fig. 8

Roadblocks and Bumps in the Road

Family foundation boards may experience challenging situations while overseeing the investments of the foundation, including:

- **Family members as paid investment managers:** Prudent boards will be wary of arrangements in which a family member is paid to manage the investments of the foundation. Reviewing the performance of a family member is not always easy, and trying to remove a family member as manager can be even more difficult. Combined with the need to ensure that the compensation arrangement is within the self-dealing rules, this practice may not be one that you will want to tangle with.

- **Liquidity considerations:** Foundations have annual payout responsibilities and, in most cases, ongoing operations costs. As such, you need to ensure that an adequate amount is kept in cash or some other easily converted investment type for annual (or more frequent) grant payments and other expenses.

- **Over-management of the endowment:** Just as individual investors do, foundation boards have a tendency to overmanage their investments — buying and selling new funds, changing advisors, and even changing investment styles regularly. Because of the high cost of these transactions, and because foundations usually invest for the very long-term, it is important that the board resist these temptations and, whenever possible, stick to a predetermined strategy through the inevitable ups and downs of the markets.

- **Time lags between meetings:** At the same time, cases arise where individual stocks or classes of stocks experience rapid shifts in price, and action may be needed either to rebalance the portfolio or take other more radical action. Because many foundation boards do not meet more than one or two times per year, it is important to have some system in place to account for these situations — this could be as simple as giving one or more of the trustees discretion to make these decisions.

- **Disparity of interests and abilities:** All board members — regardless of their investment background and experience — need to understand the strategy and decisions made with regard to the foundation's investments. This can be accomplished in a number of ways (see above for specific ideas).

- **Excise tax on net investment income:** Private foundation endowments are subject to an excise tax of at least 1 percent, and up to 2 percent, of investment returns each year. These taxes are paid on realized net gains, and a portfolio with constant turnover will likely trigger the maximum tax payments. Although it may not be possible to avoid the maximum tax in any given year, families may wish to consider working with advisors who have sensitivity in managing the portfolio in a tax-efficient manner.