ENDOWMENTS & FOUNDATIONS

Brown ADVISORY
Thoughtful Investing.

Our Perspective on Optimal Governance Structure

Your Investment Committee and Investment Advisor as Collaborating Partners

Related Resources:

- E&F Overview
- Good Preparation Leads to a Good Audit Experience: What to Expect from Your Investment Advisor
- Are Alternatives Right for Our Organization?
- Beyond Investing: Strategic Advice for Nonprofits

Leaders of mission-driven nonprofit organizations understand that their board's investment committee (IC) typically shoulders the greatest share of responsibility in developing and fostering the organization's relationship with an investment advisor.

For many endowments and foundations (E&Fs), working with a new advisor can offer a great opportunity to consider aspects of board governance that should ensure a smooth transition and a successful, long-term, collaborative partnership. At Brown Advisory, over decades of work investing on behalf of E&Fs, we have learned from our clients the key questions to ask and critical choices to make that can enable the IC and investment advisor to optimally fulfill their mutual responsibilities.

The right governance structure, including a clear allocation of roles and responsibilities among the advisor, IC and staff, seeks to lay the foundation for efficient and effective strategic investment decision-making that nimbly adapts to evolving market conditions while supporting an organization's long-term mission and evolving programs.

STRUCTURE YOUR IC TO SUPPORT YOUR LONG-TERM INVESTMENT GOALS

In our experience, the most consistently effective and high-functioning ICs share certain common structural features:

- **They plan and manage IC membership and leadership.** The most efficient ICs typically have five to 12 seats. An IC with four members or fewer runs the risk of an insufficient diversity of views, while one with more than 12 members may prove unwieldy and have difficulty reaching consensus. Similarly, establishing a timeline and process for the IC chair's term and rotation is essential to maximizing smooth continuity in governance.
- **The IC's tenure system reflects the portfolio's long-term investment horizon.** Term limits of three to seven years and a system of staggered turnover help ensure a measured and consistent transition in IC membership. The goal is to balance continuity of institutional knowledge and consistency in governance with a regular infusion of fresh perspectives.
- **The IC makes a limited number of key decisions annually.** Even the most effective committees can only make a handful of well-reasoned and impactful decisions each year. ICs, which generally meet infrequently and often for only an hour, are no exception and should purposely work with their investment advisor to focus on the right questions at meetings.

Of course, these are broad guidelines, and organizations may make somewhat different choices, conscious of the trade-offs involved. As a good partner, the investment advisor's role is to support an organization's governance structure and make recommendations for improvement based on years of experience working with similar institutions. Open communication and patience are critical, as the collaborative relationship between an IC and a new investment advisor can take as long as a decade to reach its full potential.

LAY THE FOUNDATION FOR COLLABORATIVE SUCCESS IN YOUR INVESTMENT POLICY STATEMENT

We believe that embarking on a partnership with a new investment advisor offers your IC the ideal opportunity to revisit your organization's investment policy statement (IPS). From the outset, the IC should consciously own and always maintain ownership of the IPS on the organization's behalf. A good investment advisor can support the revision process by asking probing questions, recommending modifications, candidly assessing trade-offs of potential options and helping synthesize IC members' ideas. Important considerations that should be defined in the IPS include the organization's return objectives, risk tolerance, liquidity preferences, and approach to environmental, social, and governance (ESG) and diversity, equity, and inclusion (DEI) criteria.

The advisor may be of particular help when an IC is transitioning to a new model of investment management. At one end of the spectrum, an IC may have worked with an investment consultant, who is typically restricted to researching and making recommendations on investments whereby the IC makes all decisions and implements the portfolio. At the other end, an IC may have previously delegated total discretion to an outsourced investment provider running a single commingled fund, which, in effect, forfeits the IC's ownership of the IPS.

In our view, these extremes present flawed models—we believe that effective accountability lies between them. The optimal approach is for the investment advisor to implement the portfolio after collaborating with the IC to define the portfolio guidelines and expectations documented in the IPS. The advisor takes responsibility for day-to-day portfolio management consistent with the guidelines detailed in the IPS—which means, ultimately, being consistent with your organizational mission.

