CHAPTER VIII

SELECTING *and* WORKING WITH INVESTMENT ADVISORS

By Sally S. Kleberg

Providing sound advice on and effective management of a family foundation's assets constitutes one of the most important responsibilities of the trustees. Investment advisors and managers may be chosen from among family members, trusted associates, or outside professionals. Trustees should choose their advisors and managers with care, provide them with appropriate leadership and support, and change course as circumstances require. The selection process involves finding qualified candidates, checking their backgrounds, interviewing them in depth, establishing performance measures, and agreeing on fees. Trustees should also establish a sound process for working with their investment advisors and managers, including a periodic performance reporting schedule.

FAMILY FUND TRUSTEES TAKE ASSET management very seriously. They know that the capacity of a family fund or foundation to carry out its philanthropic mission depends on successful asset management. Success rests on time-honored principles of discipline and professionalism in investing and monitoring portfolio performance.

Trustees may choose to perform investment management tasks themselves, find other members of the family to do so, or seek outside professional advice. They may entrust asset management to another entity, such as a bank or a community foundation. In every case, trustees remain responsible for protecting the assets and for investing them prudently. (See Chapter VI, "Understanding Trustee Responsibilities and Duties.")

DETERMINING APPROPRIATE LEVEL OF FAMILY INVOLVEMENT

Critical to the success of choosing and working with investment advisors and managers is involvement of at least one responsible, able family member or experienced trustee. The duty to identify this person falls to the board or directing individual who is entrusted with oversight of the philanthropic mission. If members of the board do not have investment knowledge or expertise, it is particularly important that they become educated on these issues and cooperate with those who have this expertise and knowledge. In cases studied for this chapter, successful programs involved one responsible family member who directed the flow of management and coordination with the staff, treasurer, and finally the full board. The staff person and the treasurer might be a family member, an employee of the family office or family business, or an outside hire.

Successful programs also follow clearly defined, businesslike procedures for activities such as regularly scheduled quarterly meetings to review investment performance. Finally, as in other activities related to the stewardship of the family philanthropy, professionalism is paramount for investment management activities.

THE FAMILY MEMBER *is* MORE LIKELY TO UNDERSTAND THE CULTURE OF *the* FAMILY AND THE INTENT OF THE PHILANTHROPIC MISSION *as* FOUNDATIONS *for* A SUCCESSFUL INVESTMENT STRATEGY.

The role of families in investment management inevitably leads to consideration of family members as advisors and managers. Many families of wealth have a board member who is an experienced investment professional, a newly minted graduate of a first-rate business school, or a bright young person who has just married into the family and has a top job with a financial consulting firm or brokerage. Trustees of many family funds turn to their own board or other family members as the first source of expertise for investment advice and management.

Reasons for using family members are several. The relationship with other trustees can be open, easy, trusting, and confidential. The family member may be willing to serve without compensation, greatly reducing the cost of administration. The family member can be expected to pay close attention to the account. The family member is more likely to understand the culture of the family and the intent of the philanthropic mission as foundations for a successful investment strategy.

There are also reasons for not using family members. The family member may not be experienced or talented enough to handle the portfolio. He or she may not have the energy level or work ethic needed. A lack of objectivity is more likely in someone so close to the foundation's mission. And how does the board handle dicey situations, where the advice or management is subpar and a decision is looming to seek a new advisor or manager?

In any event, families should think carefully and realistically about the commitment and expertise of family members being considered to manage the foundation's assets. Trustees should try to lead the family toward having a sense of group stake in the success of the foundation; yet seldom are all members of a family uninvolved at least at some level in the investment decisions about family assets that form its capital base. Using a family member as a funds manager, even one in the profession, may taint the independence of the operation. Arms-length is often the best policy and is, in fact, to some extent required by federal laws. (See Chapter IV, "Avoiding Conflicts of Interest and Self-Dealing.")

Trustees must decide this issue for themselves, and the unique nature of each family dictates that every board find its own solution. Many cases exist where trustees have asked one of their own to handle investments and the portfolio has done very well indeed.

