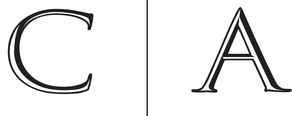

CAMBRIDGE ASSOCIATES LLC

CONFLICTS OF INTEREST

A Trustee's Guide to Conflict of Interest Policies with a Particular Focus on Investment Committees

2005

Ann Bennett Spence

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ABSTRACT

1. In the current climate of closer regulatory scrutiny and expanded disclosure, we recommend that Boards of Trustees review their conflict of interest policy to ensure that it is sufficiently robust to withstand current pressures. Institutions without a conflict of interest policy should move quickly to develop one. Institutions should ensure that their policies cover top officers and key employees as well as Board members.

2. The essential elements of a conflict of interest policy are:

   - **Definition** of "conflict of interest" within the context of the particular organization or institution, and the identification of the classes of individuals to be covered by the policy;
   - **Disclosure** of all related-party interests;
   - **Deliberation**, sufficiently thorough, possibly including data or research on relevant alternatives to the "conflicted" transaction and/or expert advice;
   - **Recusal** of any "disqualified persons;"
   - **Documentation** of the handling of any conflict of interest issues; and
   - **Enforcement** that is regular and effective.

3. The appropriate degree of strictness and specificity in a conflict of interest policy depends upon a given Board's assessment of a variety of risks that it faces and how these risks might relate to one another: legal liability risk, public relations risk, portfolio risk, shortfall risk, operating risk, revenue risk, business investment risk, and debt downgrade risk. Hence, there is no one policy that is suitable for all institutions.

4. Thus far, the law has been largely silent on the matter of investment-related conflicts of interest.[1] However, greater required disclosure of investment information appears to be in the offing; and it would probably require only one conflict of interest brouhaha in the investment area to attract close scrutiny and tighter regulation of the investment activities of all nonprofit institutions. Investment Committees should consider whether they wish to develop their own conflict of interest policy, supplementary to the policy governing the Board as a whole.

[1] Except in the case of private foundations, which are covered by legislation dating from 1969.

5. Although it appears that there is currently no statutory prohibition against engaging in a related-party transaction, this statement is importantly qualified by the following key factors:

   - Statutes vary from state to state.

   - The legislative and enforcement picture is moving fast, in the direction of specific prohibitions and tighter enforcement, and therefore must be monitored closely.

   - Minimal protection from legal liability in a decision to execute a "conflicted" transaction requires establishing a "rebuttable presumption" that the transaction is not an "excess benefit transaction"—which in turn requires the existence of a policy for handling conflicts of interest, and evidence that the policy was adhered to.

   - The rebuttable presumption rests also on a demonstration that Trustees acted in a manner consistent with their fiduciary responsibilities—typically their duty of care and their duty of loyalty. A robust conflict of interest policy is a necessary part of such a demonstration.

SUMMARY

Overview

In a few short years, the term "conflict of interest" has grown from a limited reference in the literature on good governance, into a major preoccupation of regulators, legislators, and journalists. For both corporate and nonprofit boards, the risk environment has changed dramatically. Adequate protection from legal liability now requires a carefully crafted conflict of interest policy, regularly enforced, and with documentation of that enforcement.

Even a cursory glance at the Internet reveals an immense amount of chatter on this subject, with guidelines and advisories emanating from many points of view and many varieties of expertise: lawyers, audit firms, tax authorities, bond rating agencies, state attorneys general, nonprofit associations, and trade groups of every stripe, and, of course, legislators. The Sarbanes-Oxley (SOX) Act of 2002 has proven to be a powerful engine, hauling a very long train of issues primarily affecting publicly held companies, yet unavoidably dragging along the nonprofit sector as something of a caboose. This situation will not last. In short order, the nonprofit sector is likely to have federal legislation of its very own, in addition to prevailing state legislation.[1] In the meantime, many nonprofit institutions and organizations are working hard to develop self-regulation and to influence the many legislative initiatives now underway.

