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INVESTMENT CONSULTANTS

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15 Ways to Enhance Donor Trust by Improving Your Investment Stewardship

A Roadmap to Action for Nonprofit Leaders

Executive Summary

Many trustees, investment committee members and board members of nonprofits do not realize that they have a fiduciary obligation under the law. They are frequently committed to the mission of the organization, but they may not have experience with investing or fully understand how their decisions impact their organization's wellbeing. Nonetheless, these individuals are still considered fiduciaries. Fiduciaries have the authority to make investment decisions and bear the potential liability for the organization if any legal consequences occur. Current research shows that lay fiduciaries are responsible for $26 trillion of U.S. investment assets (Henriques et al., 2021). Fortunately, resources are available to help these investors. This paper summarizes many available resources and training programs that can help the lay fiduciary understand how to approach their fiduciary responsibilities. In addition, we outline fifteen practical steps to becoming a better fiduciary, including Fi360's Prudent Practices®. There are many benefits to fiduciary training. These include a deeper understanding of the roles and responsibilities of service providers and other related parties, mitigating reputational risk and personal and organizational liability, and potentially attracting more donors, gifts and volunteers.

Today's Realities—Some Background Information

For nonprofits…reputation is everything.
—MIT Sloan Management Review

When donors decide where to place their charitable gifts, they look for causes they support—and organizations they can *trust*. Whatever the charitable cause, donors want to know that their gifts will be in the hands of careful stewards—leaders that will care for those gifts as if they were their own.

That is why, for a nonprofit, reputation is essential.[1] Yet, less than half of nonprofit directors think their board has a solid understanding of their responsibilities.[2] So, it's not surprising that one in four people *does not* trust charities.[3] Given these figures, it may be time to understand why this is happening and take steps to distinguish your organization from other nonprofits.

According to John Seitz, founder of Foundation Financial Research, almost three-quarters of private foundations in the U.S. underperformed global stock and bond markets for the five years ending in 2016.[4] Drawing on its database of 40,000 foundations with endowments over $1 million, Seitz focused on 14,000 private foundations with fiscal years that end in December. Over that five-year period, the median annual return was 7.7%. But, if they had been invested in a low cost, passive global index fund that anyone can buy, such as a Vanguard fund invested in 70% global stocks and 30% global bonds, they would have had average annual returns of 9.04% for the same five-year time period. This outcome is closer to the annual 9.3% or higher returns of the best-performing 25% of private foundations for the five years ending in 2016.

However, in the bottom quartile, the returns were less than 6.3% annually. The lower returns are only two-thirds of the amount of the higher returns. A shorter time horizon or more conservative risk profile may result in lower returns. What if someone asks you how did your organization do? What are your foundation's investment returns? Are the risks and returns for the investments as expected? If not, what are you doing about it?

The study also showed that what looks like small changes in investment returns could make a significant impact. For example, a one percentage point in its investment returns can make a substantial difference for a nonprofit with assets of $100 million. In this example, each percentage point would represent $1 million of lost or gained investment returns that could be used for the organization. Similarly, if a foundation or endowment with assets of $100 million pays one percentage point more in investment costs than it needs to, it's a drag on the growth of the assets. That 1% in higher costs can mean they will make $1 million less per year on their investment returns. That extra expense means they would have $1 million less a year to spend on their mission.

With this example, you can calculate the numbers that reflect the situation in your organization. How is your organization doing? What would you do with the extra dollars? Most nonprofits annually distribute about 5% of their endowment funds. In the previous example, the 1% loss represents 20% of the annual distribution or giving budget.

In 2020, the average spending rate for private foundations was 5.6%, while community foundations had a spending rate of 4.7%,[5] according to the 2020 Council on Foundations' *Commonfund Study of Investment of Endowments for Private and Community Foundations®*. But, larger private and community foundations, with more than $500 million in assets spent an average 6.1%. Private foundations are required to spend at least 5% annually, while community foundations have more discretion in their spending rate. However, in most states, the Uniform Prudent Management of Institutional Funds Act (UPMIFA)'s provisions state that an annual spending rate higher than 7% of the foundation or endowment's fair market value would be "presumptively imprudent."[6]

Anyone who is considering donating to your organization will likely contemplate how prudently the organization is managing its hard-earned money. They may wonder if they can trust the organization. Donors may never tell you this directly, but they probably think about it. People generally do not want to be associated with waste, failure, scandal, or bad press. They want to be part of the best. So how can we improve an organization's trustworthiness? We can build a fiduciary culture.

Building A Fiduciary Culture

What is a Fiduciary?

A fiduciary is an individual who manages assets on behalf of others, placing the others' interests ahead of their own. Fiduciaries are directly responsible for managing those assets and must do so with prudence and competence. They must always place the interests of the beneficiaries before their own in a relationship of trust and confidence. Foundation or endowment board members, the investment committee, and staff leadership are fiduciaries—typically *lay fiduciaries*[7] as opposed to professional fiduciaries.[8]

Managing the organization's assets may seem like a daunting task. You don't have to do this alone. In fact, unless you have specialized investment knowledge, you should hire prudent experts to help you manage those assets in the best interest of the organization. Board members, the investment committee, and staff have legally defined roles with obligations to carry out those roles according to a standard of care.

In general, when you are in a position where you can make or influence investment, administrative and financial decisions for the foundation, you will likely be considered a fiduciary for those decisions. If you are a fiduciary, you need to know your fiduciary responsibilities and how to fulfill them.

Also, if you are on a board or in a decision-making role—you are a fiduciary. Fiduciary excellence leads to trust. Trust leads to enhanced donor confidence and board engagement, which ideally leads to increased donations, financial security, and mission success.

History of Fiduciaries

The fiduciary culture has a long history. We believe fiduciary principles are among the most revered and long-term concepts in medicine and law. The history of the fiduciary dates back more than four thousand years to the Code of Hammurabi, which was one of the first written and complete legal codes. Another example from the ancient world, still often quoted today, is the golden rule in Christianity. The golden rule is an excellent example of the fiduciary concept in its early development.