Balancing Goals, Needs, and Resources

Selecting the investment team begins with the investment strategy developed by the board. The broad contours of a family foundation's investment policy are actually sketched by the donor-founder. The articles of incorporation (or deed of trust) will often establish the life duration of the philanthropy and its mission, and the donor's gift will determine both the size and nature (that is, whether cash, real estate, or other asset) of the endowment.

Trustees must work with these realities. They must assess the board's program goals, and calculate how much revenue the foundation needs each year to reach those goals. They should be aware of the current rate of real inflation, and how much money the asset base must produce to maintain the purchasing power of the endowment. It is crucial that an investment strategy has been or is developed that fits both the goals and the available resources of the family prior to beginning the process of selecting the investment managers for the foundation's endowment. (See Chapter VII, "Developing an Investment Strategy.")

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Reviewing the Strength of the Asset Base

How much can the board expect of the endowment? The best advisors in the world, who are experts in understanding business cycles and the globalization of the U.S. economy, still cannot predict the real interest rate two years from now. The best investment managers in the world cannot time their puts and calls with maximum effectiveness every time. In the short term, there is a lot of luck involved. In the longer term, sound strategy pays off. But it can only pay off in terms of what kind and level of assets are handed to the advisors and managers to put that strategy to work.

Trustees would also do well to review the history of their portfolio's performance: How successful has the board been, for example, in growing the asset base while maintaining the grantmaking program? Such a review may be especially pertinent when the founding donor steps down or dies, when board leadership changes, or when members of the next generation first join the board or assume majority control. As a matter of sound investment policy, annual review and rebalancing of the portfolio mix are commonplace and are recommended, just as they would be in one's personal asset management practice.

A board decision to adopt a new investment strategy and select professional advisors and managers (whether family members or not) can signal an exciting new era in building the philanthropic capacity of the family foundation.

Understanding Options of Sources and Experts

Trustees are fortunate to have available an array of options for sources of investment advice and management expertise. Some donors actually use donor-advised funds in commercial institutions, public foundations, or community foundations partly to place asset management in expert hands; family foundations can also turn over asset management to a community foundation. Some boards entrust asset management to banks or their trust departments, mutual fund managers, financial planners, brokerages, insurance companies, investment advisory firms, or funds established just for the purpose of serving philanthropies, such as The Investment Fund for Foundations (TIFF). Foundations organized in the trust form typically employ trust departments of banks for their investment program.

Many smaller family funds, with assets in the range up to $20 million, find it cost effective to use family members or personal financial advisors to select investments and monitor portfolio performance, perhaps with some initial assistance from contracted outside professionals. Many smaller family foundations operate their entire portfolio management activities out of the family office or family business, taking

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scrupulous care to separate philanthropic and other business. (See pages 108-109 for the legal rules on using a family office or business for foundation work.) The KT Foundation is an example. Two trustees, who are second cousins and represent the more than 100 family members, manage the portfolio with advice from a local bank. The two trustees receive no fee; the foundation pays the bank for processing market transactions and for maintaining books, and it pays an outside auditor, whose oversight helps minimize family concerns in the family gift committee over what it viewed as "excessive" overhead. Operating costs average $25,000, annual grant distributions $350,000, and income $450,000. Asset value has risen from $2 million in 1977 to $7 million in 1999.

The larger the foundation, the more sophisticated are the investment management needs and the greater the likelihood for relying on outside portfolio managers. Large foundations retain consultants to screen and monitor the performance of the professionals who actually manage the investments.

Sources of information on these options should be widely available: trustees can turn to their attorneys, accountants, financial planners, bankers, and other professional advisors. Family members or friends in the business are also good sources. The most reliable sources may be other investors, investment firms, consultants, and advisors to investors. (Be sure to ask professional advisors whether and how the referral source is compensated for making the referral; failure to disclose compensation for a referral is a serious breach of ethics.) Trustees should always perform due diligence on their own, of course, and never take someone else's word alone.

