

Planned Giving Council
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Investment Fiduciary Duties and Developing Trends

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Uniform Prudent Management of Institutional Funds Act (UPMIFA)

Primary Fiduciary Duties (Section 112.11, Wis. Statutes)

- Exercise Care/Prudence
 - Use same care as similar person under similar circumstances
 - Diversify-Unless purposes of fund are better served otherwise
 - Consider general economic conditions and charitable purposes
- Investigate and verify facts relevant to fund management
- Incur only reasonable costs
- Maintain loyalty and obedience
 - Avoid misuse of funds, self-dealing and misconduct
 - Fulfill mission and tax-exempt social purposes
 - Balance current and future needs

Duties Specific to Charities

UPMIFA Drafting Committee's Legislative Intent:

- Investment strategies must be appropriate for the fund and charity
- Managers must consider charitable purposes of the institution

"UPMIFA requires a charity and those who manage and invest its funds to . . . consider the charitable purposes of the institution and the purposes of the institutional fund for which decisions are being made. These factors are specific to charitable organizations." [Prefatory Note and Comment to UPMIFA s. 3]

Mission and Public Purpose

Tax exempt entities have unique obligations

"A charitable organization must serve a valid public purpose and must confer a public benefit. According to the Supreme Court, all taxpayers are affected by a governmental grant of tax exemption. . . . Charitable exemptions are justified on the basis that the exempt entity confers a public benefit." [Nonprofit Organizations: Law and Taxation]

"[The duty of obedience] requires the director of a not-for-profit corporation to be faithful to the purposes and goals of the organization, since unlike business corporations, whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives." [Manhattan Eye, Ear and Throat Hospital v. Spitzer]

Fiduciary Practices are Evolving

- Economic, environmental and social circumstances change
 - Climate change; population growth; investor short-termism; pollution; rising income inequality; Great Recession; etc.
- Investment knowledge and theories evolve
 - Purchase of stock was once considered imprudent

"There are no universally accepted and enduring theories of financial markets or prescriptions for investment that can provide clear and specific guidance to trustees and courts."

[Restatement of Trusts, 3rd, §227, Comment (f)]

F.B. Heron Foundation Investment Policy

"For Heron, return is measured both in financial terms and by the degree to which any given use of capital leads to outcomes that are consistent with our philanthropic mission and public purpose. In this policy statement, "risk" refers to the probability of non-performance on both social and financial dimensions ..."

"We believe that the fiduciary responsibilities of all philanthropic institutions mean that we have both a duty of obedience to our specific mission, and a duty of obedience to a larger public purpose. As a practical matter, we are obligated to examine our portfolio on an ongoing basis to identify holdings that may unintentionally do harm to our missions or to the broader shared interests of society."

Steps Toward ESG Integration

- **Define** charitable mission and measures of success
- **Evaluate** how investments and other activities might affect mission and public benefit goals
- **Select** advisors who can support your goals
- **Invest** with managers that deliver on both financial and charitable goals
- **Align** investment policy and service provider contracts with mission and public benefit goals
- **Monitor** performance against both investment and mission goals

