A Call for Disclosure:

Endowed Foundations, Investments and Institutional Mission*

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This paper has a modest objective -- to advance a proposition and invite critical discussion of it. The proposition is this:

> *as a matter of expected, good practice, an endowed grantmaking foundation should disclose – regularly and publicly – how its investment program strives to advance the institution's mission.*

The central purpose of a foundation's investment program is, of course, to advance the institution's mission. The investment function accomplishes that by supplying the financial resources needed to finance philanthropic spending. The disclosure standard proposed here asks whether, in addition, investment activity includes other efforts that help the institution accomplish its public purpose.

Boundaries

The proposition asserted here focuses exclusively on endowed, grantmaking foundations. It is not meant to apply to other types of tax-advantaged institutions, such as colleges and universities, pension funds, or endowed public charities. The question of whether these institutions should make similar disclosures is beyond the scope of the paper.

Also, unlike some commentators, this author draws a clear line to separate the philanthropic work of an endowed grantmaking foundation from the responsibility of stewarding the institution's long-term financial assets. The proposition focuses entirely on the investment side of that line. Thus, for those familiar with foundation sector

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terminology, it has no concern with "program related investments" (PRIs) which are, by definition, philanthropic instruments. Reporting about PRIs would naturally be part of a foundation's disclosures concerning its program initiatives and expenditures.

Finally, the term "institution's mission" is a very deliberate choice of words that should be read as a rejection of other formulations, especially ones that draw on notions of "social responsibility" or "responsible investing." With foundations, it is the mission of the institution that centers and guides decisionmaking and that justifies the favorable economic status that these entities enjoy. Hence, "mission" is the appropriate reference.

Further Detail

This paper proposes a standard for good disclosure, not a mandatory new section for the federal Form 990-PF or for any of the forms that foundations file regularly with state tax authorities. Foundations would comply with the suggested standard within the framework that they currently use to provide information about their operations to the general public. The format for that varies widely from foundation to foundation but is generally of sufficient flexibility to accommodate the additional commentary urged here.

The disclosure should be "owned" by the chief executive officer of the foundation or the board chair, i.e. those who typically report on the institution's efforts to accomplish its mission. It could be part of the message from either one of these individuals in the foundation's annual report.

The thrust of the proposition is disclosure, which implies tolerance for a broad range of institutional choices. It does not insist that foundations engage in certain types of investment activity or that they commit a minimum percentage of their assets to particular investment strategies. It does assume, however, that foundations will engage deliberately and thoughtfully with the following questions:

- in addition to striving for financial return, should the foundation's investment function undertake other efforts to advance the institution's mission?
- if so, what types of activities and why?
- if not, why not?

Some foundations will report that their investment activity focuses solely on the pursuit of financial return and does not otherwise attempt to further the institution's mission. The reasons for this position will vary. At some institutions, there may be a weak connection between philanthropic priorities and investment activity. At others, the opportunity to link these two may have been eliminated by a decision to outsource investment management to a third-party service provider that commingles the foundation's assets with those of other institutions – institutions with differing purposes and objectives. And at still others, there may be a strong institutional preference to dedicate the time and attention of foundation investment professionals exclusively to achieving financial objectives. Whatever the reason, an explanation of it should be part of the disclosure.

Foundations that have made different choices will communicate how they are working to align at least some aspects of their investment operations with institutional priorities and objectives. In some cases, that might focus on proxy voting. In others, it could involve screened portfolios of marketable securities investments or targeted real estate, private equity or natural resource investments. The disclosures should explain what the foundation is doing, what it hopes to achieve, and why the activities are consistent with prudent financial management.

A Similar Recommendation

In broad outline, what is proposed mirrors advice on the investment of charitable funds that the Charity Commission for England and Wales has provided to the organizations that it regulates. In its guidance, the Commission notes first that the Cabinet Office's Strategy Unit has recommended that the trustees of larger charities should be required to

disclose in their annual reports "the extent (if any) to which social, environmental or ethical considerations are taken into account in the selection, retention, and realisation of investments." This language comes from requirements that apply to pension fund trustees. The Commission then provides, "Whilst there is, at present, no legal requirement on any charity trustees to do this, it would be good practice to include such information in the charity's annual report."[1]

While the text quoted above invokes general social, environmental or ethical considerations, it is worth noting that, earlier in its guidance, when discussing how far trustees can allow their investment strategy to be governed by considerations other than the level of investment return, the Charity Commission advises charities to hew closely to their "aims and objectives" rather than to broad moral standards.[2] In the terminology of this paper, "institutional mission" not "social responsibility."

Also consistent with boundaries delineated here, the Charity Commission places beyond the scope of its investment guidance "programme-related or social investment." The Commission does not regard PRIs as investments but rather as qualifying expenditures, like grants.[3]

Reasoning

The justification for the proposition is simple and straightforward. Society confers significant financial advantages on foundations because it values their ability to contribute to the public good. Those contributions have generally been viewed to take the form of charitable expenditures – grants, program-related investments, and supportive administrative outlays. Foundations, however, are investors as well as spenders. And, in terms of overall financial significance, their investment activity exceeds, by several orders

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[1] Charity Commission for England and Wales, *Investment of Charitable Funds: Detailed guidance*, (Version February 2003), paragraphs 92 and 93, http://www.charitycommission.gov.uk/supportingcharities/cc14full.asp#52.

[2] Charity Commission for England and Wales, paragraphs 86 and 91.

[3] Charity Commission for England and Wales, paragraph 13.

of magnitude, their annual charitable spending. Given that, it seems reasonable for the public to inquire whether foundations are contributing to the public good – advancing their missions – as they manage their substantial investment portfolios. Foundations should address that question in regular reporting about their operations.