Identifying a Family Foundation's Needs

Trustees may find it useful to identify the talents they need. The following descriptions are adapted from a useful source, *Engaging Investment Advisors,*[31] by Kathryn McCarthy, president of the Ochs-Sulzberger Family Office in New York City:

- *General Advisor:* A family member, lawyer, accountant, consultant, or other person who can offer general advice;
- *Consultant:* A person who can help trustees to establish a decisionmaking structure for investment management, develop a strategic plan, and find investment advisors and managers;
- *Manager:* A trustee, foundation employee, or outside manager who selects actual investments, buys and sells stocks and bonds, handles administrative aspects of investments, and reports to the investment committee; and
- *Custodian:* A bank or trust company that holds assets, collects income, and reports periodically on investment activities.
- *Investment Committee:* Boards of many family foundations, even small ones, assign oversight duties to an investment committee, which typically reports to the full board quarterly.

Finding Candidates for Investment Advisor and Manager

Analyzing the Context: How the Family Operates

Trustees should be realistic about defining the context in which major decisions about investment strategy, growth goals, and so on, will be made. It is helpful to list family characteristics.

For example: Who leads the family, and in what style—democratic, authoritarian, anarchic? How does the family debate issues—respectfully and rationally, or contentiously? Who are the solid supporters and who are the faultfinders? What is the level of financial sophistication? Which issues pull the family together, and which drive it apart?

Trustees can then list in rank order the three dominant family characteristics. They can follow the same process in analyzing the dominant characteristics of the family fund and family office (if there is one), asking such questions as: What resources—human, technological, etc.—are available? How are decisions made? What is the level of professionalism? What standards do people follow? What are the style and techniques of communication—easy and open, or formal and controlled? How are misunderstandings dealt with? What is the stress level?

Trustees should now be armed with a cool and realistic sense of the context in which decisions will be made about two of the most emotional of issues in any family—money and control.

Examining Styles of Leadership and Supervision

Investment advisors and managers are usually not employees of the family foundation, even if they are family members, but they report to the investment committee. (In very large foundations, advisors and managers usually report to a professional financial officer who in turn reports to the investment committee.) How will the trustees deal with the investment team?

To answer this question, trustees can usefully examine their own personalities and styles of operation. Which of them are conceptualizers and which are organizers and implementers? How do they go about governing and managing—by focussing on process or on project? How do they send and receive information—preferably in person or by telephone, e-mail, or in writing? How often would the trustees meet and talk with a professional advisor or manager, even those who are family members? What makes individual trustees angry, and how do they deal with their anger?

Trustees can use this analysis to structure a wholesome and effective supervisory relationship with the investment advisor and the manager, whether family or outsider. As in any relationship, of course, good communication is bedrock.

Writing Position Requirements

Trustees should develop a written position description before the search begins. The document need not be more than a few paragraphs or bullets, but it should state educational, experience, and performance requirements (such as at least an MBA in finance, successful completion of the CFA exam, at least five years of experience in a similar position, meeting or exceeding objectives in similar positions, etc.). Trustees might also consider these attributes:

- *Vision:* How far into the future will the manager be expected to plan?
- *Discipline:* How firm must the manager be in maintaining discipline in asset allocation? To what extent will the manager be expected to set standards?
- *Reality-based:* How grounded in research and facts should the manager be?
- *People skills:* How much will the manager be expected to meet and work with the trustees, CEO, or staff? Which style is preferable: a firm and assertive leader personality or a flexible and accommodating team player personality?
- *Social skills:* How much will the manager be expected to interact with members of the family?
- *Persuasive skills:* How important is the ability to persuade trustees or family members?

The position requirements should also ask for references and for permission to call current or former clients.

Establishing Fees and Expenses of Investment Management

Trustees want to control fees for investment management and ensure that costs of management are well focused. Fees include compensation for management, incentives for meeting and exceeding goals, and the costs of trading: commissions, trading and execution costs, custodial charges, and administrative expenses.