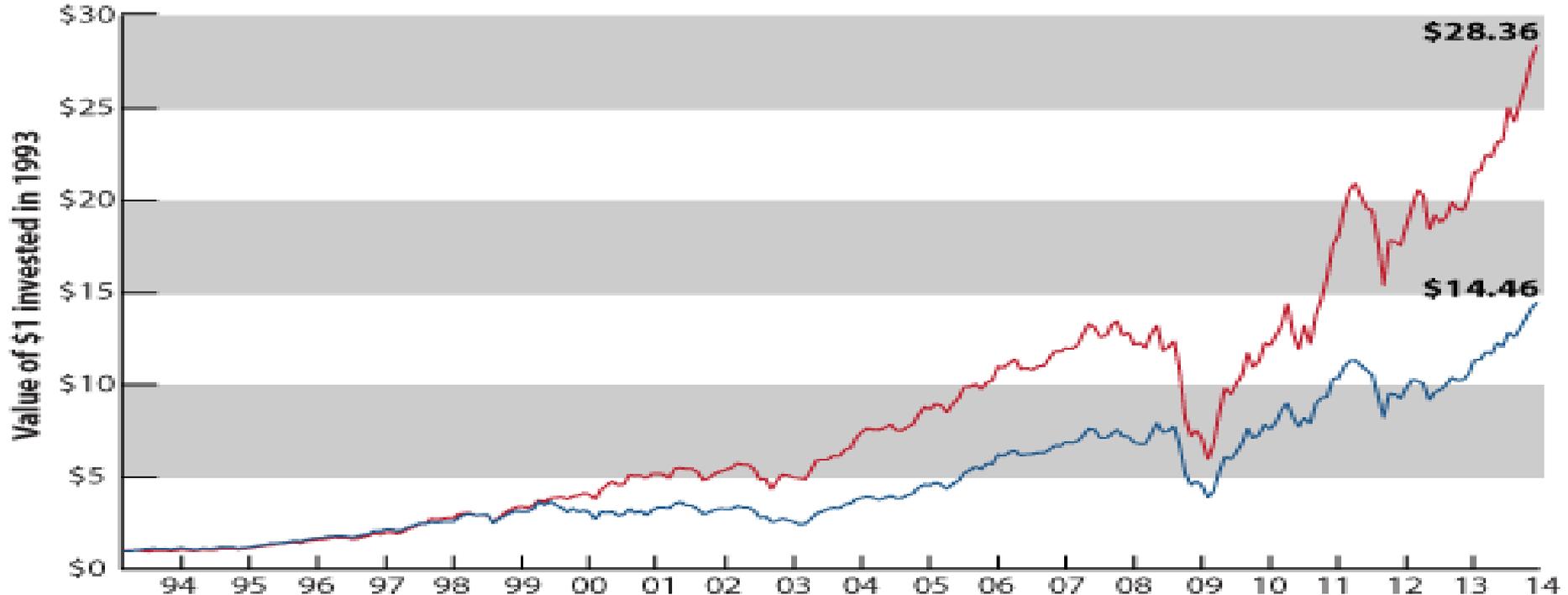
Developing Trends

- Evolution from ethical screening toward integrating sustainable investing methods
- Research on advantages of integrating ESG factors into investment and risk analysis
- Growing company use of sustainable practices as a competitive advantage
- Worldwide spread of investor stewardship codes
- Investor focus on duties of loyalty and obedience
- Creation of Sustainable Accounting Standards Board, Principles of Responsible Investment, Global Integrated Reporting Initiative, etc.

Harvard: Sustainability Study

--- High Sustainability Companies --- Low Sustainability Companies

Figure VI: Investment Performance



The figure shows the evolution of \$1 invested in a portfolio of firms with high performance on the material sustainability issues versus competitor firms with low performance on material sustainability issues. Materiality of sustainability issues is industry-specific and it is defined by the Sustainability Accounting Standards Board. Source: Mo Khan, George Serafeim and Aaron Yoon. Corporate Sustainability: First Evidence on Materiality. HBS working paper, 2014.