History

How has this situation come to pass? Historically, the concept of conflict of interest has been discussed within the context of a board member's fiduciary obligation to adhere to a *duty of care* and a *duty of loyalty.* For private foundations, the Tax Reform Act of 1969 covered "self-dealing" prohibitions. But for other nonprofit institutions, related-party transactions or "insider transactions" received only sporadic attention until the early 1990s, when several high-profile prosecutions put the spotlight on the sorry consequences of poor governance involving conflicts of interest.[2] These spurred Congress in 1996 to legislate "Intermediate Sanctions" on nonprofit entities[3] found to have engaged in inappropriate related-party transactions. This was an important development, because heretofore the only sanction available had been to strip the institution of its tax-exempt status—a drastic step that federal and state authorities had been reluctant to take. With intermediate sanctions, the Internal Revenue Service (IRS) can now levy excise taxes

[1] In the absence of federal legislation, it falls to states to oversee nonprofit entities, and indeed a typical lawsuit against a nonprofit entity is brought by a state attorney general, on behalf of the public. There have been notable exceptions—for example, private foundations have been subject to detailed federal regulation since passage of the Tax Reform Act of 1969.

[2] The most notorious of the cases involving nonprofit institutions or organizations were focused on self-dealing on the part of board members of a university, a national conservation organization, and certain chapters of the United Way. Some of these cases were covered assiduously by *The Washington Post,* with the result that members of Congress were reminded daily of the problems. Similarly, some years later, press coverage of handsome executive compensation at a major California foundation brought to the attention of reporters everywhere that it is possible to gain considerable information on the inner workings of nonprofit entities by consulting the IRS 990 forms posted on the GuideStar website.

[3] In this paper, the terms "nonprofit sector," "charitable organizations," "tax-exempt entities," etc., are used more or less interchangeably to refer to 501(c)(3) organizations, although in various areas of the law there are distinctions among the organizations within this classification. Chief among these is the distinction between a private foundation and a public charity—the two categories into which virtually all endowed institutions fall.

on errant board members and also on any board members voting to approve inappropriate transactions. Thus, individuals are penalized, rather than the organization as a whole.

While the rules had become tougher, enforcement of these sanctions was not generally aggressive—partly because of insufficient IRS personnel dedicated to the task—and many nonprofit institutions continued either to have no conflict of interest policy, or a policy of minimal specificity (disclosure and recusal).

The watershed was SOX. Of course, this act was aimed not at bad behavior in the nonprofit sector, but in corporate America. It followed upon the stock market bust and its attendant revelations of undisclosed business risks, outsized and often hidden executive pay, and inordinate conflicts of interest—all sparking shareholder anger and disillusionment. Built largely on the ashes of the Enron and WorldCom implosions, SOX legislation focused on the need for auditor independence, strengthening of the board's Audit Committee, accurate financial disclosures, and vigilance against inappropriate related-party transactions.

In fact, SOX added few prohibitions to the ones detailed in the intermediate sanctions by which nonprofit entities were already regulated.[4] Nevertheless, in an effort to avoid fallout from the SOX legislation, law firms, audit firms, and professional associations began quickly to adapt SOX to the nonprofit environment, citing the legislation as the basis for "best practices." And some state attorneys general have put forward state versions of SOX that would apply to nonprofits. All this has led to the expenditure of much ink describing how the audit function should work, and the role of the board's Audit Committee in enforcement of the best practices. Yet, almost nothing is said about investments: the Investment Committee appears, thus far, to be relatively uncharted territory.

Further detail on the history of the conflict of interest issue can be found in Appendix A.

Investment Committees, Regulation and Disclosure

The relative lack of legislative and enforcement attention to investments, thus far, presents Investment Committees with an opportunity to craft conflict of interest policies and procedures, whether as part of their Boards' conflict of interest policies, or as a supplemental investment-related policy. Ideally, this would be done in a manner sufficiently robust to provide an effective response to inquiries and potential criticisms—and perhaps also to preclude excessive or misguided regulation by those unfamiliar with the complexity of the issues handled by these committees.