The family foundation can absorb some costs by handling routine tasks. For example, one regional bank quoted the KT Foundation annual fees of $50,000 for partial and $100,000 for full service to manage its $7 million portfolio, which is invested in low-risk, income-generating positions (no equities). The same bank charges another foundation $40,000 to oversee a more diversified portfolio of $9.2 million aiming at a trustee-established objective of an annual 9 percent yield. The latter foundation holds down other bank management fees to $25,000 by using in-house capability: the board investment committee voluntarily monitors portfolio performance, manages the bank's recommendations on purchases, directs the rebalancing of the investment portfolio as needed, and with the staff secretary, administers the funds.

At the high end, investment consulting and management firms—with large staffs and immense databases—charge on the basis of work provided. One consultant frankly stated: "A foundation with less than $25 million to $30 million in investable assets would not be able to justify or afford our fees." This firm offers a beginning annual retainer of $25,000 to $30,000 for 24 hours of consulting time and access to data, site visits, and attendance at quarterly trustee meetings. The next level of effort includes a search for an investment manager, research on asset allocation, and an annual review of portfolio performance for a retainer of $70,000 per year.

The Lowe Foundation, a family foundation based in Houston, Texas, that began in 1988 with $9 million in capital and now has $24 million, pays a management fee of 0.05 percent of assets. More likely for a foundation would be the industry standard of 1 percent of an asset base of anywhere from $1 million to $5 million invested in equities. The fixed-income portion management fees are calculated differently as they do not require such active management. Trustees may be able to reduce transaction costs or obtain waivers of or lower consulting fees if they ask the investment manager to direct trades through the company that searched for, recruited, or referred the manager. The O&G Fund followed this route when it hired its first manager.

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Vetting Candidates

Trustees are familiar with methods of gathering information on candidates for various professional positions, but investment managers may present a new situation for them. Due diligence is critical because the client has an especially high need to know about the person to whom substantial sums of money will be entrusted. Although the candidates firm's first contact with the family fund may be through marketing representatives, trustees will naturally want to meet the principal who will be advising them and making important decisions on behalf of the fund. Managers will generally find time to meet with prospective clients, and their accessibility and willingness to talk about the fund's investment program may foretell how they will serve the trustees later.

Trustees can send the candidate firms a request for information (RFI) form used by investment consultants and advisors. The form seeks information on the firm's:

- Structure, staffing (including education and experience), and fee rates for various personnel;
- Research policy and practices, reporting procedures, and client service procedures;
- Style and investment philosophy; and
- Level of experience through market cycles and performance (correlated to indices, such as the Standard & Poor's 500, and other benchmarks) over time.

(For more guidance on this point, see Appendix E.)

ANY CLOUDINESS *in* ACTIVITIES CAN JEOPARDIZE A FOUNDATION'S STATUS *with* LEGAL AND TAXING AUTHORITIES.

Interviewing Candidates for Investment Managers

Armed with their lists of important characteristics of family dynamics, self-appraisal, and position requirements, the trustees can now schedule interviews with candidates. Trustees should set the ground rules. Interviews with promising candidates are best conducted in a professional setting, either at the family's chosen location or at the firm; a site visit to the firm is a must, in any event. Trustees can prepare themselves for the interview by reviewing key points about family context, reporting relationships, fees, position requirements, evaluation, and so on.

Philosophies of interviewing vary; many people believe that a friendly and professional but informal atmosphere brings out the most in the interviewee. Others prefer a nice-guy, bad-guy approach, with one person asking more confrontational questions. Chances are, the candidate has been interviewed many more times than the trustees have conducted interviews, so there's no reason to be shy. Still, an atmosphere of trust and respect is critical to establishing a good working relationship for the long haul.

Trustees should set an expected time limit for the interview—say, one hour—and respect it, or at least ask the candidate if extension is convenient. A sense of having and living by the rules is important from the outset. It can be useful to inform the interviewee that the first part of the interview will be devoted to learning more about the candidate, and the second half to a discussion of the position—including questions from the candidate. Trustees and candidates should discuss mutual expectations about performance: both parties should seek realistic outcomes.

