The roots of fiduciary practice run deep—the principles are reflected as far back as the Babylonian Code of Hammurabi (ca. 1790 BC) and in both the Old and New Testaments. No less a moral authority than Confucius (551 BC–479 BC) is said to have posed this basic question of motivation: “In acting on behalf of others, have I always been loyal to their interests?”

As venerable as it is, the fiduciary principle today is more relevant and urgent than ever—given the weighty obligation of all institutional investors to diligently and consistently maintain the most careful and responsive stewardship of assets even as modern investment markets become ever more complex, hard to forecast, and difficult to navigate with confidence.

At the same time, the core challenge of fiduciary responsibility has endured: How is one to know that one is on the right path, with the support of best practices, when it comes to fiduciary compliance?

But an even more fundamental imperative than following the letter of the law is at work. In our experience, the best investment committees are doing far more than just meeting the core requirements of fiduciary responsibility, as codified by the Uniform Prudent Management of Institutional Funds Act (UPMIFA). In fact, such committees are actively practicing the spirit of their responsibility, with a passion for organizational mission and consistent dedication to seeing mission manifest in every aspect of their oversight of the investment function.

We believe that fiduciaries—especially members of foundation and endowment investment committees—are universally distinguished and driven by sincere intent to do the right thing. Not all, however, have access to the knowledge and support they need for ongoing governance truly in the spirit of their fiduciary responsibility.

Consultants and advisors have a tremendous opportunity to expertly nurture the desire of foundation and endowment investment committees to fulfill not only the letter but also the fundamental spirit of their roles, for the benefit of the organization and its constituencies as well as for the self-fulfillment of committee members.

This article is our road map for realizing the spirit of fiduciary governance—including some thoughts on the principles at work when fiduciaries reflect that spirit. We believe that these principles, in addition to capturing the practices of the best committees, also can legitimately serve as a benchmark for committees in evaluating the degree to which a consultant or advisor is equipped to support their aspirations for fiduciary service at the highest level.

We’ve honed these insights over years of working with foundation and endowment investment committees, observing their successes as well as the potential pitfalls of their responsibility. These views are shaped by our conviction that state-of-the-art governance practice—far from a narrow, technical function—can immeasurably empower foundations and endowments to realize organizational mission, for even greater impact on all of their constituencies.

‘LETTER OF THE LAW’: FIDUCIARY BASICS

For foundations and endowments, governance of institutional investments is the responsibility of the entire board and most often is assumed by the board’s investment committee.

The core requirements for these responsibilities are found in UPMIFA, drafted by the National Conference of Commissioners on Uniform State Laws and in force in the District of Columbia and all states except Pennsylvania. UPMIFA is an updated version of the Uniform Management of Institutional Funds Act, created in 1972 and adopted in 47 states.

UPMIFA stipulates that investment committees dedicate sufficient time to implementing and monitoring investment objectives and policy, maintain an appropriate level of understanding of investment strategies and products, and use external investment professionals when appropriate.

Committees need to review annually and ensure adherence to the organization’s investment policy statement (IPS), so that investment objectives are aligned with fundamental portfolio assumptions. In addition to portfolio asset allocation and allowable investments, the IPS must specifically reflect mission and goals, return objectives, risk tolerance, lifespan (spend-down or perpetual), liquidity requirements, and the process for working with outside advisors.
The spending policy—the document governing the ongoing distribution of funds—also should be reviewed annually to ensure operational needs are balanced appropriately with overall investment strategy. UPMIFA stipulates that the following factors should be considered in determining prudent spending policy and individual investments:

- duration and preservation of the foundation fund
- purposes of the institution and foundation fund
- general economic conditions
- effects of inflation and/or deflation
- expected total return
- the institution’s other resources
- the institution’s investment policy

TOWARD THE SPIRIT OF FIDUCIARY: SOME NOTES FROM THE FIELD

Yet, UPMIFA is just the framework within which investment committees need to discharge three key duties more closely reflecting the spirit of fiduciary governance:

Duty of mission. The duty of mission (sometimes referred to as the “duty of obedience”) is the responsibility of investment committees to ensure that the institution operates to further its mission (defined in its governing documents) and complies with the law. Central to this duty, of course, is a clearly articulated mission statement deliberately crafted to offer an effective North Star for the organization’s activities, particularly its investment practices.

Duty of care. The duty of care requires officers to carry out their responsibilities in good faith while applying the diligence and skill that ordinarily prudent persons reasonably would exercise under similar circumstances in like positions. Accordingly, a board member must act in a manner that he or she reasonably believes to be in the best interests of the institution. Critical to fulfilling duty of care is the investment committee’s understanding of relevant asset solutions and avoidance of overly complex approaches when considering key policies and strategies.