There is a correlation between **philanthropy** and **fiduciary**. The word *philanthropy* means the love of humankind and working for the benefit of others. It dates in English from about 1600 and comes from the Late Latin and Greek *philanthrōpia*—acts of kindliness, benevolence, and humanity. But the origins of the practice have been traced to much earlier.

The National Philanthropic Trust traces the timeline of philanthropy back to the Sung Dynasty in China (960-1279), in which the state provided soup kitchens, orphanages, and other relief.[9] Individual giving began in the Ming Dynasty (1368-1644) with public projects financed by private donors and in the Ottoman Empire (1494-1566), Spain (1526), Jerusalem (1552), and private benefactors in China (1580). In the Americas, Tribal Nations were already practicing philanthropy when the first European settlers arrived. Both *philanthropists* and *fiduciaries work for the benefit of others*. A fiduciary is entrusted to care for the property or something of value for the benefit of others.

In the context of a *lay fiduciary* charged with managing nonprofit foundation or endowment assets, you are caring for the assets of the nonprofit for the sole benefit of the beneficiaries of your nonprofit's programs. So efforts as a fiduciary serve a larger purpose than prudent investment management alone—an effort and purpose exponentially larger than oneself. Ultimately, your efforts as a *lay fiduciary* make a difference in how foundations and endowments help feed, clothe, and shelter thousands of people and sustain or conserve farmland or forests. Other causes include supporting education, human rights, culture, the arts, providing refuge and preventing extinction of animals, and many other charitable endeavors.

What are some of the anticipated results of a fiduciary culture within an organization? More effective management and enhanced reputation may be direct outcomes, potentially attracting more confident donors.

Building A Fiduciary Culture

Speak Fiduciary to Me

Most people join a nonprofit to be involved with the good work of the mission. They may not be familiar with the vocabulary of finance and investing. As many groups have their unique terminology and shorthand, fiduciaries are no different. Kate McBride, Founder and President of FiduciaryPath™, has developed ***The Language of Nonprofit Fiduciaries™***, a booklet that defines standard terms that fiduciaries need to know. Most nonprofit trustees are lay fiduciaries from walks of life that are not part of the investment world, with its special terms and jargon. So, it's essential to have a reference for those terms.

For example, most *lay fiduciaries*[10]—including individuals who are trustees and decision-makers for a nonprofit retirement plan but who are not professional investors, would not be expected to know that a custodian is not the janitor and a portfolio is not a briefcase.

In the context of investing, a custodian is a financial institution that holds securities for safekeeping. A portfolio is a basket or grouping of the cash and investment securities that the foundation must prudently manage. There may be more than one portfolio for different purposes.

Portfolios can contain various items such as cash, investment securities, art, or real estate. These are collectively known as assets. The custodian is usually a bank or brokerage firm that holds the investment securities for safekeeping to minimize the risk of theft or loss. The custodian also executes securities trades—buys or sells investments, as directed by the foundation or the prudent experts that the foundation hires to manage the portfolio. Schwab is an example of a custodian.

The Centre for Fiduciary Excellence (CEFEX) and Fi360 are resources for developing a fiduciary culture.[11] CEFEX is an independent international organization that oversees and verifies adherence to the Global Fiduciary Standard of Excellence, which is discussed in the handbook, *Prudent Practices for Investment Stewards*, published by Fi360. CEFEX certifies investment stewards, such as foundations and endowments, investment advisors, recordkeepers, third-party administrators for retirement plans, and investment managers who adhere to best practice standards.

Fi360 provides fiduciary training, tools, and designations, including the Accredited Investment Fiduciary® (AIF®) and Accredited Investment Fiduciary Analyst® (AIFA®). Both require ongoing education, experience, and accountability.

15 Ways to Get to Fiduciary

Way 1. Embrace Your Responsibilities as a Fiduciary

Lay fiduciaries who must oversee the management of the assets of a nonprofit have the power to engage and delegate discretion to professional fiduciaries. They also can fire and replace professional fiduciaries. These powers mean that the lay fiduciaries are fiduciaries, though they can delegate certain, but not all, of their fiduciary tasks to the professional fiduciaries.

Lay fiduciaries may hire investment advisors to provide professional investment advice and expert guidance as professional fiduciaries. However, it is important to delegate this fiduciary role along with all of the fiduciary tasks they will provide in writing in the agreement and in the investment policy.

Investment professionals may also be hired to provide investment management. Those with discretion to manage the assets are also professional fiduciaries.

Performing certain fiduciary functions can mean that the persons performing those tasks are actually fiduciaries—sometimes without realizing that this is the case.

Way 2. Fast Track to Fiduciary Excellence

There are resources available for you and your board or foundation. You can train and engage your leadership with the *Fast Track to Fiduciary Excellence™.* Understanding Fi360's *Fiduciary Essentials®* outlined in this paper is the first step. The second step is completing the Fiduciary Gap Analysis and Fiduciary Assessment. The third step is verifying the organization's prudent practices and achieving independent third-party certification by CEFEX based on the ***Prudent Practices for Investment Stewards Handbook***. Your foundation's board may wish to accomplish these steps to comply with the global fiduciary standard of excellence.

1. Fiduciary Essentials® Training
2. Fiduciary Gap Analysis – Fiduciary Assessment
3. Independent Third-Party Verification and CEFEX Certification

Way 3. Know Who Is and Isn't a Fiduciary

People who perform specific roles at the direction of others, such as brokers executing trades without discretion or authority to act on their own, do not provide professional advice, and do not have the power to appoint fiduciaries, are generally not fiduciaries.

Custodians and other administrators who hold the assets for safekeeping are generally not fiduciaries.

