in their investment decision making. At TIAA-CREF Trust Company, FSB ("Trust Company"), we believe a properly constructed IPS should include:

- A brief overview of the organization including the source of funds
- Definitions of the roles and responsibilities of members involved in the investment process
- Clear investment objectives
- Spending policies and liquidity requirements
- A long-term asset allocation policy that includes target ranges for each asset class
- Return objectives with appropriate benchmarks
- The degree of risk permitted in the investment portfolio
- Portfolio monitoring and rebalancing procedures
- Manager selection guidelines
- Specific investment restrictions

The IPS should include sufficient information to provide a framework for board members and investment professionals to establish and follow an investment strategy during the ongoing management of the portfolio.

## A way to protect you and your organization

An IPS does more than describe investing and spending parameters and guide your organization through difficult markets. It can also serve as a way for board members to know that they are fulfilling their responsibilities under the "duty of care" provisions of the Uniform Prudent Management of Institutional Funds Act (UPMIFA).[4] Under their duty of care, directors must act in a manner that protects the best interests of the organization and in a manner that an ordinarily prudent person in a similar position would exercise under similar circumstances.

Because one of the key aspects of your board service may involve overseeing your organization's asset management activities, you need to be attentive to investment discussions and understand the issues. You also need to protect yourself from unintentional breaches of duty, such as allowing the organization's funds to be invested in securities prohibited by the IPS.

Having a carefully constructed and conscientiously applied IPS can demonstrate that you and other board members have provided the necessary investment oversight. In addition, your efforts to monitor investments regularly to ensure compliance with the IPS are typically considered the best evidence that you consistently met your fiduciary obligations.

In fact, in most breach of duty cases, nonprofit directors were found liable not because the investments underperformed, but because key investment decisions were neglected, conflicts were ignored, or there was a failure to supervise how the decisions were made. All of these situations are less likely with the support and guidance provided by a well-drafted IPS.

### Creating an effective IPS: Manager selection and oversight

If yours is one of the 24% of foundations still without a formal IPS[5]—or you're concerned that the IPS your board has approved needs to be reviewed—it's critical that you find the right investment advisor to assist you in creating a document that reflects your organization's unique investment requirements and spending goals.

Every nonprofit organization is different—from the level of investment savvy that the board members possess to the resources they have to draw from. If your board is short on resources or lacks the investment acumen to manage your portfolio, selecting an outside manager can provide the experience, objectivity and specialized investment skills that your organization requires. An external investment advisory firm can also help you develop and document your organization's investment policy.

If you decide to choose an outside investment advisor, you'll want to do that with care as well, looking closely at the firm's expertise and experience. Many state regulators (as well as UPMIFA) allow nonprofits to limit their liability for investment decisions if they can show that:

- The investment firm that is taking on the decision making was selected with "reasonable skill, care, and caution,"[6]
- The scope and terms of delegation to the investment firm are defined, and
- The nonprofit regularly reviews the performance and compliance of the investment firm.

Your IPS should include guidelines for the investment advisor selection process as well, to be sure all three of these requirements are met.

### Eight requirements for overseeing your nonprofit's investments

The Uniform Prudent Management of Institutional Funds Act or UPMIFA spells out the factors that charitable endowments and foundations should consider in making investment decisions.[7] It specifies that a charity and those who manage and invest its funds must:

1. Give primary consideration to donor intent as expressed in a gift instrument
2. Act in good faith, with the care an ordinarily prudent person would exercise
3. Incur only reasonable costs in investing and managing charitable funds
4. Make a reasonable effort to verify relevant facts
5. Make decisions about each asset in the context of the portfolio of investments, as part of an overall investment strategy
6. Diversify investments unless due to special circumstances, the purposes of the fund are better served without diversification
7. Dispose of unsuitable assets
8. In general, develop an investment strategy appropriate for the fund and the charity

A well-designed and carefully executed Investment Policy Statement will help your organization meet these important obligations.

## Your guide through time—and tough markets

For many nonprofit board members, one of the most challenging aspects of the job is overseeing the investment portfolio for the organization. Whether the board of directors manages the assets in-house or works with an independent investment advisor, a comprehensive, well-written IPS will serve as a guide for the management of the portfolio over time and as an essential anchor during periods of market turmoil.

A carefully constructed IPS gives your organization a clear road map for the management of investments and spending over time, creates guidelines for periodic portfolio review and rebalancing, and helps board members fulfill their fiduciary responsibilities. It can also keep you and other board members protected against breaches in "duty of care" by providing evidence that the organization has formal guidelines for investment decision making.

For all of the reasons outlined above, your organization's Investment Policy Statement is one of the most valuable documents you can create to support the success of your endowment or foundation's mission.

## For more information:

Call **855-200-0355**, visit **TIAA.org/endowments**, or email **endowmentsandfoundations@TIAA.org**

### TIAA-CREF Trust Company, FSB's commitment to nonprofits

- We understand the dynamics of the nonprofit community.
- We offer a full range of services to help you meet your fiduciary obligations.
- Our investment management team can help you develop a well-constructed IPS.
- We use an open investment architecture to offer objective portfolio strategies that are in your organization's best interests.
- As a federal savings bank, TIAA-CREF Trust Company, FSB has full fiduciary powers and is subject to comprehensive regulation and supervision by the U.S. Treasury's Office of the Comptroller of the Currency.
- We hold our employees to the highest standards for integrity, service, commitment and customer satisfaction.

1. 2015 Foundation Operations & Management Report, Exponent Philanthropy.
2. Based on a 2009 survey of 435 institutions of higher education sponsored by TIAA and the Commonfund Institute **ncbi.nlm.nih.gov/pmc/articles/PMC2658555/**
3. Nonprofit Management Research Panel Poll: Investment Governance Practices for Nonprofits September 2013 **agb.org/sites/default/files/legacy/2014_nct_sei.pdf** "…almost all participating organizations (98%) reported having a formal Investment Policy Statement (IPS) that defines asset allocation, rebalancing, goals and performance metrics for the portfolio."
4. Uniform Prudent Management of Institutional Funds Act (UPMIFA), July 2006
5. 2015 Foundation Operations & Management Report, Exponent Philanthropy
6. UPMIFA Section 5, "Delegation of management and investment functions"
7. UPMIFA Prefatory Note and Comments, National Conference of Commissioners on Uniform State Laws, November 2007.

Please note that TIAA does not and cannot provide legal advice and that we recommend that you consult with your own legal counsel for such advice.

**Investment, insurance and annuity products are not FDIC insured, are not bank guaranteed, are not deposits, are not insured by any federal government agency, are not a condition to any banking service or activity, and may lose value.**

TIAA-CREF Trust Company, FSB provides investment management and trust services.



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