Duty of loyalty. The duty of loyalty requires investment committees to act in good faith and in a manner that they reasonably believe to be in the institution’s interests rather than their own interests or those of another person or organization. The fiduciary must not act out of expediency, avarice, or self-interest, and must take care to avoid conflicts of interest.

It seems straightforward. But committee members can sometimes veer—completely inadvertently—from the best path.

Here are some of the pitfalls that I have observed:

DUTY OF MISSION

The duty of mission demands focus on mission adherence throughout the investment process—not just with how investment proceeds are deployed to support mission. Generating competitive risk-adjusted investment returns to support institutional mission is absolutely on the mark. However, committees should not lose sight of how they are investing resources to generate those returns—because investment types and return sources often can run counter to institutional mission.

Should an institution focused on community health and welfare fund its work through proceeds earned from investments in alcohol and tobacco companies? Arguably not. Alternatively, there is strong evidence that mission-aligned investments can provide equally competitive risk-adjusted returns.

Investment policy statements and spending policies are the guiding documents for the work of investment committees. I often see such policies that do not clearly articulate or map back to institutional mission. In fact, mission cannot be separated from investment policy.

DUTY OF CARE

For some fiduciaries, duty of care suggests a focus solely on fees. I have seen investment committees put a disproportionate weight on fees as the sole determinant of investment strategy, but in fact assessing value and results relative to fees is the appropriate focus.

At the same time, investment committees sometimes will derive comfort from a long-standing relationship with a particular investment consultant. But committees cannot take comfort in simply providing continuity in the way things have always been done.

Complex investments represent another potential pitfall. Some foundations and endowments have adopted increasingly complicated investment strategies—such as private equity and hedge funds—as a source of investment returns, an approach driven by the success of well-known institutions such as Yale University.

Frankly, the trend toward such investments also is driven by consultant recommendations and the associated fee revenue. But very often such strategies are not fully understood by nonprofessional investment committee members—and pose risks to the portfolio that are not sufficiently well recognized. Committees need to strive for a good understanding of strategies at their disposal—and indeed, the onus is on advisors and consultants to ensure, via their support, that their committee clients are guided by exactly the necessary depth of understanding.

DUTY OF LOYALTY

Simply stated, duty of loyalty demands putting the interests of the institution first. In my experience, investment committee members are absolutely dedicated to doing what’s right for the institution. But at the same time, they sometimes will equate what is best for
the institution with what is best for their own personal investing situation.

For example, a committee member nearing retirement may think, rightfully, that managing volatility in his or her own portfolio is paramount given the relatively short investment horizon—and then attempt to apply that same principle to decisions for the institution. The rationale is “I will care for the institutional resources in the same manner as I care for my own.” But what’s lost is that, because the time horizon for the institution is perpetuity, the appropriate investment approach likely is much different than that for any individual.

**SIX PRINCIPLES FOR SUSTAINING THE SPIRIT OF FIDUCIARY GOVERNANCE**

When fulfilling the spirit of fiduciary governance, an investment committee views governance not merely as a narrow, compliance-focused function, but rather as a responsibility to the very meaning and mission of the organization that suffuses every aspect of the committee’s operations, from the meeting process, to investment and spending, to administration, to communications and reporting.

At times, even the best-intentioned investment committees can fall short of optimal support for the organization’s mission and management. But such shortfalls can be addressed and corrected.

Fulfilling the letter of the fiduciary principle obviously is critical—but operating in the spirit of fiduciary governance can make all the difference in terms of the following:

- quality of the oversight
- the benefits to the organization and its constituencies
- the value that committee members can bring to their roles—and the satisfaction derived from the experience

In our experience, the following six principles most typically are at work when a committee is discharging its governance responsibilities firmly in the spirit of fiduciary practice:

**Rigorously focusing on the education and understanding of members.** Going the extra mile to ensure that all committee members fully understand their fiduciary duties, both current and emerging, and tapping external guidance to sustain that understanding if needed.

**Learning from peers—and diligently applying those lessons.** Striving to ascertain what peer organizations are doing in all aspects of fiduciary governance and modeling their own behavior against those benchmarks however possible.

**Investing (as well as spending) for deliberate and explicit support of the mission.** Taking advantage of the growing opportunity of portfolio investments that specifically reflect—and in many instances, even help advance—the organizational mission.

**Utilizing emerging technology to enhance portfolio efficiency and effectiveness.** Working to understand and deploy the opportunity of new technology to make portfolios more flexible and responsive to organizational needs, to reduce costs, and to make investment activities even more visible and understandable to the entire organization and important external constituencies.

**Consistently putting the organization first, in obvious conflict situations—and beyond.** Being thoughtful about not just obvious conflicts of interest but also more subtle situations where the intent is good but the institution’s best interests simply are not being placed first and foremost—and outcomes could be counterproductive.

