The Board's Role in Supervising Investments and Three Must-Dos

The legal responsibility for supervising investments resides with the board of directors. Whatever authority other parties may have to influence or implement investment decisions, such authority ought to be shaped, guided, and controlled by the oversight of an informed board.

The fundamental challenge for board members is to balance their legal responsibilities against the organization's practical needs. The CEO or, more commonly, the CFO handles investment operations, including the supervision of outside investment advisors, yet the finance committee and ultimately the full board is still responsible to ensure the investments are aligned with the investment policies.

Well thought out and developed policies help maintain the right balance. With effective policies and procedures, a board can be very active in supervising investments while still delegating authority for the operational management of investments.

There are three actions board members must take to discharge their legal and fiduciary responsibilities — as well as to build a structure that will best promote the organization's investment goals.

1. Adopt Investment Policies

The primary role of policies is to help everyone — board members, senior management, and outside advisors — understand the organization's investment goals and the risks the board is willing to take to achieve those goals. The first step is to adopt and periodically update a policy for outlining investment goals.

To get started, the board should ask — and answer — the following questions:

- What assets have been designated to be managed as investments?
- What are our investment goals, including time frames, asset allocations, diversification, and possible investment restrictions?
- Do we want our investing to be within an environmental, social, and corporate governance framework? Should they align with our values?
- What is our tolerance for risk?
- What structures and policies need to be created to reach our goals (i.e. responsibilities for monitoring and rebalancing of the portfolio)?

2. Consider Hiring Investment Advisors

Although the board should not choose specific investments (everything from stocks and bonds to hedge funds and other, alternative investments), someone must. Delegating this responsibility to someone else is not only permissible but preferable, assuming that the board is conscientious and careful in its choice.

Selection of investment advisors should incorporate the use of a process which should include many evaluation criteria on which to help make the final selection. Factors such as experience in nonprofit investments, social impact investing, along with a demonstrated commitment to diversity and racial equity should be top on the list in the selection criteria.

3. Review Performance

Hiring an investment advisor is not a one-time event. The board's legal responsibilities are not discharged unless the board, or its investment committee, regularly reviews the advisor's work and the organization's adherence to established policies in a disciplined manner. This is so central to sound investing that any qualified advisor should present a recommended review process as part of the package of services. (If the advisor does not recommend regular reviews, they are likely not the appropriate choice.)

After the board has taken care of the above, its job is to give the process it has outlined time to work. This means, among other things, having the courage to stick to your guns during tough times, resisting impulsive policy changes, and refusing to allow the occasional downturn in results to cause hurried changes in allocations and/or hasty divestitures. It is critical to have a well thought out and documented risk tolerance policy to successfully endure inevitable market volatility.

THE ROLE OF AN INVESTMENT COMMITTEE

While the ultimate responsibility for the health and well-being of the organization rests with the board, most boards delegate the actual authority over more complex operations to committees or its senior management. This is often the case with investments.

An investment committee is, typically, a smaller committee of board members that also may also include additional non-directors as committee members, if allowed by the organization's bylaws. While there are many variations of how investment committees are established, it is not uncommon for the nonprofit's chief financial officer to act as a liaison between the committee and those delegated to do the actual work.

BoardSource advises that board members supervise yet not actually manage funds themselves. Direct management by board members effectively eliminates independent supervision. The reason to stress the role of an investment committee is that it facilitates the supervisory process by allowing the work to be done by those board members who have the time, interest, and knowledge that such supervision requires. If there is no designated investment committee, the finance committee should assume these responsibilities.

The committee will typically receive and review the performance reports submitted by staff and outside advisors, meet regularly (at least annually) with the primary investment advisor(s) and participate in other meetings or reviews as needed. How active the committee might be will depend on the size of the organization, the complexity of the investments, and the presence or absence of internal staff available to assist. In doing this work, the committee is satisfying the prudent-investor requirement of ongoing supervision of outside advisors and is thereby protecting both the organization and the other directors from liability.

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Resources: Financial Responsibilities of Nonprofit Boards, The Nonprofit Policy Sampler