TOPSY-TURVY TIMES CALL FOR KEEPING FINANCES SECURE

By Robert Seaman

In most states, the Uniform Prudent Investor Act, or similar legislation, obligates nonprofit officers and directors to invest their organizations' funds in a reasonably prudent manner. Failure to do so properly can expose individual officers and directors to personal liability. Not sure what qualifies as "prudent" or how to avoid such liability? The following tips will help guide you and your board to oversee your association's investments with confidence:

Start with an investment policy statement (IPS). An IPS serves as a portfolio management blueprint and a means of fostering communication between a group's board, investment committee, chief executive and investment managers and consultants. The IPS should identify your organization's goals, needs, risk tolerance and time horizon as well as establish its portfolio composition, asset allocation targets and relative performance objectives for invested assets.

Separate short-term and long-term funds. The goal of many nonprofit organizations is to "live forever"—that is, to provide services in perpetuity. In order to generate sufficient growth to both withstand a long life span and keep up with inflation, an association's long-term funds should be invested in a broad mix of asset classes, and investment costs should be kept to a minimum. However, the need for immediate or frequent withdrawals from the account would dictate appropriate investment options for short-term funds. Generally, short-term assets are best invested primarily in short-duration government bonds or cash equivalents, such as money market funds and CDs.

Keep ahead of inflation. Rising operating costs will erode the purchasing power of your association's long-term assets over time unless they are invested to hedge inflation. Historically, stock market returns have exceeded the rate of inflation over the long term. Nonprofit organizations with a long-term horizon should invest at least 60 percent of their reserve funds in a mix of equities diversified across growth and value; large, medium and small companies; indexed and managed strategies; and domestic and foreign companies. Additionally, including some exposure to Treasury Inflation Protected Securities (TIPS) in the fixed-income portion of your group's portfolio will help maintain purchasing power. TIPS are specially designed government bonds that return interest income and capital gains (or losses) quarterly as principal is adjusted to account for inflation.

Diversify globally. International holdings can broaden investment opportunities by providing exposure to dynamic overseas companies and economies that may be growing faster than their U.S. counterparts. Adding international exposure to long-term portfolios also aids diversification, reduces risk and helps offset the effects of domestic inflation and a weak dollar environment.

Minimize investment costs. It's your duty as a chief executive to stay aware of all investment expenses, including hidden charges such as administrative fees, start-up fees and termination fees. Avoid commissions, sales loads and other transaction and custodial fees whenever possible. A few general rules: If your association's portfolio includes mutual funds, choose funds with low expense ratios, such as institutional class shares; avoid funds that charge 12b-1 fees (a type of sales charge); and include a few index funds.

Stay on course. Follow the asset allocation targets established in your association's IPS, regardless of market fluctuations; these targets are important, not only to keep your investment adviser on track, but also to keep your board and investment committee focused during periods of extreme market volatility. Rebalance your group's long-term portfolio at least once every 12 to 18 months—or more often as needs and circumstances dictate—to return allocations to their target levels.

Enlist the services of a qualified adviser. Keeping abreast of financial developments and investment opportunities is a full-time job, even for financial professionals. Retaining a seasoned investment adviser or portfolio manager who can provide the necessary services is generally the best course of action, not only to protect the association's paid staff and board members from personal liability but to ensure a long and healthy financial future for your organization. ■

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