We advise Investment Committees to move sooner rather than later, as the pace of regulatory efforts in the nonprofit sector has picked up enormously in the past two years. Currently, the Senate Finance Committee is engaged in a study of proposed reforms for nonprofit organizations. In 2004, it issued a draft white paper containing a long list of specific proposals, some of which elicited groans of dismay from nonprofit entities. In like manner (some would say in competition), the states' attorneys general have begun

[4] The only additional constraints were the SOX prohibition of loans to board members or executives, along with the law's protection of whistle-blowers and constraints on document destruction.

to scrutinize nonprofits, and in some states there are aggressive legislative initiatives underway. At the federal level, the Senate is not alone in its investigations—the House Ways and Means Committee, the Joint Committee on Taxation, and the IRS have launched inquiries into nonprofit regulation. In the private sector, the bond rating agencies have begun to issue statements about conflicts of interest. In the case of Moody's, these statements do include specific concern about investments and Investment Committees.[5]

Parallel to these public and private efforts to expose and discourage conflicts of interest has been the development of technology capable of bringing detailed disclosure to the attention of anyone sitting in front of a computer and familiar with GuideStar. Since 1999, the GuideStar website has posted the IRS 990 forms filed by 501(c)(3) entities. This new, startling access to what was once closely held information is now well-known to investigative journalists, individual bloggers, and anyone pursuing a private agenda. Thus, only very recently, disclosure itself has become an important variable in the mix, regardless of what is being disclosed. Because certain facts, once disclosed, are more vulnerable to misinterpretation (both benign and malign), Trustees are well advised to linger over the question of how they intend to deal with these misinterpretations. It is better to anticipate potentially unflattering disclosures by having in place a robust process for dealing with conflicts of interest, than to await public unmasking of allegedly conflict-ridden transactions.[6]

The Legal Landscape

Common Law Basis

In terms of common law and subsequent state and federal statutes, the Trustees of a nonprofit entity have certain fiduciary responsibilities. These are the *duty of care,* the *duty of loyalty,* and (less frequently) the *duty of obedience.*

The duty of care requires that Trustees be diligent in the execution of their responsibilities. They must "care" enough to gain sufficient information before making a decision,[7] they must participate in decisions, and they must do so in good faith. Because good faith has been interpreted by courts to mean in the best interests of the organization, it may suggest the concept of loyalty as well as diligence. Importantly, the "business judgment rule" is based on the duty of care. It holds that a Trustee who adheres to the duty of care—the care of a prudent person in similar circumstances—is generally not liable, should there be adverse

[5] "We often find that potential managers are being identified and selected based on personal relationships and connections with individual committee members. In fact, some endowments have such weak conflict of interest policies that they are actually investing with funds run by committee members themselves. Most of these institutions believe that they are deriving a benefit because their committee members have access into the hedge fund world that the institution would otherwise lack. However, these institutions are vulnerable to the variability of the individual committee members' personal relationships. They also may suffer from a lack of adequate checks and balances and scrutiny by the committee as a whole." *Risks and Opportunities of Hedge Fund Investments by Higher Education and Other Nonprofits,* Moody's *Special Comment,* August 2004.

[6] Although this paper focuses on Trustees, any conflict of interest policy should apply equally to officers and any professional staff who are key decision makers with respect to the matter at hand (e.g., investments).

[7] "Sufficient information" may be interpreted to mean research on alternatives and the use of outside experts to advise on the decision.

consequences of a Board decision, so long as the decision is based on care, as described above. Further, compliance with any policies established by the Board (including any conflict of interest policy) should be enforced as part of a Trustee's duty of care.