Following the interview, trustees should make a written record of their reaction to each candidate.

Evaluating Candidates for Selection

Based on their interviews, trustees should be able to develop fairly complete files on each candidate firm. Standard practice calls for checking references after the interview, not before; the candidate's references are almost always favorably inclined toward the candidate, but they may be sources of more disinterested peers, clients, or coworkers. The best approach is to explain to references immediately that the trustees are interested in the candidate as an investment manager and want to know more about him or her. Trustees who are considering hiring a manager to work in-house can ask the candidate about sensitivities in talking with his or her current employer, clients, etc.

A letter or call to candidates not chosen is the appropriate thing to do, while a second interview or formal offer to retain the firm's services is appropriate for the successful candidate.

Three Winning Attributes for Successful Investment Managers

People who succeed as professionals or managers often exhibit one or more of the "Three Winning Attributes":

- *High self-knowledge and subject knowledge:* The person has a sense of his or her own limitations, and will try not to commit to perform something he or she cannot do, thereby wasting money and time;
- *Willingness to confront:* The person who cannot say no or confront others will be unable to present his or her own true opinion in stressful moments, and will be unable to establish or maintain standards and disciplines; and
- *Insight:* This person judges people and situations realistically and reasonably, matches people and responsibilities well, makes sound assessments, and is easy to oversee.

Monitoring and Managing the Program

Family fund trustees probably have several options in deciding where to locate a central oversight function. At the KT Foundation, for example, all activities of this extended family's philanthropy are kept separate from their family business operations and the personal family offices; the trustees follow this course to avoid conflicts of interest and to ensure compliance with legal requirements to retain the foundation's nonprofit status. The Lowe and O&G Foundations, on the other hand, operate from their respective family offices, but with clear procedures for separating foundation activities conducted there.

Keeping Foundation Work Separate

To maintain functional delineation, the family office manager, whether family member or not, should keep separate financial statements for the foundation including balance sheets, income and expense statements and records, and tax files, charging the foundation for overhead as if it were an outside client. Of course, if offered free of charge, the office should book it as a contribution and the foundation should, too, to keep the gesture at arms length. In return, the office provides all support services, meeting space (if required and available), trustee relations functions, and so on. The important thing is to maintain the integrity of the foundation. Any cloudiness in activities can jeopardize its status with legal and taxing authorities.

Once the location is settled, trustees can design their oversight program. The Lowe Foundation, for example, has adopted a strict monitoring policy developed over many years of experience with investment managers of family financial assets. A family member serves as president of Lowe and is one of two investment committee members. Her daughter was recently elected to the board and serves with five non-family trustees. Trustees approve all investment committee actions, including its rolling five-year plan, additions to manager portfolios, bond issue placements, and hiring and firing managers. The foundation board gives investment managers explicit directions on investments and then allows at least a year before even questioning a manager's positioning. In most cases, the board allows a three-year timeline before warning a manager of potential termination. When the foundation first retained managers, the investment committee (consisting at that time of the funding family member and the treasurer, who is a CPA and family office CFO) and the board used a five-year investment horizon for planning purposes.

At inception, when the foundation was smaller ($9 million), from its close working relationship with 15 to 20 managers, Lowe chose three to manage the equity portfolio and a premier investment firm to manage the bonds. After the board agrees with a recommendation for placement of capital amounts, the investment committee acts on the purchases. The O&G Fund retains a consulting firm to assist the board in monitoring the performance of its investment managers.

All three of these foundations—KT, Lowe, and O&G—expect their investment managers to provide quarterly performance reports. O&G also receives monthly manager statements. At the quarter, the staff treasurer of O&G prepares a one-page spreadsheet report for the full board.