Way 4. Understand the Three Fiduciary Duties

Three obligations form the foundation of a fiduciary's duty to a nonprofit organization's program beneficiaries in the case of a nonprofit lay fiduciary or their client in the case of a professional fiduciary. These are loyalty, care, and obedience. These principles are the bedrock of fiduciary duty. They are based on the state laws that govern trusts and charitable organizations and are underscored by court findings.

Loyalty—Fiduciaries must serve the interest of the beneficiary, act in good faith, strive to avoid conflicts of interest, and manage unavoidable conflicts of interest in the best interest of the beneficiaries of the foundation or endowment.

Care—The duty of care requires that the fiduciary be competent and act with the same level of attention, skill, prudence, and diligence that someone who is an expert and familiar with the underlying circumstances would employ. If you don't have these necessary traits, you are *obligated* to hire a prudent expert to help you. Proper delegation of certain fiduciary responsibilities to prudent experts may transfer some of your fiduciary obligations to those professional fiduciaries.

Obedience—Lay fiduciaries must act to fulfill the nonprofit's mission and understand and follow the governing documents, including bylaws, the Investment Policy Statement, and your trust agreement or other foundational agreements. And they need to understand and obey the laws and regulations governing foundations and endowments.

Way 5. Know the Three Types of Investment Fiduciaries

There are three main types of investment fiduciaries: stewards, advisors, and investment managers. Their roles are distinct but may sometimes overlap:

Stewards—Stewards are the lay fiduciaries that are responsible for the management of the nonprofit's assets. Though they may manage the assets themselves, if they are not professional investors and professional fiduciaries, they should prudently select professional fiduciaries—prudent experts—to provide expert advice and manage the investments. The stewards can bring in these professionals but will always have the fiduciary responsibility to select them diligently, monitor them, and replace them should that become necessary.

Investment Advisors—Investment advisors are professional fiduciaries who are paid a fee to provide advice. Stewards should ensure that if they want professional fiduciaries, they select professional fiduciaries to advise in the best interest of the nonprofit and its mission and beneficiaries of that mission. Not all investment professionals are fiduciaries, so a prudent process to select the advisor is crucial, as is delegation of their fiduciary responsibilities with discretion or authority to carry those responsibilities out. These would be articulated in the governing documents, such as the Investment Policy Statement, and contractually—in writing—including all tasks the steward wishes to delegate.

Investment Managers—Investment managers are professional fiduciaries with the authority and discretion to invest the actual assets. They have the authority and discretion to manage the assets under their mandate. There may be several investment managers. For example, a mutual fund manager is an investment manager.

Way 6. Adopt Fi360's Eight Fiduciary Precepts

Another important and practical way to build your fiduciary aptitude is by using Fi360's "Eight Fiduciary Precepts." These crucial concepts form a cycle of fiduciary care and help create a fiduciary language and culture within your nonprofit. Each Fi360 precept is backed by law, court cases and regulation. Each precept falls within one of the four parts of Fi360's Fiduciary Quality Management System (FQMS).

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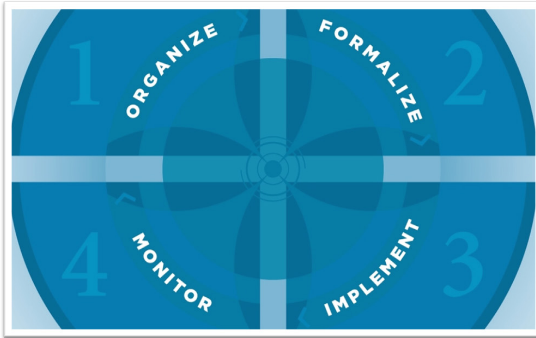
Way 7. Put Fi360'S Fiduciary Quality Management System to Work

The Fiduciary Quality System (FQMS) is a framework developed by Fi360 which addresses fiduciary responsibilities in the investment process in the handbook, ***Prudent Practices for Investment Stewards,*** published by Fi360.[12] This framework is based on the ISO 9000 standard for quality management systems, which is process-driven and emphasizes a cycle of continual improvement.

The Fiduciary Quality Management System

1. ***Organize***—gather the data
2. ***Formalize***—analyze the data and create the strategy
3. ***Implement***—execute the strategy
4. ***Monitor***—review and assess what is working and what is not, and correct the course when necessary.



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Fiduciary Quality Management System

Being an excellent lay fiduciary requires diligently working in the best interest of your foundation or endowment's beneficiaries while remaining obedient to donor intent, as long as that's lawful.

Continual improvement is part of that diligence, made easier by implementing the four parts of the FQMS. These are discussed in Ways 8 through 11.

Way 8. Organize

Fiduciary Quality Management System Step 1: Organize

The first step of the Fiduciary Quality Management System is to organize. Think about what governs the actions you, as lay fiduciaries, take to manage the investments of your nonprofit. Some documents are essential for running the nonprofit when delegating responsibilities to other fiduciaries and for creating a culture of fiduciary excellence among your board and leadership colleagues at the nonprofit. Gather all the information required to make investment decisions that are in the best interest of the nonprofit and its beneficiaries, including the laws and regulations that govern nonprofits in your state, trust documents, bylaws, the Investment Policy Statement (IPS), agreements with service providers, and public information about your nonprofit. The state laws that govern nonprofits include the Uniform Prudent Investor Act[13] (UPIA) and Uniform Prudent Management of Institutional Trusts Act[14] (UPMIFA), which have been adopted by most states, sometimes with state-mandated provisions. Find your state's version in the references. These are the building blocks for your fiduciary files.

FQMS Step 1 is where *Precept 1: Know the laws and the governing documents that define how you manage your nonprofit*; and *Precept 6: Avoid or manage conflicts of interest* fit into the FQMS.