The duty of loyalty requires that a Trustee act in the best interests of the organization, rather than in the interests of himself/herself, another person, or another organization. This duty holds that if a Trustee (a) has a conflict of interest, (b) fails to disclose it, and/or (c) participates in a decision that benefits the Trustee or another party, then that Trustee has breached his/her fiduciary responsibility. A related requirement is that the Trustee not use for himself/herself, to the detriment of the organization, any information or "opportunities" available to the organization. This principle is referred to as the Business Opportunity Doctrine (the Trustee should not "usurp" the organization's opportunities—e.g., by taking advantage of certain investments). Further, the duty of loyalty demands that Trustees keep confidential the organization's private information: Trustees "should not...disclose information about the [organization's] legitimate activities unless they are already known by the public or are a matter of public record."[8]

The duty of obedience requires Trustees to conduct themselves within the law, and in accord with the organization's mission, the latter defined in the organization's charter and by-laws. Here the relation to conflicts of interest is, as yet, more tangential. Presumably, to the extent that inappropriate conflicts of interest are barred by either state or federal law and a Trustee with an undisclosed conflict of interest participates in a Board decision that favors him/her, then that Trustee has violated the duty of obedience as well as the law. Taking an organization in a direction not encompassed by its mission may also be impermissible, but this is not necessarily related to a conflict of interest.

State Statutes

State laws are generally the primary source of authority over nonprofit entities. If the mission of the nonprofit is (among other noble aims) to provide for the public good, then states' attorneys general represent the public in seeing that the organization, in executing its mission, justifies its tax exemption. Attorneys general frequently interpret this to mean that it is within their purview to ensure that a nonprofit Board does not engage in improper conduct.

The passage of the SOX legislation at the federal level has spurred many state legislatures to consider adopting similar laws at the state level, and states' attorneys general to examine nonprofit institutions within the framework of SOX. This has meant, foremost, a considerable attention to the roles of the external auditor and the Audit Committee, and the kinds of abuses most egregious among publicly traded corporations. Such abuses did not generally include inappropriate investment (portfolio management) decisions, and hence most states have been largely silent on the subject. On conflicts of interest in general, however, many states have taken action. For example:

[8] Source: *American Bar Association Guidebook for Directors of Nonprofit Corporations,* 2002.

- In New York, Attorney General Eliot Spitzer has proposed that SOX provisions apply to nonprofits within the state. However, his proposed actions with respect to conflicts of interest are not particularly restrictive. In a recent publication, he states that if a Trustee has a financial interest in a decision to be taken by the Board, he/she needs to disclose the interest and be excluded from the decision making. He further states that "it is wise" to have a conflict of interest policy that "clearly states the procedures to be followed if a board member's personal or financial interests may be advanced by an action of the Board." The implication appears to be that if it is properly handled, a financial interest is not necessarily a prosecutable conflict of interest.[9]

- In Massachusetts, Attorney General Tom Reilly states that there is a presumption that a transaction between a nonprofit entity and a related party is fair and reasonable if certain procedural protections are in evidence.[10] These protections include disclosure of a board member's financial interest in the matter at hand, the use of appropriate comparability data prior to the Board decision, a two-thirds vote (majority vote insufficient) of the Board or Committee, and adequate documentation of the proceedings, including "the comparability data and a description of how it was obtained." Clearly, at least in Massachusetts, a nonprofit organization without a conflict of interest policy is an organization at legal risk. It is also at risk if it does not adequately research the financial implications of a related-party transaction.

- In Minnesota, the office of the Attorney General has posted on its website a sample conflict of interest policy. This states, among other things, that a "conflicting interest" arises through "owning stock or holding debt or other proprietary interests in any third-party dealing with" the organization on whose Board the Trustee sits. Further, "transactions with parties with whom a conflicting interest exists may be undertaken only if all of the following are observed: (1) the conflicting interest is fully disclosed; (2) the person with the conflict of interest is excluded from the discussion and approval of such a transaction; (3) *a competitive bid or comparable valuation exists;* and (4) the board or *a duly constituted committee thereof has determined that the transaction is in the best interest of the organization"* [italics added]. Again, an organization without a conflict of interest policy and process is one that is at risk.[11]

- In California, the Nonprofit Integrity Act was signed by the Governor on January 1, 2005. Much of it targets commercial fundraisers. However, the Act claims authority over any 501(c)(3) organization soliciting donations from California residents by mail, including organizations located in other states. Thus, any such organization conducting an annual nationwide alumni appeal, for example, would be covered by this legislation insofar as it seeks contributions from alumni living in California.