Deutsche Bank 2012 Research Survey

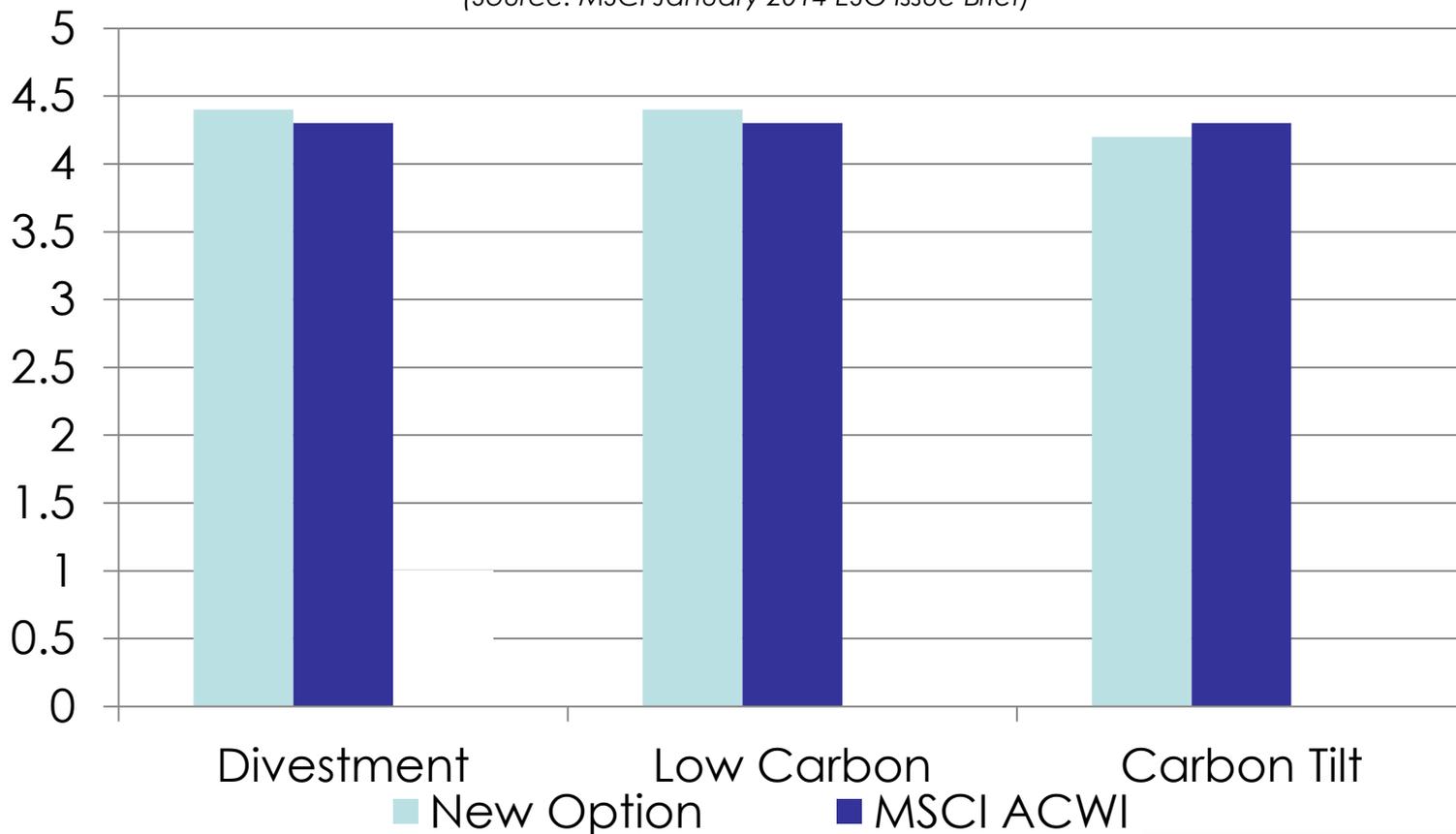
Comprehensive survey of 162 research studies:

- All found that companies with high ESG ratings had a lower cost of capital
 - Recognized as lower risk investments
- Market outperformance for companies with high ESG ratings was found in 89% of studies
 - Across three- to ten-year performance periods
- Socially responsible investment funds have generally performed similar to other funds

MSCI Carbon Risk Reduction Options

Annualized Returns: January 1, 2007 to December 31, 2013

(Source: MSCI January 2014 ESG Issue Brief)



Heron Foundation Performance Benchmarks

<u>Asset Class</u>	<u>Proposed Primary Benchmark(s)</u>	<u>Secondary ESG Benchmark(s)</u>
US Equity	Russell 3000 Index	MSCI USA IMI ESG
Non-US Developed Equity	MSCI EAFE Index	MSCI EAFE ESG
Emerging Market Equity	MSCI EM Index	MSCI EM ESG
Fixed Income	Blend of Barclays MBS, Taxable Municipal and Non-Investment Grade Municipal Bonds	Barclays Aggregate Bond Index: MSCI US Aggregate Sustainability Index

