

Form 990 Policy Series

The attached Memorandum is a part of the *Form 990 Policy Series*, developed by a group of lawyers, all members of the California bar and practicing nonprofit law (the “Form 990 Policy Series Group”). The *Form 990 Policy Series* includes Memoranda containing rationales and procedures for legal counsel to use in advising their clients on drafting and adopting appropriate policies responding to the new Form 990 as well as form policies and/or questionnaires.

The members of the Form 990 Policy Series Group with respect to the attached Memorandum (posted July, 2011) were as follows: Joel S. Corwin, Co-Chair; Barbara Rosen, Co-Chair; Elizabeth Bluestein; Lani Meanley Collins; the late Gerald A. Laster; Henry Lesser; Nancy McGlamery; Louis Michelson; Joy P. Paeske; Alicia Plerhoples; Lisa A. Runquist; Robert Siemer; Myron Steeves; Patrick Sternal; and Martin J. Trupiano. The views expressed in the Memoranda do not necessarily reflect the views of the law firms or employers at which these lawyers practice or any individual member of the Group.

The date at the top of the attached Memorandum is the date that the Memorandum was finalized, and the Memorandum may not reflect changes in law or practice since that date.

**FORM 990 POLICY SERIES
MEMORANDUM**

**Re: Investment Policy
(Form 990 Policy Series Memo #6.1)**

Date: September 14, 2010

NOTE ON THE SCOPE AND INTENT OF THIS MATERIAL

This material is designed to provide general guidance about an aspect of nonprofit corporate governance in the specific and limited context of the governance questions contained in the new IRS Form 990 (published by the IRS in 2008 and applicable to 990 filers based on a 2009-2011 filing year phase-in period depending on the size of the nonprofit). It is intended to provide some general guidance on the establishment of processes and/or policies to address a specific governance question in the Form. The subject matter of that question implicates a broad array of legal and practical issues ranging far beyond the immediate subject matter of the question itself. This material may address some of those issues but does NOT attempt to review them comprehensively and is NOT intended to be relied on for guidance on how they should be addressed in any specific situation.

Whether or not a nonprofit organization adopts a specific governance process or policy (or modifies an existing one), either in response to the disclosure requirements of the new IRS Form 990 or to change its governance practices is a matter to be carefully considered by that organization, with input from its board and advisors and evaluation of its specific circumstances. The IRS has explicitly stated that adoption of the policies and practices about which the new Form 990 asks is not mandatory, although the IRS has also indicated that it attaches significance to the manner in which all tax-exempt nonprofit organizations govern themselves. The inclusion of a sample policy in this material is not intended to suggest that the policy is appropriate for every nonprofit organization nor that, if a policy on that topic is determined to be appropriate, the formulation in the sample necessarily fits the needs of an individual nonprofit organization. A customized approach, with outside professional advice, is recommended. Accordingly, this material is intended as general information for legal practitioners advising nonprofit organizations as to their governance and does not constitute legal advice for any particular nonprofit organization.

Although the subject matter of this material may have relevance to nonprofit organizations that are not required to file informational tax returns with the IRS or are permitted to file on an IRS form other than Form 990, the focus of this material is 990 filers. While this material is meant to apply to Form 990 filers who are exempt under Section 501(c) of the Internal Revenue Code, certain portions of this material may be applicable only to Section 501(c)(3) organizations. In addition, although this material may be of assistance with respect to nonprofit organizations that are not subject to oversight under California law, there may be portions of this material that are relevant only to nonprofits organized under, or (by reason of their California-related activities) otherwise subject to, California law and, except as specifically discussed in this material, the laws of other States are not addressed.

1. Summary

The new Form 990 does not ask whether an organization has an investment policy, although it does refer to investments in various places. In any case, the members of the Form 990 Policy Series Group recognize the importance of an Investment Policy to the proper governance of a nonprofit corporation and therefore have created this Memorandum and accompanying sample policy.

The Form 990 Policy Series Group also recognizes that many nonprofits do not routinely hold investments and therefore may not need a policy of the type described in this Memorandum. However, a large number of nonprofits from time to time are offered gifts of securities. The Form 990 Policy Series Group recommends that all nonprofits consider formulating a policy to formalize their practices when such offers are made. Such a policy needs to address, for instance, (1) whether marketable securities will be immediately sold regardless of market value, (2) if not, how long a holding period would be appropriate in discharging the organization's prudent management of its assets, and (3) whether the organization will accept any gifts of non marketable securities and, if so, within what parameters considering the illiquidity of the security. It should also be noted that such considerations with respect to gifts of securities could be part of a gift acceptance policy. The Form 990 Policy Series Group is preparing a separate memorandum and sample policy on that subject.