In a recent essay, Columbia University professor and former Rockefeller Foundation senior executive Kenneth Prewitt makes a useful distinction between procedural accountability and substantive accountability. He writes, "The American foundation sector has been successful in deflecting demands for substantive accountability by expanding in such procedural areas as transparency and professionalism, which … are less threatening to foundations than substantive accountability."[4] For Prewitt, substantive accountability refers to "… a review of their program priorities or of the effectiveness with which they accomplish their self-defined missions."[5]

Whether foundations should be pressed to practice more substantive accountability is beyond the scope of this paper. What is proposed here is a further step in the direction of broader procedural accountability which, as Professor Prewitt observes, foundations have been willing to embrace in recent decades.

Support Systems

To increase the likelihood that foundations will take that step, internal and external systems of support are required.

Internally, dialogue about institutional mission and investment management needs to become a routine part of organizational life. The foundation's investment committee should address the topic at least once each year in its reporting to the board of directors. The board should consider the subject during its annual review of the chief executive's performance and priorities. And, the topic should be part of the annual discussion of the

[4] Kenneth Prewitt, "American Foundations: What Justifies Their Unique Privileges and Powers," in *The Legitimacy of Foundations*, ed. Kenneth Prewitt et al. (New York: Russell Sage Foundation, 2006).
[5] Prewitt.

chief investment officer's performance. If dialogue about the relationship between asset management and institutional purpose is easy and familiar within foundations, the disclosure practice recommended here will gain broader acceptance.

Responsibility for introducing and sustaining such supportive internal dynamics should fall on the shoulders of the foundation's chief executive and its directors/trustees. It is not realistic to expect that leadership will come from either the investment committee or the professional investment staff.

A robust internal support system is necessary but not sufficient. Complementary external encouragement is essential. Some foundations will embrace the new disclosure voluntarily. Others will do so only after being nudged in that direction. For the latter group, the media can play an important role. Media here refers both to foundation sector publications, e.g. *The Chronicle of Philanthropy*, and to publications that reach more general public audiences. Nonprofit advocacy organizations could also be effective agents for change, especially ones that have a track record of pushing constructively for greater foundation transparency.

Building and maintaining external systems that reinforce accountability is a challenge with foundations, since these institutions lack active and engaged third-party stakeholders, i.e. no voters, no shareholders, and no funders. Nonetheless, it must be part of any effort to encourage foundations to practice the type of disclosure proposed here.

Costs

Are there costs to proceeding with the proposal? Two types occur to the author. There may be others. Discussion of them is welcome.

First, the recommended disclosure would introduce a new time demand on foundations, with implications for directors and trustees, chief executives, investment staff, and possibly

communications professionals. Some of those affected may not welcome this development.

The time commitment need not be significant – no more than what is required for thoughtful discussion about the relationship between investment management and institutional purpose, followed by preparation of a written communication that shares the conclusions of that conversation with a public audience. Indeed, the substance of the disclosure may not change materially from one year to the next. Given the extent of the financial benefits that foundations enjoy, it is not unreasonable to ask them to make that modest effort.

Second, broad acceptance of what is proposed might cause foundations to be less attractive to certain talented investment professionals. This could occur if a stronger commitment to dialogue about investments and mission within these institutions led a greater number of them to embrace a broader conception of the role of the investment function. Some in the investment profession might have reservations about operating within that framework.

Conclusion

The intent of the proposition advanced here is to place an important, but infrequently explored, topic closer to the center of the agendas of endowed grantmaking foundations. That topic is the relationship between a very substantial area of activity for these institutions (investment management) and the pursuit of their philanthropic missions.

The proposition is meant to encourage more deliberation and dialogue within foundations, not steer toward particular outcomes and not compromise the integrity of decisionmaking practiced on the investment side of the foundation house. It clearly assigns responsibility for ensuring that those discussions occur, and it points to existing communications vehicles that might be employed to share the results of internal discussion with external public audiences. The emphasis is on transparency and disclosure, which is accepting of a range of reasoned institutional choices.

If one effect of the proposition is to move more foundations to dedicate a broader mix of their resources (both human and financial) to pursuing their institutional priorities, the positive impact on the public good could be significant.

Endnote: Visualizing Success

With foundation grantmaking, a good practice at the beginning of any philanthropic initiative is to sketch a picture of success, with as much specificity as possible. Taking on that challenge here, a vision of success in a five-year timeframe might have the following elements.

By December 31, 2012,

♦*The Chronicle of Philanthropy* surveys, every other year, the top 100 foundations by asset size to determine the extent to which these institutions link investment activity with mission objectives. The results appear in grid form in a two-page spread in one of *The Chronicle's* regular issues. The format is similar to the one used for displaying information about executive compensation practices. Entries in the grid highlight priority initiatives at foundations that are attempting to embed mission priorities in some aspects of their investment programs. More than two-thirds of the top 100 foundations have a publicly available statement about the relationship between their investment activities and their institutional purposes. This is up from less than one-third when *The Chronicle* published the results of its first survey of this kind.

♦Release of *The Chronicle's* survey results leads regularly to related stories appearing in the general press (*The New York Times*, *The Los Angeles Times*, etc.), as well as in print and online publications that target business and investment professionals (*The Wall Street Journal*, *Pensions & Investments*, Fund*fire*). Articles appearing in publications of the latter type provide detail on some of the innovative investment vehicles to which foundations

have committed capital in order to achieve, simultaneously, financial and philanthropic objectives.

♦Cambridge Associates, a firm with a significant share of the market for investment consulting in the foundation sector, releases an annual paper on trends in mission-linked investing among foundations. The publication is available, free-of-charge, on the firm's web site.

♦All of the members of The Foundation Executives Group, a forum of the chief executives of many of the largest U.S. foundations, have embraced the disclosure and led their institutions to release informative public statements about their respective positions.