Way 9 - Formalize

Fiduciary Quality Management System Step 2: Formalize

After gathering information and documents for the *Organize* stage, the next step is to *Formalize*. This stage is where nonprofit lay fiduciaries determine how, most often with the prudent experts you've hired, to establish the investment strategy. It's not simply about which investments to buy and sell. First, it's about setting the goals and objectives of the nonprofit and determining how long assets will be invested. According to how and when the money will be used, there may be separate endowments or portfolios with longer or shorter time horizons.

- What are the appropriate investment risk and return levels necessary to meet your objectives?
- According to Modern Portfolio Theory, what are the asset classes and the optimal mix among them most likely to help the organization meet its goals and objectives? What are the sub-asset classes in that allocation that will further help create a diversified portfolio?
- Who is performing which roles within the lay fiduciary leadership, trustees, and investment committee? And who are the professional fiduciaries to whom you've delegated certain responsibilities?

Only after these items are discussed and agreed upon, likely with the prudent experts or professional fiduciaries you have hired, would you decide on mutual funds or investment managers to be hired to fulfill the investment strategy.

The IPS is your GPS that guides your hired fiduciaries and the lay fiduciaries in how you manage the investment assets. The IPS includes the investment strategy, the roles and responsibilities of all parties, and the intentions of the nonprofit. In addition, how the strategies are to be implemented, objective, measurable due diligence and monitoring criteria for the investments *and* the service providers, and how you control investment costs—are all also articulated in the Investment Policy Statement (IPS).

Remember, you can delegate certain responsibilities in writing in the IPS and the contracts with service providers to prudent experts—professional fiduciaries. If this is correctly done, some fiduciary responsibilities may be lifted from the lay fiduciaries and borne by the professional fiduciaries. But the lay fiduciaries will always have oversight and monitoring responsibilities. Still, that differs from shouldering all of the investment fiduciary responsibilities!

The *Organize* and *Formalize* steps are crucially important in setting up and managing the investment assets of your nonprofit.

Fi360's *Precept 2: Diversify to manage risk and return*, and *Precept 3: Prepare and manage the IPS* are part of *FQMS Step 2: Formalize.*

A more detailed approach can be found in the ***Prudent Practices for Investment Advisors*** handbook.

Way 10. Implement

Fiduciary Quality Management System Step 3: Implement

This step is where you put the setup and organization of *FQMS Step 1: Organize*, and the thinking, discussions, and decisions made in *FQMS Step 2: Formalize*, into action. The Fi360 *Precept 4: Select service providers* through due diligence; and *Precept 5: Control and account for costs* guide lay fiduciaries here.

Due diligence in selecting prudent experts in professional fiduciary roles such as the investment advisor and investment managers is paramount. Lay fiduciaries can delegate some fiduciary responsibilities to prudent experts, but only if they follow a prudent process when doing so. Part of that process is understanding who is a professional fiduciary and who is not.

Who is a fiduciary? Registered Investment Advisors (RIAs) are federally registered under the Investment Advisor Act of 1940, or under state laws, if they have less than $100 million under management. They are regulated by the SEC or states, and they are fiduciaries and must by law place their clients' interests ahead of their own interests. They generally are paid a flat fee or a percentage of assets, not based on what they recommend. Therefore, one of the conflicts of interest in investing can be avoided because they are free to recommend lower cost, cost-effective investments. In other words, they don't get paid more to recommend more expensive investment securities. RIAs and their Investment Advisor Representatives must be loyal to their clients, placing the client's interests before their own interests. This is a fiduciary relationship, and therefore, they are considered to be professional fiduciaries—prudent experts.

Who is not a fiduciary? Investment broker representatives, who work at broker-dealer firms, banks, mutual fund companies, and some insurance companies that have a broker-dealer, are not fiduciaries. They are licensed by FINRA. Their mandate is buying or selling securities as directed by their customers. They are generally paid based on what they are selling, either by a commission or fee that comes out of the client's assets. There is a conflict of interest here because the broker's pay varies according to how much you buy or sell through them. This situation can be costly to the foundation or endowment because there's a temptation for brokers to sell higher-cost investment securities with higher commissions or fees that the broker and their firm receive. This association is a sales relationship. Their loyalty may be to their firm, not to the customer.

There are also hybrid broker-dealer/investment advisor representatives who essentially wear two "hats"—a fiduciary hat and a sales hat. They may receive fees or commissions. It is nearly impossible to tell which hat they are wearing at any point in time. Their loyalty is to their firm, though when wearing their IAR hat, their loyalty should be to the client.

To make things more complicated, various investment professionals can use many different titles—financial advisor, wealth manager, Senior VP, and many others. But only one can legally use the title Registered Investment Advisor.

Lay fiduciaries need to dig deep and find out who is advising them and whether or not they are getting advice from a professional fiduciary—or not. Lay fiduciaries also need to know all the costs for the investments and whether they are reasonable for the service provided. Understanding costs is part of the due diligence that fiduciaries do.

Once you know who you want to have on your service provider team, which investment advisor, investment manager professional fiduciaries, custodian, and any other needed service providers, it's important to hire them using a prudent process, such as a request for proposal (RFP). That is a way of looking at several firms and individuals you might be working with and comparing them to each other based on your criteria. You would also document how you run the RFP, compare the candidates, make your choice, and record this in your fiduciary file. In addition, you would monitor that their performance is as you expected, that the costs are reasonable for the service provided, and that all the things you need from them are being provided.

As you set up your Investment Policy Statement, you will outline everyone's roles and responsibilities. Then delegate the investment advice and investment management functions to those prudent experts—the professional fiduciaries, providing them with the authority and investment "discretion" to implement the strategies you've discussed. This arrangement is part of a voluntary safe harbor that, when done correctly, may shift some of the lay fiduciaries' fiduciary responsibilities to the professional fiduciaries.

Way 11. Monitor

Fiduciary Quality Management System Step 4: Monitor

Monitor is the review stage, once you've gone through the FQMS *Organize, Formalize,* and *Implement* steps. But it's not "set it and forget it!" Lay fiduciaries are still responsible for monitoring the service providers and overseeing the investments—with help from the fiduciary professionals you engaged earlier through a prudent process.