The Form 990 Policy Series Group also recognizes that a nonprofit's cash-on-hand may exceed its short-term obligations, but its liquidity requirements may preclude it from making investments of the kind that warrant an investment policy of the type described in this Memorandum. It nevertheless needs to make prudent decisions about the appropriate management of that excess cash, balancing factors such as return, safety and accessibility. Those are in effect investment decisions, and nonprofits need to fashion a governance mechanism designed to provide guidance and authority to management while preserving the ability of the board (or a committee thereof) to discharge its oversight function.

The information contained in this document and any attachments is intended for advisors to California nonprofit corporations. The legal background for the most part refers to California laws that are applicable to California Public Benefit Corporations, but the general principles and sample policies may be used by any California nonprofit corporation, depending on whether it has limited or substantial investments. Charities that are formed as trusts are advised to look to the applicable sections of the California Probate Code.

2. Rationale for Adoption of an Investment Policy

The purpose of an Investment Policy is to provide a clear statement of the organization's investment objective, to define the responsibilities of the board of directors and any other parties involved in managing the organization's investments, and to provide or identify target asset allocations, permissible investments and diversification requirements. Those involved in managing investments, besides the Board, may include, for example, committees and investment managers.

If the organization also holds accounts that are "true endowments," that is, donor-created endowments rather than board-created endowments, the organization may need a separate Endowment Policy (including an endowment fund agreement) that supplements its Investment Policy. The Endowment Policy will be covered in a separate Form 990 Policy Series Memorandum (#6.2).

3. Background of Requirements/Sources for the Policy

Under California law, investment assets of a nonprofit public benefit corporation are governed by the California Corporations Code and the Uniform Prudent Management of Institutional Funds Act. Federal law provides special requirements for private foundation investments under IRC Section 4944.

A. California Corporations Code

Investment criteria for assets held for investment by a nonprofit public benefit corporation are provided by California Corporations Code (“CCC”) §5240. CCC §5240(b) states that the board of a nonprofit public benefit corporation must observe the following standards: “(1) Avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety, of the corporation’s capital.” and “(2) Comply with additional standards, if any, imposed by the articles, bylaws, or express terms of the instrument or agreement that contributed the assets to the corporation.” Under CCC §5240, the standards of care and prudence for directors, found in CCC §5231, apply to the directors’ investment activities. These Sections provide that the Board may delegate the everyday management of investment assets to a knowledgeable and competent investment professional. The investment criteria specified in §5240 only apply to investment assets, not to assets “which are directly related to the corporation’s public or charitable programs.”

The CCC mutual benefit corporation provisions do not have a section equivalent to §5240. However, as indicated below, California mutual benefit corporations are subject to §7231, regarding the standards of care and prudence for directors, which section is virtually identical to §5231.

CCC §5210 (§7210 for mutual benefit corporations) provides that the directors of a California nonprofit public benefit corporation are responsible for all of the activities of the corporation. Under either section, the board may delegate the management of the activities of the corporation to any person or persons, management company, or committee however composed, provided that the activities and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board.

CCC §5212 (§7212 for mutual benefit corporations) provides that the directors may delegate authority to a properly formed and constituted board committee. Such a board committee, which may be dubbed “finance” or “investment” committee, may act in place of the full board, as long as it is made up only of 2 or more directors. Board committees may only conduct activities that are specifically authorized by the board, and should report their activities back to the board at predetermined intervals. The Board may also establish an investment committee as an advisory committee, with committee members who are not directors, or with a combination of director and non-director members. An advisory committee may not be authorized to act for the board or for any

board committee; an advisory committee may however meet at regular intervals to review information and make recommendations to the board or board committee.

B. UPMIFA

California has adopted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), codified in California Probate Code §§18501 through 18510, and applicable to institutional funds existing on or established after January 1, 2009. Probate Code §18502(d) defines an "Institution" to mean any of the following: 1) a person, other than an individual, organized and operated exclusively for charitable purposes; 2) a government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; and 3) a trust that had both charitable and noncharitable interests, after all of the noncharitable interests have terminated. For this purpose, the term "person" is defined to mean an individual, corporation, business trust, estate, trust, partnership, LLC, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity. Thus, UPMIFA could apply to any charitable entity, including a trust, that holds institutional funds as defined in Probate Code §18502(e). Probate Code §18502(e) defines an "Institutional Fund" as a fund held by an institution exclusively for charitable purposes, but not including the following: 1) program-related assets; 2) a fund held for an institution by a trustee that is not an institution; and 3) a fund in which a beneficiary that is not an institution has an interest other than an interest that could arise upon violation or failure of the purposes of the fund.