[9] Eliot Spitzer, *Internal Controls and Financial Accountability for Not-for-Profit Boards,* January 2005.
[10] Office of Massachusetts Attorney General Tom Reilly, *An Act to Promote the Financial Integrity of Public Charities, Summary of Draft 1.0.* Certain private foundations (regulated by federal law) are excluded from this statement.
[11] Source: www.mncn.org/info/template_pacc.htm.

The point in citing these examples is to underscore the central significance of state laws as they pertain to nonprofit entities, and to note that these laws may well vary considerably from state to state. It is imperative that all Boards seek counsel on the applicability of state laws to their particular issues, and that Boards stay abreast of changes in their states' laws.

Federal Law

Currently, the major ongoing initiatives lie in the deliberations of the Senate Finance Committee and the stepped-up enforcement efforts of the IRS. These two initiatives are related to one another insofar as the IRS has testified before the Senate Finance Committee, and enforcement in turn has been bolstered by the publicity attached to the Committee hearings. The public attention devoted to both has no doubt spurred many nonprofit entities to establish a conflict of interest policy (if none) or to re-evaluate and strengthen those policies already in force.

In 2004, the Senate Finance Committee issued its draft white paper with a daunting list of new rules and regulations upon tax-exempt entities. The proposed rules most relevant to conflict of interest situations include:

- Periodic filing of a conflict of interest policy, which would be publicly available.
- Establishment of federal liability for breach of Board duties, which include (1) performance of duties in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the Trustee reasonably believes to be in the best interests of the mission...of the organization; and (2) the duty of Trustees with special skills or expertise to use such skills or expertise.[12]
- Required inclusion, in the annual IRS 990 filing, of the Board's review and approval of the organization's budget and financial objectives as well as *significant investments*, joint ventures, and business transactions [italics added].
- Required inclusion, in the annual IRS 990 filing, of a conflict of interest policy and a summary of conflicts determinations made during the year.
- IRS authority to remove any Trustee found to have "violated self-dealing rules, conflicts of interest, excess benefit transaction rules, private inurement rules or charitable solicitation laws."
- Enhanced disclosure of related organizations, insider transactions, and "*all partnership interests and the organization's role in the partnership*" [italics added].
- Requirement to make publicly available, upon request, the organization's investments.

[12] Source: *Not-for-Profit Alert,* Grant Thornton, July 2004.

- Application of private foundation self-dealing rules to other tax-exempt organizations.[13]

For Investment Committees, among others, this is not a pretty picture. It remains to be seen how many of these proposals will survive the energetic attempts by many tax-exempt institutions and organizations to counter (with good reason) some of these requirements. Nevertheless, even as merely suggested legislation, these measures give an indication of the depth and direction of current regulatory expansion.

While the Senate Finance Committee is pondering the details of its proposals and the responses to its proposals from representatives of tax-exempt entities, the Congressional Joint Committee on Taxation has weighed in with further recommendations. These include a five-year review of the tax-exempt status of every nonprofit organization, an increase in the excise taxes levied on those engaged in self-dealing, and other expanded penalties under the IRS "intermediate sanctions" (see below). These inquiries are ongoing.