Step 4 incorporates Fi360 *Precept 7: Monitor service providers* and *Precept 8: Assess conformity to fiduciary practices.*

The *Monitor* step sometimes confuses lay fiduciaries. Once you've taken care to *Organize, Formalize,* and *Implement* your agreed-upon strategies and goals, some lay fiduciaries think it's enough to monitor the investments. But they omit to monitor the service providers. To operate more effectively, the service providers must also be monitored.

It's essential to monitor both the investments and the service providers. The interval at which you monitor them should be articulated in the IPS. You'll have help from the investment advisor to monitor the investments each quarter—that is a best practice. You've already specified an objective, measurable due diligence, and monitoring criteria in your IPS. It's there to ensure that you can see whether the investments are performing as expected. If they are not performing as expected, you should discuss with your professional fiduciaries why this is happening. Should the investment be on a watchlist? Should they be replaced? Are there recommendations? You'll also want to see if the asset allocation is in balance or if any changes are required by your asset allocation rebalancing criteria as stated in the IPS. If changes are necessary, and you've delegated this task to the professional fiduciaries, they may have already performed this and would report it to you. Are the investments still cost-effective? There should be measurable criteria for that and fee benchmarking along with performance benchmarks versus peer groups.

One thing we often see missing from the IPS is the “objective, measurable due diligence and monitoring criteria.” It’s a best practice to have monitoring criteria and use it. Otherwise, how would you know if the investments perform within the expected risk and return criteria you’ve articulated?

When you get monthly statements from your custodian, review them to ensure that the asset amounts and any inflows and outflows are as expected, that fees taken from accounts are reasonable and as expected, and that there aren’t any disbursements that are unknown or unexpected. You will likely have your accountant monitor these as well. Be sure to keep the documents in the fiduciary file.

When it comes to monitoring the service providers, the interval may be longer. Still, it is just as important as the other due diligence and monitoring criteria you’ve thoughtfully set up and stated in the IPS. The investment advisor continually monitors the Investment managers and reports to you quarterly or sooner when there’s an issue. The custodian also would typically be monitored to ensure they’re doing what you need them to do and that the costs are reasonable compared with peers.

Similarly, a review of the investment advisor every three years or so to ensure that they perform all the tasks you need, such as selecting investment managers that perform within the risk and return parameters you’ve set and at a reasonable cost, based on fee benchmarks. Have your needs changed? Are there additional tasks that you’d like the investment advisor to perform?

Have costs come down for the services provided? At the three-year interval, conducting a Request for Proposal (RFP) for your investment advisor and custodian can help answer those questions and determine whether you keep your current providers or choose a new one.

Fi360 and CEFEX discuss four steps in the monitoring process:

1. Gather the facts
2. Analyze the facts
3. Act on the facts
4. Document actions and reasons

It’s essential to monitor the Investment Policy Statement (IPS) and the fiduciary practices at the foundation or endowment annually. You may revise the IPS more frequently if needed. You can add a “revised” date in the header or footer of the IPS. Include what was changed, why, and when, so all involved will know the details. Also, update the strategic asset allocation changes or risk parameters changes in the IPS. You can easily make the additions via an attached addendum.

Way 12. Undertake Fiduciary Gap Analysis

A Fiduciary Gap Analysis involves bringing in an expert such as an Accredited Investment Fiduciary Analyst® (AIFA®) or CEFEX Analyst who has specific expertise in the Prudent Practices process. These analysts can help you understand how the Prudent Practices apply to your organization and how they can be used to fill in any gaps. They will evaluate your current process or any Prudent Practices that you already have in place and provide a confidential report. The report will tell you where you are succeeding and where you have gaps or opportunities for improvement. They will also help you close the gaps by putting the Prudent Practices in place. Identifying the gaps is essential because they can be the underlying cause of many issues you may encounter.

Way 13. Fix the Gaps

An Accredited Investment Fiduciary Analyst® (AIFA®) or CEFEX Analyst—who is trained to apply ISO Standard 19011—sets the framework for conducting Quality Management System audits. This audit can identify gaps in a nonprofit’s fiduciary practices and show you how to fill those gaps. Identifying gaps in your prudent practices

is a significant step. A fiduciary expert can help you improve your process and implement Prudent Practices where they may be missing. Kate McBride of FiduciaryPath™ said, "Organizations that have undergone a gap analysis and fixed these gaps using a CEFEX certified service provider are well-positioned to make the most of their mission and possibly become CEFEX certified themselves."

Way 14. Get Independent Third-Party Certification

Obtaining CEFEX certification isn't for everyone as the process can be demanding. However, the potential benefits from certification are worth the effort. There are many possible valuable outcomes from acquiring a third-party certification of excellence. These benefits include reduced regulatory and reputational risk. The due diligence and education derived from third-party certification decrease the likelihood of non-compliance with regulatory standards, thereby avoiding reputational harm to the organization.

CEFEX certification is known as the gold standard of independent third-party verification of fiduciaries. Third-party certification and organizational due diligence encourage higher board confidence and engagement levels and increase donor trust and confidence. Enhanced donor trust may promote larger donations, revitalized impact, and expanded mission success—all significant objectives. In addition, the increased operational impact may reduce fiduciary liability insurance premiums, possibly by 10 to 15 percent. These improvements loop together in a continuous cycle which has the potential to attract top talent—volunteers and staff who strive for continued progress.

Way 15. Ongoing Fiduciary Training

Implementing the previous steps helps develop a process so that the organizational leadership operates within a shared fiduciary culture. These steps also educate nonprofit leaders because many don't realize that they have legal responsibilities to be fiduciaries and to ensure that the assets are managed prudently.