Standards of care and rules for managing investments are found in Probate Code §18503. Probate Code §18503(b) applies a prudent person standard to each person responsible for managing and investing an institutional fund, saying they must each act in good faith and with the care of an ordinarily prudent person in a similar position. Under Probate Code §18503(e)(2), UPMIFA provides a "total portfolio" as opposed to "individual asset" approach to the making of an individual investment. According to UPMIFA, "Management and investment decisions about an individual asset must be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution." This language indicates that under UPMIFA a small percentage of "high-risk" or "alternative" investments might be appropriate in a particular portfolio. Directors of California nonprofit public benefit corporations may find some tension between UPMIFA's total portfolio approach and the more conservatively stated standard in CCC §5240.

UPMIFA generally does not apply to mutual benefit corporations. As indicated above, the investment of assets held by a nonprofit mutual benefit corporation is governed by the general standards of care applicable to the performance of duties by a director, which are found at CCC §7231.

C. Internal Revenue Code §4944 (private foundations)

IRC §4944 imposes excise taxes on private foundations and on their managers for making improper investments that jeopardize their ability to carry out the foundations' charitable purposes.

4. Considerations and Procedures for Implementation of the Policy

Prior to adoption, it should be determined where the policy should be placed in the organization's documentation. Alternatives may include, for example, in the bylaws, in a board policies and procedures manual or as a stand-alone item. The manner in which the policy must or will be adopted – such as by the board of directors (recommended), by the members, or both – should also be determined. In every case, the policy must be disseminated to all affected constituencies such as, for example, employees, directors, members and volunteers. Finally, the client should be cautioned that the organization should only adopt policies which it is confident it can follow. It could well be worse to adopt a policy which is not followed than to have no policy at all.

5. Sample Policy¹

INVESTMENT POLICY OF [NAME] (the “Organization”)

PURPOSE OF INVESTMENT POLICY

The purpose of this Investment Policy is to provide a clear statement of the Organization's investment objective, to define the responsibilities of the Board of Directors and any other parties involved in managing the Organization's investments, and to identify or provide target asset allocations, permissible investments and diversification requirements.

INVESTMENT OBJECTIVE

The overall investment objective of the Organization is to maximize the return on invested assets while minimizing risk and expenses. This is done through prudent investing and planning, as well as through the maintenance of a diversified portfolio.

GENERAL PROVISIONS

- All transactions shall be for the sole benefit of the Organization.
- The Directors shall consider updating the Organization's investment policy on an annual basis.

¹ Thank you to Tamkin Foundation, Inc. for permission to incorporate language from the Foundation's Investment Policy Statement into this Sample Policy.

- The Directors shall conduct an annual review of the Organization's investment assets to verify the existence and marketability of the underlying assets or satisfy themselves that such a review has been conducted in connection with an independent audit (if any) of the Organization's financial statements.
- Any investment that is not expressly permitted under this Policy must be formally reviewed and approved by the Directors.
- The Directors will endeavor to operate the Organization's investment program in compliance with all applicable state, federal and local laws and regulations concerning management of investment assets [including IRC §4944 if the Organization is classified as a private foundation for federal tax purposes.]
- Investments shall be diversified with a view to minimizing risk.

DELEGATION OF RESPONSIBILITY; RELIANCE ON EXPERTS AND ADVISORS

- The Board of Directors has ultimate responsibility for the investment and management of the Organization's investment assets.
- The Board may delegate authority over the Organization's investments to a properly formed and constituted Investment Committee, being a Board Committee comprised only of directors.
- The Board or Board Committee may hire outside experts as investment consultants or investment managers.
- The Board may also establish an advisory committee (which may include non-directors) to provide investment advice to the Board or to the Board Committee. Advisory committees have no authority to act for the Board, but may monitor compliance with the investment policy, recommend changes, and assist the Board or Board Committee in selecting and retaining Investment Managers to execute this Investment Policy.

RESPONSIBILITIES OF THE BOARD, OR IF AUTHORITY IS DELEGATED, THE INVESTMENT COMMITTEE

- The Board, or if authority is delegated, the Investment Committee, is charged with the responsibility of managing the investment assets of the Organization. The specific responsibilities of the Board or the Investment Committee, as applicable, include:

1. Communicating the Organization's financial needs to the Investment Managers on a timely basis.
2. Determining the Organization's risk tolerance and investment horizon and communicating these to the appropriate parties.
3. Establishing reasonable and consistent investment objectives, policy guidelines and allocations which will direct the investment of the assets, to be reviewed by the Board on an annual basis.
4. Prudently and diligently selecting one or more qualified investment professionals, including investment managers(s), investment consultant(s), and custodian(s).
5. Regularly evaluating the performance of investment manager(s) to assure adherence to policy guidelines and to monitor investment objective progress.
6. Developing and enacting proper control procedures; e.g., replacing investment manager(s) due to a fundamental change in the investment management process, or for failure to comply with established guidelines.