How to Manage the Foundation's Assets—The Family Office Alternative

Donors and families who form family foundations are concerned about how to manage the foundation assets. Most family foundations are operated by the donor and his or her family, with perhaps a few non-family directors. If the family has a family office, many families prefer that their foundation run out of that office. From the family's viewpoint, operating a foundation through the family office is simply a matter of convenience—the procedures and operations of the family office transfer easily to the day-to-day management of family foundation activities. From the foundation's standpoint, co-location permits sharing of the space, staff, office equipment, and supplies of the family office. The arrangement occurs naturally because, in the early day of operation, most family foundations lack the staff and office space to operate independently.

In addition, managing a private foundation through a family office allows the foundation to benefit from the expertise of existing managers and consultants, including accountants who can keep books and prepare tax returns, legal counsel who are familiar with the family and its assets, and investment advisors who can help invest foundation assets.

Still, issues of self-dealing must be addressed before a private foundation co-locates with a family office. If the family office is a corporation and its stock is held by family members, the IRS will most certainly view it as a disqualified person with respect to the foundation, which may raise a problem. For instance, the foundation cannot sublease space from the family office, because a disqualified person cannot lease space to or from a foundation. Thus, the family office must furnish the space to the foundation without charge. Similarly, although the foundation can pay reasonable compensation to a disqualified person for personal services and thus can pay the family office for the use of its staff, the foundation may not reimburse the family office for the use of supplies, computers, or the photocopying machine. The foundation must buy its own supplies and equipment, or hold separate leases with outside vendors for shared equipment. In addition, the foundation should make payments for utilities directly to providers rather than reimbursing the family office for utility expenses.

Arrangements between a family foundation and a family office can be spelled out such that self-dealing rules are not violated. Although somewhat daunting at first, these arrangements can be worked out if the needs of the foundation are considered and an agreement for the use of family office services and equipment is structured to address those needs in advance of co-location. Once the mechanics have been worked out, having a family office manage the foundation can benefit both the foundation and its trustees.

Structuring Investment Committee Meetings

Investment committees of some family funds operate rather informally, as befits their style and size, while others hold regular formal meetings as part of their investment management oversight. The KT Foundation trustees, for example, monitor asset management through regular telephone conversations among the two managing trustees and the local bank that handles investments; an annual gift committee meeting to make grant decisions, which of course are linked to portfolio performance; and quarterly meetings of the two managing trustees, bank officers, and administrative personnel to review performance, technical matters, grant requests, and program reports from and site visits to grantees. This approach enables the trustees to link portfolio performance to program activities and to integrate the decision process.

Keeping Manager Relations in Good Repair

Every foundation has preferred techniques for maintaining good relations with its investment managers. Some prefer to have a consulting firm conduct an annual review and present a report to the foundation investment committee or board. Some prefer an annual review with managers at the manager's place of business. Others prefer visits from relationship managers and financial advisors, but only rarely by their investment manager. And, still others are satisfied with phone contacts, on an as-needed basis only.

THE FOUNDATION BOARD *and* ITS INVESTMENT MANAGERS MUST CLEARLY UNDERSTAND WHAT IS EXPECTED FROM EACH. AS A RULE, *those* EXPECTATIONS ARE LAID OUT WHEN *the* ASSET ALLOCATION AND INVESTMENT POLICY IS ESTABLISHED.

The Lowe Foundation sends a member from its investment committee to all annual meetings of managers. The investment committee of the O&G Foundation chooses to meet with managers, either face-to-face or over the telephone, on a semi-annual basis. (When a new manager is being added, meetings between the consultant, committee and prospective managers are, of course, more frequent.)

Whatever the management style of the foundation, established practices for working with investment managers should be investigated before a system is finalized for managing these relationships. An important consideration here is that most investment managers prefer not to travel to their client's offices for meetings. They are paid to manage foundation money, not to attend meetings. Thus, establishing a relationship that involves a combination of regular communications and presentations to the investment committee may be best.

