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ENTERPRISE
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Money

Liability for foundation managers may become issue

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If you serve as an officer or as a director of an organization that has a foundation, endowment or retirement plan, you could be sitting on a legal time bomb.

The law imposes fiduciary obligations on many individuals and organizations.

Examples of fiduciaries include: charitable organizations, educational institutions, officers and directors of both nonprofit and for-profit organizations.

The courts hold a fiduciary to a higher degree of care and responsibility in properly conducting his or her duties. To help avoid liability, a fiduciary must have a clear understanding of his or her duties and comply with them.

Compliance sounds simple, right? As a fiduciary, you will likely be held to a professional standard, not the "Joe Public" standard. This is the point that causes litigators to bare their fangs and start salivating. For investment pools, fiduciaries must develop and implement "best practices" for the selection, retention and monitoring of investment advisers and managers.

Not concerned because you have outsourced all of "that stuff" to your local stockbroker, bank, money manager, or mutual fund company?

Oops! All of these organizations have business structures which have conflicts of interest with your beneficiaries.

These conflicts of interest are likely to increase your potential liability.

Fiduciary audits

To help protect yourself, you need to cover the "basics" with routine fiduciary audits.

You can build your own audit program or hire an independent investment consulting firm for your reviews.

If you hire an outside firm, only use an independent investment consulting firm. An independent firm, or fee-only firm, is one that does not receive any compensation from the sale of financial products.

Fee-only firms, because of their compensation structure, are normally unencumbered by conflicts of interest. Outsourcing to a fee-only firm may reduce your potential liability.

Your fiduciary audit should use your current Investment Policy Statement (IPS) as a powerful first line of defense. Without an IPS you face going into battle with a cardboard shield.

At a minimum, your IPS should document investment goals, how performance is benchmarked, how risk is measured, diversification, asset allocation targets and rebalancing and have an investment manager retention/termination policy.

The manager retention/termination policy should be flexible enough to allow patience with quality managers during their inevitable rough periods, but also stringent enough to release mangers who are failing to meet objectives.

After reviewing your IPS, you should conduct a cost/benefit analysis. Total expenses are important, but many times the focus of a successful plaintiff's case is demonstrating a lack of services relative to fees paid.

Going "cheap" can get you into hot water the same way being lavish could. It is not what you paid, but what value was received.

Understanding what your total investment program costs are can be tricky to determine. In addition to visible fees, many times fees are buried into the value or cost basis of the securities.

If you use separate accounts, you need to examine directed trading and security "markup" costs. For mutual funds you need to examine the share classes used, underlying operating expense ratios and referral fees.

Retirement plans need to analyze the portion of costs that are being borne by participants versus the trustees. For some employers, the after-tax cost of bearing a portion of plan expenses may be more advantageous than trying to load all expenses on the plan participants.

Many times this cost sharing advantage is found in retirement plans where the owners also hold dominant positions in the retirement plan. Examples of this advantage can be found in entrepreneurial and professional service firms such as medical, legal and engineering firms.

A cost/benefit analysis will be subjective, but if properly done, fiduciaries should have a greater understanding if they are "in left field or in the ballpark."

Diligence prevents problems

Being diligent with your fiduciary obligations may prevent future fiduciary liability issues. More important, the beneficiaries you represent may experience benefits such as better portfolio performance, lower risks, and improved cost/benefits.

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