RESPONSIBILITIES OF INVESTMENT MANAGERS

- Each investment manager will invest assets placed in his, her or its care in accordance with this investment policy.
- Each investment manager must acknowledge in writing acceptance of responsibility as a fiduciary.
- Each investment manager will have full discretion in making all investment decisions for the assets placed under his, her or its care and management, while operating within all policies, guidelines, constraints, and philosophies outlined in this Investment Policy. Specific responsibilities of investment manager(s) include:
 1. Discretionary investment management, including decisions to buy, sell, or hold individual securities, and to alter allocation within the guidelines established in this statement.
 2. Reporting, on a timely basis, monthly investment performance results.
 3. Communicating any major changes in the economic outlook, investment strategy, or any other factors that affect implementation of investment process.

4. Informing the Board, or if authority is delegated, the Investment Committee, regarding any changes in portfolio management personnel, ownership structure, investment philosophy, etc.
5. Voting proxies, if requested by the Board, or if authority is delegated, the Investment Committee, on behalf of the Organization.
6. Administering the Organization's investments at reasonable cost, balanced with avoiding a compromise of quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs chargeable to the Organization.

GENERAL INVESTMENT GUIDELINES

- A copy of this Investment Policy shall be provided to all Investment Managers.
- The Organization is a tax-exempt organization as described in section 501(c)(3) [or section 501(c)(6), etc., as applicable] of the Internal Revenue Code. This tax-exempt status should be taken into consideration when making Organization investments.
- The Organization is expected to operate in perpetuity; therefore, a 10 year investment horizon shall be employed. Interim fluctuations should be viewed with appropriate perspective. [The foregoing may or may not be included, as applicable, depending upon the Organization's liquidity requirements.]
- A cash account shall be maintained with a zero to very low risk tolerance to keep cash available for grant distributions, tax obligations and other anticipated expenses.
- Transactions shall be executed at reasonable cost, taking into consideration prevailing market conditions and services and research provided by the executing broker.
- Permitted investments include: [Provide a list of permitted investments here] Cash and cash equivalents, marketable securities including equities and fixed income securities, _____, _____.

[Note: The Organization should determine its own credit quality standards and prohibited transactions, based on its investment objectives and risk tolerance. The following two bullet items represent samples only and are not recommended for use without review by investment counsel.]

- No fixed income security shall have an equivalent credit quality below investment grade at the time of purchase, defined as:

1. BBB by Standard & Poors for straight bonds and convertibles
 2. Baa3 by Moody's Investor Service for straight bonds and convertibles
 3. A1 by Standard & Poors for short term securities
 4. P1 by Moody's Investor Service for short-term securities
 5. AAA for money market accounts
- The following transactions are prohibited: Purchase of non-negotiable securities, derivatives, high risk or junk bonds, private placements, precious metals, commodities, short sales, any margin transactions, straddles, warrants, options, life insurance contracts, leverage or letter stock.

DIVERSIFICATION

- The Organization will maintain a reasonable diversification of investment assets between asset classes and investment categories at all times.
- Investments in the equity securities of any one company shall not exceed [5%] of the portfolio nor shall the total securities position (debt and equity) in any one company exceed [10%] of the portfolio.
- Reasonable sector allocations and diversification shall be maintained. No more than [25%] of the entire portfolio may be invested in the securities of any one sector.
- Investments within the investment portfolio should be readily marketable.
- The investment portfolio should not be a blind pool; each investment must be available for review.

ASSET ALLOCATION

- The asset allocation policy shall be predicated on the following factors:
 1. Historical performance of capital markets adjusted for the perception of the future short and long-term capital market performance.
 2. The correlation of returns among the relevant asset classes.
 3. The perception of future economic conditions, including inflation and interest rate assumptions.

4. Liquidity requirements for the projected grants and other charitable expenditures.
5. The relationship between the current and projected assets of the Organization and projected liabilities.

ALLOCATION RANGE

[Note: The Organization should determine its own allocations, based on its investment objectives and cash needs. The following allocation schedule is only a sample and is not recommended for use without review by investment counsel.]

Asset Allocation Range	Target	Upper limit
Cash & Equivalents	5%	0 – 15%
Fixed Income	40%	20 – 60%
Equities: Domestic Large Cap	25%	20 – 40%
Equities: Domestic Small/Mid Cap	20%	10 – 25%
Equities: International	10%	5 –15%

- Rebalancing shall be done on a semi-annual basis or more frequently if deemed necessary.

PERFORMANCE

- Performance objectives are to be met on a net of fees basis. The investment performance of each asset allocation class will be measured on two levels: against inflation objectives for the total Organization and against index objectives for individual portfolio components. Investment performance shall be measured no less than quarterly on a net of fees basis. Performance shall be evaluated on a three to five year basis to allow for market fluctuations and volatility.