Even if they have some idea of their fiduciary duties, many leaders are not aware of the full scope of their responsibilities. They have never been shown how to be a fiduciary.

Ongoing fiduciary training can help reinforce the prudent practices for the organization's current leadership and introduce those practices to the incoming administration so that the fiduciary culture is continuously rebuilt and sustained. New leadership will learn what it means to be a fiduciary. Many organizations implement training for the current board members and then review it at quarterly meetings or have it available for their new board members, new executives, or any decision-maker that is part of the organization on an ongoing basis. This training reinforces existing leadership and focuses on incoming leadership.

Fiduciary Essentials® training is one of the first steps you can take to put a fiduciary culture of excellence in place at a nonprofit. Fiduciary Essentials® training for nonprofit leaders can be provided through on-site half-or full-day workshops or live interactive Zoom meetings. These meetings are customized for the specific nonprofit and encourage participants to contribute to group discussions. Opportunities to talk about case studies and discuss questions are provided. There is also an online version of the training available. Participants can take the training at their convenience and learn at their own pace.

Where Are You on the Fast Track to Fiduciary?

Where are you on the fast track to fiduciary? It would be overwhelming to try to do all fifteen steps simultaneously. Organizations are at different stages in the fiduciary process. One suggestion is to begin the process by aligning these fifteen ways with your organization's objectives and priorities. Then you can determine where you are on your fiduciary continuum.

To get started, you can look at the fifteen ways to fiduciary and choose one or two to implement and then obtain help if you need it.

15 Ways to Get to Fiduciary

In summary, the fifteen ways to fiduciary are:

1. ***Embrace Your Responsibilities as a Fiduciary***—Understand the benefits the responsibilities provide you and the organization. Know what is needed to keep the organization in good standing.
2. ***Fast Track to Fiduciary Excellence™***—Fiduciary excellence training starts with Fiduciary Essentials® training, next a fiduciary gap analysis, then closing the gaps and obtaining CEFEX certification of your nonprofit's prudent practices. Completing these steps helps donors understand that you know what you're doing and that you're worthy of their trust.
3. ***Know Who is and isn't a Fiduciary***—Understanding the definition of a fiduciary keeps you from crossing lines inadvertently. You will also realize that you are a fiduciary if you make decisions on behalf of the organization.
4. ***Three Fundamental Fiduciary Obligations***—Know the three fundamental legal duties of a fiduciary: loyalty, care, and obedience.
5. ***Three Types of Investment Fiduciaries***—Understand the three types of investment fiduciaries. Investment fiduciaries include investment stewards such as nonprofit leaders, directors, trustees, and executives. The second type of investment fiduciary is an investment advisor who would advise you and help you manage the investments prudently. The third type is the investment manager who would invest the assets for the nonprofit.
6. ***Use the Eight Fi360 Fiduciary Precepts***—The sixth way to get to fiduciary is to know and use the eight fiduciary precepts. These precepts include: (1) know the rules, (2) diversify your assets, (3) develop and follow an Investment Policy Statement (IPS), (4) select prudent service providers using a prudent process like a request for proposal or RFP. Next, (5) know *all* your investment costs and control them, (6) avoid or manage your conflicts of interest, (7) monitor your investments and service providers, and (8) assess how well you and your organization are meeting your fiduciary responsibilities.
7. ***The Fi360 Fiduciary Quality Management System***—The framework developed by Fi360 addresses fiduciary responsibilities in the investment process in the handbook called ***Prudent Practices for Investment Stewards.*** The four sections of the FQMS make up the next four ways to fiduciary.
8. ***Organize***—Collect the necessary information for making investment decisions.
9. ***Formalize***—Define priorities and plan how to accomplish goals.
10. ***Implement***—Apply due diligence and research prior to engaging service providers and making investment selections.
11. ***Monitor***—The most labor-intensive of the responsibilities; requires continuous supervision and assessment of the prior decisions and outcomes.
12. ***Undertake a Fiduciary Gap Analysis***—Identify gaps in your fiduciary process with the help of an Accredited Investment Fiduciary Analyst® (AIFA®) and CEFEX Analyst.
13. ***Fix the Gaps***—Once you have assessed the gaps, resolve the issues, and fill the holes.
14. ***Get Independent Third-Party Verification***—Becoming certified by an independent third-party qualified to make this determination in a peer-reviewed process will show that you understand your fiduciary responsibilities, fulfill your fiduciary obligations, and follow fiduciary best practices.
15. ***Ongoing Fiduciary Training***—Provide ongoing training for your board and staff, constantly repeating this cycle, reinforcing the process of a true fiduciary.

Donors are becoming more interested in the quality of the management within the nonprofit organizations that they support. Donors also tend to make more significant donations to the nonprofit organizations that they feel have the financial expertise to manage larger donations. For example, a philanthropist in Minneapolis may make a $50 million contribution to a local nonprofit. It is likely that only a few dozen organizations in the Twin Cities would

know how to manage a $50 million gift prudently. Individuals making such a significant gift will want to ensure that the organization has addressed all the essential responsibilities of a prudent fiduciary culture.

Building a fiduciary culture requires focusing on many concepts discussed in this paper. Some of these concepts include reputation, trust, stewardship, responsibility, and fiduciary. Research has estimated that there are over 17 million *lay fiduciaries* in the United States.[15] These people are board members of nonprofits, ERISA plan sponsors, or trustees of personal trusts or charitable trusts. No standardized training program is available to guide members of a Board.

Many people join a nonprofit board without clear direction or knowledge of their fiduciary duties. The fifteen ways to a fiduciary culture outlined in this paper offer practical solutions that lay fiduciaries can use to improve investment stewardship. Ongoing fiduciary training for nonprofit leaders is a significant way to develop better governance for the nonprofit organizations they support.