**Actively claiming and affirming responsibility.** Consistently seeking to affirm the committee’s responsibility and build the larger organization’s understanding regarding the committee’s fulfillment of its fiduciary duties, particularly via communications that establish mission alignment as much as portfolio performance.

**TURNING PRINCIPLES INTO PRACTICES**

Every aspect of the committee’s operations offers a clear opportunity for action in the spirit of the fiduciary—and in direct support of organizational mission. Best practices, both current and emerging, reflect these opportunities, which can be readily seized by committees acting on their own or, increasingly, with the help of consultants who are particularly attuned to the power of a truly mission-aligned fiduciary function.

Here is our view of some of these key opportunities:

**THE COMMITTEE: TRULY COLLABORATIVE, EDUCATED DECISION-MAKING**

Every committee needs to foster truly open discussion, trust, and mutual respect, with a consistent and honest eye toward what is best for mission support. The science as well as the art of effective committee practice is fast developing. In fact, committees now can tap expertise in the emerging discipline of “behavioral governance,” a term popularized by Don Trone of Sethos, a leading authority on the issue of professional standards of care. Among other objectives, behavioral governance focuses on helping investment committees recognize and manage the biases and pressures, often unconscious, that can lead to bad decision-making.

When it comes to the basics, committees need to cultivate a long-term market view as well as stay aware of current market dynamics—an area where the support of an experienced consultant can be invaluable. The committee needs to maintain the optimal number of members to facilitate collaboration and sound decision-making—likely five to seven—and also institute staggered terms for institutional continuity. Committee meetings should focus annually on
revisiting and reaffirming as necessary the fund’s asset allocation—being careful to avoid any bias toward the short term—with other regularly scheduled meetings geared more toward ongoing education and communications issues, as well as benchmarking discussions. All meetings should be documented via detailed minutes fully reflecting the extent and scope of the discussion.

Most importantly, committees need to ensure that all members deeply appreciate—and are comfortable practicing—the essence of their fiduciary responsibility. Many committees understandably won’t be equipped to marshal this kind of perspective on their own. When gaps of understanding exist, committees need to turn to external experts for basic training in fiduciary governance as well as strategies for better aligning the overall governance function with mission support.

In sum, committees need to strive for the structure of a governance system—a coherent, well-thought-out, continuously followed set of practices and procedures reflecting ongoing concern for the highest fiduciary compliance, both letter and spirit.

**MISSION-ALIGNED INVESTMENT**

Developing and executing investment policy provides considerable opportunity for mission alignment and support. The committee’s stewardship of institutional resources needs to consistently reflect the heart of the institution and serve as a model for all constituents regarding the institutional mission in action.

When it comes to external advisory service, the investment committee must ensure that its investment consultant has a superior process for manager due diligence as well as capabilities for tapping the broadest spectrum of investment approaches—in short, an open architecture that ideally does not include a manager’s or consultant’s own proprietary offerings.

A duty of care requires understanding—and investment committees cannot fulfill their duty of care unless they fully understand all the strategies available to them, assess value delivered for fees paid, avoid needlessly complex investments, and have full transparency into the organization’s investing activity. To that point, availability of a full slate of passive investments is extremely important, in particular, given that passive approaches have strongly proven their ability to deliver highly cost-efficient, readily understood, easy access to key investment sectors.

Committees need to examine the breadth, frequency, and quality of the commentary and education that the consultant offers regarding the capital markets at large, as well as the consultant’s ability to provide insight into the practices of other institutions for benchmarking purposes—both of which are key elements of the committee’s duty of care.

When it comes to mission-aligned investment, committees can tap the growing range of focused investments geared toward supporting specific societal impacts—strategies that can be an ideal complement to a specific mission focus. Indeed, we have seen a striking expansion in recent years in both investment expertise and tools that support investing with mission in mind.

Investments that reflect specific environmental, social, and governance (ESG) criteria are among the industry’s fastest-growing categories. Investment funds incorporating ESG factors grew by more than six times in total net assets from 2010 to 2014, and institutional ESG assets under management almost doubled—from $2.5 trillion to $4.7 trillion—in just four years, from 2012 to 2016, according to the US SIF Foundation.

Total dollars invested in the United States through sustainable, responsible, and impact investing reached $8.72 trillion in 2016, up 33 percent from 2014, according to the US SIF Foundation’s latest biennial “Report on US Sustainable, Responsible and Impact Investing Trends.”

Among the insights driving the growth trend is increasing recognition among investors that investing for impact is not at all concessional—that is, a matter of inevitably sacrificing portfolio performance for societal benefit. In fact, track records increasingly demonstrate that the performance of socially responsible strategies compares favorably with that of more traditional investments, and in some instances has even delivered a performance premium.