UN Principles for Responsible Investment

\$45 Trillion Under Management

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

Disparity Between CEOs and Investors

"Fully 78% [of CEOs] see sustainability primarily as an opportunity for growth and innovation, and 80% see it as a route to competitive advantage in their industry. . . . 93% believe companies should, while 73% do so: a "performance gap" of 20 percentage points." [Accenture 2013 CEO Study on Sustainability: Global survey of 1,000+ company executives]

". . . 52% of executives report that investor interest is an incentive for them to invest in sustainability, and 69% expect investor interest to be an increasingly important factor in building sustainability issues into core business. As one senior business leader put it, "We still find it challenging to convey to mainstream investors why and how sustainability can drive value creation, but they're starting to appreciate the risks of working in an unsustainable system." [Accenture 2013 CEO Study on Sustainability: Global survey of 1,000+ company executives]

Investor Stewardship

- Stewardship codes adopted in Europe, Japan, Canada, Australia, Britain, South Africa, et al.
 - Encourages investor engagement with companies
 - Urges aligned use of proxy voting rights
- Applicable to both active and passive portfolios

"Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole." [UK Stewardship Code]

Proxy Voting Approaches

"Often, proposals may address concerns with which the Board philosophically agrees, but absent a compelling economic impact on shareholder value (e.g., proposals to require expensing of stock options), the funds will typically abstain from voting on these proposals." [Vanguard's Proxy Voting Guidelines]

Versus

"TIAA-CREF believes that companies and boards should exercise diligence in their consideration of environmental and social issues, analyze the strategic and economic questions they raise and disclose their environmental and social policies and practices. . . . We believe that investors should encourage a long-term perspective regarding sustainability and social responsibility, which may impact the long-term performance of both individual companies and the market as a whole." [TIAA-CREF Policy Statement on Corporate Governance]

Sample Proxy Voting Issues

- Assess and report on Human Trafficking/Forced Labor in company's Supply Chain
- Adopt policy on Board candidate diversity
- Disclose company political campaign contributions
- Report on greenhouse gas emissions and mitigation plans
- Advisory vote on executive compensation practices
- Report on plans to reduce water, environmental and health impacts of company mining operations
- Adopt policy on tax avoidance practices
- Evaluate business financial risks from childhood obesity
- Reject Board candidates who fostered safety lapse disaster
- Review executive pay and minimum wage practices

Sustainability Accounting Standards

"The purpose of sustainability accounting is to evaluate the environmental, social and governance performance of companies through an account of their management of various forms of non-financial capital associated with sustainability – environmental, human and social – and corporate governance issues, which they rely upon for sustained, long-term value creation." [Sustainability Accounting Standards Board Conceptual Framework]

Global Trend in Charities' Fiduciary Duty?

UK Government Advisory Report (2014)

- Charity trustees in the UK are not required to maximize financial returns
 - May consider financial return and furtherance of charitable purpose
- UK charities are encouraged to use a total Impact approach which considers social impact of their grants, investments and supply chain

"A Total Impact approach is when a foundation considers the social impact of all its activity, including its investments and supply chains. [UK Cabinet Working Paper, December 2014]"

Trend Indicators?

"To do well in today's business environment, you increasingly have to measure, understand and proactively manage the value you create, or reduce, for society and the environment as well as for shareholders." [KPMG, A New Vision of Value, 2014]

"Over time, ESG factors will be considered in every part of the portfolio," [Harvard Management Company President, 2014]

"A Gates [Foundation] divestment [of McDonalds] decision in 2014 sends a signal to the activist and philanthropic communities. Other foundations may watch Gates and realize that shedding noxious investments that contradict foundation values is important and necessary." [Nonprofit Quarterly, 2-18-2015]

Questions?

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