Developing an Investment Policy Statement (IPS)

Many people volunteer for nonprofit boards without understanding investment strategy. They often do not have professional training in investment management, nor do they know how to draft an Investment Policy Statement. They may have never even seen the Investment Policy Statement. How does a nonprofit go about drafting an Investment Policy Statement? Kate McBride of FiduciaryPath™ stated that "at least three quarters to maybe a higher percentage of nonprofit stewards, trustees, board members, even investment committee members, don't have much or any investment training. And that's OK because one of the most important jobs they have outside of running the nonprofit itself is to put together an informed due diligence process in picking the prudent experts that can help them."

An informed due diligence process requires writing requests for proposals and conducting a sound process to select the prudent experts and service providers that can help. Choosing the right people is critical because, without prudent experts, it will be challenging to make the most of the organization's assets. The board should implement a prudent process to choose the prudent experts and not rely on an individual board member who may know about investments. Putting all the responsibilities on one person can lead to problems down the road.

Board members do not have to manage the assets themselves, but they must oversee the prudent experts managing them. In addition, board members don't have to know everything about Modern Portfolio Theory, but they need to understand what is necessary to oversee the service providers.

An Investment Policy Statement is critical because it is the roadmap for achieving goals with your investments. The IPS will answer expected returns, risk tolerance, and time horizon questions. There may be different pools of money for specific purposes. For instance, one pool may be earmarked for operating expenses and could not tolerate market fluctuations. On the other hand, other pools of money with a longer time horizon could be invested for growth and income. An Investment Policy Statement will describe these goals in detail. The Investment Policy Statement does not need to be complicated. A test of an effective IPS is whether a new board member coming into the investment committee can read it and immediately understand the organization's aims. Although it may be evident in hindsight, many nonprofit board members have never been told to develop an IPS.

Selection of Board Members

Many boards of directors are populated by larger donors, often successful entrepreneurs. Entrepreneurs may often have a big picture perspective and may not like checklists or be process-oriented. They may also have unique ways of doing things or different risk tolerances. So how should a nonprofit be recruiting members? What types of people should they be looking for to populate the board of directors, investment committees,

or other committees? Allan Henriques of FiduciaryPath™ believes that "one of the main criteria is to have a passion for the nonprofit's mission and want to succeed. The second is common sense. The third is a willingness to do one's best." These three qualities form a valuable starting point, creating fertile ground for instituting the fifteen ways to a fiduciary process.

Once the fiduciary culture is in place, the organization is in a position where it can thrive. If the assets are being handled prudently, the organization is free to think about what it wants to accomplish and how to achieve it. The "engine of assets" can help provide more funds for the mission of the organization. Because they are so passionate about the organization's mission, board members often forget that the engine of assets will help accomplish even more objectives. The fiduciary culture is a cycle—a repeatable set of guidelines that can help you make the most of your mission and potentially help more beneficiaries.

In addition, being a fiduciary includes legal responsibilities. However, you can't meet your legal obligations if you don't know what they are. A critical attribute of a board member is explaining the beneficial things your organization is doing and showing that you are meeting a higher standard than many other nonprofits. Unfortunately, many nonprofits are not meeting their fiduciary responsibilities. Board members generally want to do the right thing, but they have not been informed about their duties. Education is crucial in helping people learn how to meet their fiduciary responsibilities.

Fiduciary Gap Analysis Process

Board members have many questions. Who does the fiduciary gap analysis? When do they do it? How do they do it? How much does it cost? What's the benefit to the nonprofit organization? And who helps fix the gaps identified in a fiduciary gap analysis?

Review documents. To begin a fiduciary gap analysis, an Accredited Investment Fiduciary Analyst® (AIFA®) will ask the nonprofit for a list of various documents. Some of these documents may or may not be in place. Part of the gap analysis is to identify where some documents are missing. Or there may be policies that haven't been considered that would be helpful. Is there an ethics policy? Is there a conflict-of-interest policy? For example, a conflict-of-interest policy would help to ensure that decisions would be made by people who don't have a conflict of interest and not by people who do have a conflict. There are ways to manage these conflicts of interest. These policies are practical applications to develop a framework that will help your prudent decision-making process.

Discussions with foundation leadership. Next, the analyst speaks with the people running the foundation or endowment. The analyst will ask many questions. Some of the questions that are asked might be answered with ease, while other questions may not be readily answered. For example, a question that might be asked—is there a fiduciary file?

Fiduciary file. The fiduciary file is a collection of documents and represents the information that should be readily accessible so that you can oversee the people who are prudently managing your assets. Having these documents available is part of your responsibility as a fiduciary. Are these documents where you or others can easily retrieve them? Do you have all the documents you need? The fiduciary file contains a list of standard documents. The analyst doing your gap analysis can help you add the missing documents. Filling in the missing documents will give you an excellent framework for your foundation, endowment, or nonprofit.

Assets. Next, the analyst will look at the assets and asset cost. What is your organization paying? The analyst will compare what you are paying with what others are paying. Are the investment managers following the Investment Policy Statement? Are they allocating assets as planned in the Investment Policy Statement? Is anything missing from the Investment Policy Statement? If there is no Investment Policy Statement, the analyst can help you develop one with your prudent experts.

The analyst goes through the whole process with the organization. It can take a few days, a month, or several weeks depending on the complexity of the organization. Although it can take a few weeks, it is not something that requires 100% of your time every day. The process includes questions and answers back and forth, confidential reports with recommendations from the analyst, and an opportunity for a discussion about how to fix any issues that are found.

Gap Analysis Costs. The cost of a gap analysis is about $15,000 to $20,000. However, unnecessary expenses are often uncovered during the analysis. These costs reduce funds for the mission, so discovering these expenses adds to the value of a gap analysis. The savings of preventing unnecessary expenses can potentially cover the cost of the gap analysis over the long term. Although the savings may not cover the cost of the analysis on an annual basis, the analysis occurs only once, while the savings and increased efficiencies are ongoing. Allan Henriques of FiduciaryPath™ shared his observations about the cost of a gap analysis, "In every instance I've seen, it's been recouped or substantially greater than recouped, in the first year." Henriques described a situation where an analyst saved an organization $350,000 a year. These savings would not be typical, but it is a matter of scale. A gap analysis will have a more significant impact on a large organization with a bigger pool of money. The purpose of the gap analysis is to improve procedures and increase efficiencies, whatever the organization's size.