TAKE ADVANTAGE OF YOUR IPS TO CODIFY ROLES AND RESPONSIBILITIES

One of the primary purposes of the IPS is to clearly delineate the interlocking responsibilities of the IC, investment advisor and staff. The IPS can define who is accountable for what and why, and identifies the tools to evaluate progress in realizing your investment goals. We believe that three considerations underlie the rationale for this allocation of roles:

1. **Your IC is best positioned to address high-level portfolio considerations reflecting your institutional mission.** Your board members typically have more intimate and comprehensive knowledge of your organization than your investment advisor, including personal connections, affinity and long-term institutional knowledge. IC members also typically participate on other board committees or subcommittees, such as oversight, finance and audit—knowledge from that service can inform their participation on the IC and impact portfolio considerations.
2. **Your investment advisor is well-positioned to provide recommendations and guidance on big-picture issues.** Drawing upon experience working with peer organizations, your advisor understands the challenges facing endowments and foundations. They can help the IC work through complicated policy considerations, like striking the right balance between illiquidity and return expectations. In our experience, many ICs demand more liquidity than they actually need, and doing so can reduce return potential. By presenting analysis and sharing insight into the approach of peer organizations, the advisor can help the IC determine the best approach for their organization.
3. **Your investment advisor is better positioned than your IC to manage your portfolio day to day.** Your advisor maintains a full-time, up-close focus on investment markets and regularly meets with the fund managers they select for your portfolio. In contrast, most ICs meet at infrequent intervals, typically four to six times per year, and IC members usually have other responsibilities limiting their ability to think about the portfolio on a daily basis. Your advisor should be able to make critical, tactical decisions outside of the IC's regular meeting schedule in a timely way to take advantage of market changes.

ALLOCATING RESPONSIBILITIES FOR INVESTMENT GOVERNANCE

In our experience, the optimal division of responsibilities among the IC, the investment advisor and staff might look like the following:

Investment Committee

1. Select your investment advisor.
2. Develop and periodically update your IPS.
3. Establish your return objectives.
4. Determine your spending rate policy.
5. Communicate and understand the ratio between your spending rate and your operating budget.
6. Approve your strategic asset allocation guidelines, defined through ranges and targets.
7. Approve your liquidity terms.
8. Approve your portfolio and asset class benchmarks.
9. Establish and approve your ESG/DEI investment guidelines.
10. Work with your investment advisor to develop a reporting structure and IC meeting agendas.
11. Regularly review portfolio performance.
12. Evaluate your advisor's performance over a defined interval (five years minimum) that reflects your long-term investment horizon.

Staff

1. Work with your investment advisor to implement the portfolio strategy according to the IPS.
2. Partner with your advisor to ensure correct investment documentation and regulatory compliance.
3. Provide guidance to your advisor on cash flows, including upcoming drawdowns, capital projects and fundraising.

Investment Advisor

1. Support the development of your IPS by providing thought leadership and key strategic recommendations.
2. Provide quantitative and qualitative analyses regarding return objectives and strategic asset allocation.
3. Provide guidance on the level of portfolio risk necessary to achieve your return objectives.
4. Recommend a strategic asset allocation reflecting your IC's return objectives, risk tolerance, liquidity preferences and other factors unique to your organization.
5. Provide analysis and facilitate IC discussions regarding illiquidity and potential trade-offs when making less-liquid investments.
6. Implement a portfolio consistent with your IPS:
   - Establish an asset allocation within IPS guidelines.
   - Select investment managers.
   - Manage the portfolio day to day.
7. Work with your IC and staff to develop performance reporting practices that enable the IC to evaluate compliance with IPS guidelines and your portfolio's positioning and performance.
8. Help your IC structure its meetings for effective portfolio performance evaluation.
9. Support your staff by completing subscription documents and helping with investment-related projects, including unitization and audit preparation.

BROWN ADVISORY CAN HELP

In identifying the right investment advisor for your organization, you will want a partner with a meaningful history of successful collaboration. At Brown Advisory, we have decades of experience serving many different types of nonprofits, including educational endowments, private foundations, hospital systems and cultural organizations. We work with mission-driven nonprofits ranging from local organizations with portfolios valued at $5 million to national organizations with more than $2 billion in investments.

At Brown Advisory, we foster a culture of low team turnover that seeks to serve every aspect of your long-term strategy. We focus on customizing our services to each client, providing a "bespoke" experience tailored to your evolving needs. We strive to learn from every client as we help them to educate themselves about the evolving investment landscape. And when an organization experiences turnover in board membership, especially in its IC or among key staff members, we are there to serve as your vault of institutional knowledge.