

Private Foundations Bulletin

Key Considerations for Investment Policy Statement Implementation

2023 Perspective

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A private foundation's assets are a critical resource. Successful investing requires a strategic plan and provides a foundation an opportunity to strategically align the investment portfolio to their mission and core values. An Investment Policy Statement (IPS) provides a roadmap to achieve the foundation's goals, to protect its assets from a risk perspective, and to serve as a helpful resource for governance purposes. Whether a foundation is large or small, it is widely recommended that all foundations have an Investment Policy Statement.

Where to Begin

Creating an IPS may seem daunting, but it has far-reaching implications for the management of a foundation's financial assets. When developing an IPS, the foundation should consider the following major components:

- **Background and Mission** – Review the history of the foundation and its mission for considerations of how to strategically align the investment strategy of the endowment with the goals and values of the foundation.
- **Investment Objective** – Determine investment goals (such as growth, income to support spending needs, investment return that outpaces inflation over time), an investment approach to accomplish those goals, and target asset allocation ranges.
- **Time Horizon** – Consider the time horizon for the life and characteristics of the foundation to determine the appropriate target asset allocation of liquid traditional equity and fixed income investments and alternative investments (hedge funds, private equity, and real asset investments) to meet the foundation's spending and growth objectives.
- **Comprehensive Risk Strategy** – The IPS should address a holistic review of investment risk, including liquidity risk, market risk, counterparty risk, external manager risk, and other risk considerations the foundation deems necessary.
- **Asset Guidelines** – The IPS should describe the types of asset classes and financial instruments which are acceptable and those which are not permitted. This IPS should also address any portfolio level hedging by the foundation and the approved financial vehicles for hedging. Consideration should also be made to appropriate asset class-level benchmarks for comparative performance management, tax implications (UBIT), legal and regulatory compliance.
- **Governance** – Establish the respective responsibilities of the Board, Investment Committee, etc. for clarity.

- **Investment Management Guidelines** – Controls should be put in place for investment decision making, transferring cash, investing funds, and rebalancing the portfolio as well as criteria for selecting and oversight of investment consultants and managers.

Incorporating Risk Considerations

Given the unusually volatile market conditions during the past year, it is recommended that foundations develop a more comprehensive risk management strategy which captures various types of risk, such as market risk, liquidity risk, counterparty risk, external manager risk, and operational risk.

The regional banking crisis of 2023 placed a spotlight on the importance of actively monitoring counterparty risk and diversifying exposure across multiple institutions. The IPS should codify the foundation's requirements for any financial institution holding liquid assets as well as the types of financial instruments that are recommended and approved for excess liquidity. This policy should be revisited on a regular basis, at least annually, for any potential adjustments that are warranted based on market conditions.

To the extent that a foundation has an allocation to private investments with a capital drawdown structure, the IPS should disclose any outside party that has authority to instruct cash movements from banks, such as an outsourced chief investment officer firm (OCIO), custodian, or administrator and any applicable limits on that authority.

In order to reduce unnecessary risk from external managers, the IPS should include a policy that mandates operational due diligence is performed at least annually on any external investment managers, including their OCIO. The scope of the operational due diligence should include liquidity management, counterparty risk, legal/regulatory risk, operations, valuation procedures, cybersecurity/IT, among other key topics.

If a foundation uses an OCIO, it is acceptable to rely on the operational due diligence performed on the external investment managers the OCIO oversees. However, it is recommended that operational due diligence be performed on the OCIO at least annually to understand the key topics covered with managers.

The IPS should specify whether investment portfolio hedging is permitted and, if so, what financial instruments are appropriate. If portfolio hedging is permitted, any protective activities to reduce unnecessary counterparty risk should be identified. These actions might include regularly calling back excess collateral to a custodial account and holding excess liquidity away from dealers executing derivative trades.

Inclusion of Environmental, Social, and Governance Factors

A current trend we are seeing with some foundations is the documentation of the alignment of the foundation's mission and core values with its investment approach through an ESG (Environmental, Social, and Governance) strategy and policy in the IPS. A recommended starting point is to conduct a stakeholder assessment to determine the material issues that matter to both internal and external stakeholders of the organization. This can be accomplished by interviewing or surveying key stakeholders for their feedback.

ESG considerations are typically clear with regard to the foundation's grantmaking. However, documenting ESG considerations in the investment policy statement helps to clarify the strategy with which the foundation integrates its mission into its investment process. This might take the form of incorporating ESG considerations into the due diligence and selection process for investment managers and creating a proxy voting policy that aligns with the foundation's mission and values.

Going Forward

Once the IPS has been created, implementation is the next step. Detailing the main objectives of the foundation is crucial for accountability and oversight during implementation and subsequent analysis. Revisiting the investment policy statement on a regular basis is key to a prudent investment process.

Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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