CEFEX Analysis Training and Other Resources

Nonprofit organizations can now get certified for following the Prudent Practices. Kate McBride and Allan Henriques both have the AIFA® Designation. In other words, they are both accredited investment fiduciary analysts that use their training daily with a history of working with nonprofits that have gone through the certification process.

There are several prerequisites to becoming an accredited investment fiduciary. You must have worked in the investment industry as a fiduciary for some time with ethics responsibilities. In addition, there can be no blemishes on your record.

Kate McBride now consults on fiduciary practices full-time. She was an advisor many years ago, but she has been consulting on a non-advisory basis for the last several years. McBride said, "What I really want to see now is organizations do well, be able to do more of their mission. All of us have had specialized training, we've already had the investment knowledge, but we've had specialized training in applying a set of Prudent Practices."

Two handbooks written by Fi360 are helpful resources—***Prudent Practices for Investment Advisors*** and ***Prudent Practices for Investment Stewards***. The latter is for nonprofits and contains twenty-one Prudent Practices with underlying supporting criteria. Learning about these prudent practices and how to apply them to different organizations is part of the accredited investment fiduciary training. Completing this training program produces expertise in understanding the Prudent Practices and how they are used in various organizations. Applying the practices is a quality management decision-making process for organizations.

After the Accredited Investment Fiduciary® (AIF®) training is completed, one is eligible for further training to achieve the Accredited Investment Fiduciary Analyst® (AIFA®) Designation. This credential allows one to conduct fiduciary audits using proven processes on the practices in place at an organization and uncover gaps that may be present. Once gaps are discovered, recommendations for best practices and solutions for closing the gaps are discussed with the organization.

When gaps in the process are discovered, the organization can pursue consulting to close the gaps. Often it is simple to close a gap, such as when a document is missing from the fiduciary file. Obtaining the document and having it available in the fiduciary file closes one of the gaps. However, sometimes gaps are serious, requiring additional thought about the process or framework that needs to be put in place to help the organization thrive.

An Accredited Investment Fiduciary Analyst® (AIFA®) is eligible to do the informal fiduciary gap analysis and the CEFEX certification audits, which is like the gap analysis. Both types of audits use the same content. The CEFEX audit provides additional detail submitted to the Centre for Fiduciary Excellence peer review committee. CEFEX looks at the reports and asks questions. Once the questions are addressed, the organization can be certified. After an organization has gone through gap analysis and closed the gaps, it is about 75 to 80 percent ready to be certified.

All the Prudent Practices are documented in law or regulations. The AICPA reviewed and edited the Prudent Practices while the handbook was developed. The prudent practices form a concise standard with explanations, showing the steps required to best serve as a fiduciary.

Case Study of Organization and Fiduciary Training. To illustrate what may happen without fiduciary training, Allan Henriques shared an example of an anonymous organization that breached some of its fiduciary responsibilities, requiring the state attorney general to become involved with the leadership. The organization reported that there had been a change of management; no one was intentionally doing something wrong in their fiduciary breach. The errors resulted in a substantial cash flow problem affecting the organization's ongoing operations. The organization did a fiduciary gap analysis, which the attorney general required. Each year, members of the board are also required to complete fiduciary training, pass an exam, and send letters of certification to the attorney general.

FiduciaryPath™ is providing the training the organization needs because they were put on probation for 27 years. They had to make up some of the lost money due to the fiduciary breach. This case is a good example of how the training helped turn an organization around. It is also a critical example of how good people, who unknowingly overlooked and breached some of their fiduciary responsibilities, caused a detrimental outcome. The organization didn't know what they needed to do, and they inadvertently did things that they should not have done. Everyone should have this training to avoid that kind of problem. Not just to prevent the problem but also to make your organization better.

More Training Resources

Contact FiduciaryPath™ to receive a booklet outlining the 21 Prudent Practices. Kate McBride and Allan Henriques would be happy to discuss this with you on the phone in more detail. FiduciaryPath™ provides onsite or virtual training. The onsite or Zoom meetings typically last a half or full day. These training sessions are customized for the specific organization. Another resource is video training available online, which takes about 3-5 hours. To complete the training, the participant must pass an exam to receive a certificate of completion with a letter of completion provided by the Centre for Fiduciary Excellence.

Online, on-demand Fiduciary Essentials® training, developed in modules of three to five minutes each, is available for the convenience of those who don't have time to do three and a half hours of training in one sitting. Organizations can subscribe to the training annually for their board members and executive staff. The video training will allow them to do 10-minute segments to reinforce or introduce certain critical concepts as part of their monthly or quarterly meetings. The training is flexible to accommodate various schedules and requirements. Online training is also highly cost-effective for boards and individuals. There's both a board subscription and an individual option. The subscription provides access for a year, and you can complete training at your own pace, two or three modules at a time. You also have documents to support the training. The modules guide the participant and can be repeated as many times as necessary.

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Allodium Investment Consultants is a fee-only investment management consulting firm that provides investment management services to both individual and institutional investors. Advisory services include Wealth Management, Fiduciary Management, Investment Management Consulting, Financial Planning and Fiduciary Consulting. The firm is a member of the National Association of Personal Financial Advisors (NAPFA) and provides fee-only financial advice that supports the fiduciary standard of care. Allodium is the first Minneapolis-based investment advisor to be certified by CEFEX to follow the fiduciary best practices in the Prudent Practices for Investment Advisors. The firm was established as an independent Registered Investment Advisor in 2005. Learn more at www.allodium.com.

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