Given that, committees can consider impact strategies from knowledgeable providers with confidence that such investments, carefully selected, indeed can advance both the financial and the mission goals of the organization.

At a minimum, committees need to closely evaluate such approaches for the ability to screen out investments obviously at variance with their missions. Other kinds of socially responsible strategies actually can facilitate the furtherance of social goals consistent with organizational objectives. In terms of the true spirit of fiduciary governance, such investments arguably should be part of every foundation and endowment investment tool kit.

**MAINTAINING FOCUS ON THE ORGANIZATION’S BEST INTERESTS**

At a minimum, committees need to formalize a formal, written policy on avoiding conflicts of interest whenever possible when implementing the organization’s investment strategy. This policy should cover the acceptance of gifts from consultants or other vendors, toward the goal of maintaining absolute independence. In practice, committee members need to disclose all perceived or actual conflicts that cannot be avoided in the course of their committee service. Ideally, external consultants and managers also will make available their own formal policies for conflict avoidance.
But the issue of potential conflict runs considerably deeper. Duty of loyalty demands separating the interests of the individual from those of the institution even in situations where the individual’s motivations are completely benign—because even well-intended motivations can be completely misaligned with the needs and realities of the organization.

Such potential conflicts can be subtle. For example, the support of a long-entrenched consultant year in and year out might be personally comforting to committee members, but it might in fact not be responsive to the organization’s best interests.

Committees need to nurture their awareness regarding such situations, for example, by employing benchmarking to best practices by other similar institutions, including their use of consultants. A best practice is to review and formally evaluate service provider relationships on a disciplined, periodic basis, supported by a formal request for proposals. This exercise helps a committee stay educated and informed regarding current offerings, and it also can help confirm the value and appropriateness of existing relationships.

ACHIEVING EFFICIENCY AND TRANSPARENCY VIA INNOVATIVE TECHNOLOGY

In the technology area, there are evolving and important governance-based opportunities for foundations and endowments to reduce the time and the expense allocated to administrative functions, and also tap a range of advantages regarding portfolio cost efficiency and transparency.

State-of-the-art technology platforms offer a committee a highly flexible means for leveraging industry-wide benchmarking data so that members can more accurately assess whether portfolio value truly is being realized compared with fees paid. It supports portfolio monitoring and rebalancing to ensure that investments and allocations remain aligned with original mission-driven policy stipulations. It facilitates the proxy and shareholder engagement process, to help the committee ensure that its ownership rights are exercised consistent with the organization’s mission.

Many foundations and endowments remain hamstrung by outmoded technology, with multiple forces conspiring to preserve the platform status quo— inertia, lack of guidance, and cost and conversion concerns among them. Many perhaps assume that the expense, complexity, and time involved in sourcing and implementing such technology is prohibitive.

Yet, foundations and endowments have the chance right now to cost-effectively tap a more comprehensive basket of technologically driven services enabling them to strengthen their fiduciary oversight today and better positioned for the future.

AFFIRMING ACCOUNTABILITY, BUILDING UNDERSTANDING

Today, the best investment committees are revolutionizing the portfolio reporting function. They recognize that this responsibility must extend considerably beyond traditional performance reports; they also seek to inform the full board as well as important external constituencies about the alignment of investment with mission. Indeed, investment committees have at their disposal an increasingly broad spectrum of approaches for communicating the portfolio’s financial performance as well as its societal impact.

Selected consultants providing impact investments are building out their ability to provide portfolio stories communicating in very accessible terms exactly how such investments are moving the needle in terms of specific ESG objectives. These stories are both instructive to the committee but also invaluable in enhancing communications with other constituencies regarding how the portfolio—through the committee’s deliberate and mission-focused oversight efforts—actually is lending support to the mission.

Committees should seize this opportunity to proactively communicate their investment strategies and stewardship as mission in action, and build understanding and appreciation of their tangible efforts to maintain mission alignment.

SUMMING UP

The vital work of foundations and endowments relies on passionate, dedicated individuals who make organizational missions evident in the world at large via diligent, aligned management of financial assets. Those individuals want to stay true to the spirit of their fiduciary and governance responsibilities—and many have recognized that committed consultants and advisors are invaluable in maintaining this allegiance.

For these high-functioning investment committees—and those that aspire to that level of responsibility—the performance bar always will be high. But the good news is that more resources of knowledge, experience, technology, and tools are available now to help meet the challenges of true fiduciary spirit.

Individuals who want to put their time and talents to work in that spirit, and the consultants and advisors who seek to lend a hand, can be assured that we’ll see no end to the call for heightened fiduciary service in a world more eager every day to tap the goodwill—and enlightened stewardship—of committed foundations and endowments.

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ENDNOTE