In addition, the foundation board and its investment managers must clearly understand what is expected from each. As a rule, those expectations are laid out when the asset allocation and investment policy is established. From there on, the foundation has the right to expect that requested reports will be submitted by a professional manager on the agreed-upon dates, that funds will be invested according to agreed-upon parameters, and that problems in the performance of investments will be reported and discussed in a timely manner. In a similar vein, foundation officers and staff must be careful not to take up an inordinate amount of their investment manager's time with unnecessary questions or handholding calls.

In the end, if a foundation selects investment managers carefully and establishes an agreeable system for working with those managers, a long-term, mutually beneficial relationship is likely to result. The Lowe Foundation has, for instance, fired only two managers in its eight years of operation.

Evaluating the Investment Manager

Foundation's hire investment managers because they need professional expertise to ensure that assets produce sufficient income to cover office and administrative expenses, make grants in the amounts specified under the provisions of the 1969 Tax Reform Act, and grow foundation assets. The foundation has very specific annual cash flow requirements and goals for asset growth, and it is the investment managers' job to see that those requirements and goals are achieved.

Investment managers are generally evaluated on three main criteria:

- First, has the manager adhered to the established investment plan and allocated assets as required?
- Second, have assets performed as expected?
- Third, is the chemistry between the family, foundation officers, staff, existing culture, and the manager good?

Monitoring can be done by a consultant, foundation officers, or foundation staff, depending on who has the qualifications and time.

The standard "market cycle" is about three years and it generally takes that long to determine fairly just how well an investment manager is doing. Still, performance should be checked closely for the first year after funds are fully invested and then monitored first quarterly, than annually thereafter. If performance is substandard, with no market-based explanation, a serious discussion or review should be considered.

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Replacing the Investment Manager

Most investment managers are replaced for one of two reasons:

- They drift away from the agreed-upon style. For example, the manager's style is to buy-and-hold growth stocks; but the manager spots potential "hot" stocks and tries to improve quarterly performance by trading risky equities in the short term.
- Poor performance after two to three years of full positioning. Throughout a full business cycle of expansion and recession, the manager is unable to even out performance for an overall positive outcome.

As a rule, the individuals charged with monitoring the investment manager give a warning of non-performance and try to work out any difficulties, particularly if the relationship has been satisfactory. Typically, termination occurs in the following steps:

- *Step One.* Warn the manager in a face-to-face discussion.
- *Step Two.* Withdraw a portion of foundation assets if problems have not been corrected by the end of a year.
- *Step Three.* Withdraw another portion of assets at the end of the second year if performance continues to drag or style drift is clear.
- *Step Four.* Withdraw all remaining funds.

Although it may seem that this process is somewhat drawn out, in many cases it is preferable to immediate withdrawal of all funds. In making termination decisions, a foundation must weigh the cost of moving a portfolio against transaction costs that would be incurred in correcting the unsatisfactory equity positions.

Both Lowe and O&G begin the process of severing relationships with unsatisfactory managers at the three-year point, unless an understandable aberration in their market position has occurred. In the case of the two managers the Lowe Foundation terminated, no leeway was given because problems existed with the two managers from the start of the relationship.

Summing Up

Family fund trustees find it profitable—literally—to follow fundamentals in deciding when to use a family member and when to turn to an outsider as investment consultant or manager, how to recruit an outsider, and how best to manage this important function. In summary, the fundamental issues for selecting and working with investment advisors are:

- Analyzing the framework and context of your family's charitable program;
- Bringing family members into agreement over the proposed management structure;
- Encouraging only informed, responsible involvement in family or outside professional oversight of the investment program;
- Developing a cost-effective investment management plan;
- Defining clearly the fund's investment boundaries;
- Maintaining ongoing and orderly communication among the trustees and all family members and between them and other interested parties—staff, outside consultants and advisors, custodians, and money management professionals; and
- Acting thoughtfully, professionally, and quickly to adjust to any weaknesses in the process.

Principled investment management practices can go far in ensuring that the trustees have met their fiduciary responsibilities, that the fund generates income to support the grantmaking program, and that the donor's intent is met in all respects.