Meanwhile, the House Ways and Means Committee has been asking a more fundamental question: why do certain entities enjoy tax-exemption? Rep. William Thomas, who chairs the committee, has been particularly troubled by hospitals—that is, by why nonprofit hospitals should be treated any differently from for-profit hospitals. This has caused one knowledgeable observer to opine that it will be difficult to limit this issue to hospitals alone, although "hospitals are the 1,000-pound gorilla."[14] This observer goes on to propose that only organizations that are "substantially dependent on donations for their operating revenues" should be exempt from taxes. "The contrast between the big-picture questions being asked by the House and the more specific ideas under consideration in the Senate has left [nonprofit entities] confused about what bill might ultimately result: a sweeping overhaul of the laws regarding nonprofit groups, a measure that aims only to prevent abuses of tax laws, much narrower legislation aimed at specific types of charities such as hospitals, or something altogether different. In addition, some observers wonder whether the different approaches could be a sign that the House and Senate are unlikely to agree anytime soon on what legislation, if any, is needed."[15]

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[13] For example, the definition of a "disqualified person" is much more stringent for private foundations than for other 501(c)(3) entities. Unlike other 501(c)(3) organizations, private foundations are already subject to a considerable amount of federal regulation (Tax Reform Act of 1969).
[14] They are the "gorilla" because non-profit hospitals compete directly with for-profit hospitals. If for-profit higher education continues to gain traction, tax-exempt colleges and universities can expect similar scrutiny—possibly excepting those that have considerable gift and endowment support.
[15] Quotations in this paragraph are from *The Chronicle of Philanthropy,* April 28, 2005.

IRS Enforcement: Intermediate Sanctions

As noted earlier, the passage of federal legislation in 1996 completely changed the face of IRS enforcement by authorizing Intermediate Sanctions on nonprofit entities engaged in behavior deemed inappropriate.[16] Until passage of this legislation the only sanction available had been loss of tax-exempt status, which dire punishment deterred the prosecution of cases. With intermediate sanctions, however, the IRS can levy federal penalty excise taxes on Trustees who receive gains from, or who approve, transactions that are found to confer "excess benefit" upon a "disqualified person" (or insider). An excess benefit is deemed to exist when the Trustee receives an "economic value" that is greater than the value provided. The excise tax is levied upon the difference between the two values.

Disqualified Persons. More commonly known as insiders, disqualified persons are closely defined in the Tax Code. They include individuals who are "automatically" disqualified because of the substantial influence they exert by virtue of their position in the tax-exempt entity (including all Trustees with authority to vote and all key employees); and also those determined to be disqualified through a "facts and circumstances" test that shows them to have "substantial influence" in effect. Under certain circumstances, this might include major financial donors to the institution or organization. The substantial influence may be wielded up to five years before the transaction. The disqualified person encompasses any family member and any entity in which a disqualified person and/or that person's family members own more than a 35% interest.

A careful reading of the potential facts and circumstances tests suggests that at least three of these tests may have a bearing upon an Investment Committee's decisions.[17] These three tests stipulate that the tax-exempt organization must focus upon transactions with "persons" (or entities) that are "disqualified" because (1) the person receives compensation based on revenues from activities that the person controls;[18] (2) the person has or shares the authority to control a "significant portion" of the capital expenditures, operating budget, or compensation of employees of the [tax-exempt] organization;[19] and (3) the person manages a discrete segment or activity of the [tax-exempt] organization that represents a substantial portion of the organization's overall activities.[20] Any of these tests might render a person disqualified, in addition to those who are automatically disqualified. Thus, for example, an Investment Committee member who is not a Trustee may nevertheless be a disqualified person.

[16] The intermediate sanctions are contained in Section 4958 of the Tax Code. Earlier legislation had already created Section 4941, which covers "self-dealing" at private foundations, with a generally more stringent definition of "disqualified persons" than at public charities. In addition, Section 4944 prohibits "jeopardy investments"—investments that could "endanger the charitable purposes" of the foundation. Such investments are described as those that "show a lack of reasonable business judgment....For example, a private foundation investing in speculative stocks, futures contracts, or selling stock 'short' may violate this rule." Jeffrey D. Davine, *Avoiding Private Foundation Pitfalls,* Mitchell Silberberg & Knupp LLP, 1997. Thus, private foundations operate under closer scrutiny of investments than is the case, as yet, for other 501(c)(3) organizations.

[17] These are described in *Intermediate Transactions: What You Need to Know About the Proposed IRS Regulations,* Independent Sector, October 2002 (posted on the Independent Sector website as of May 2005).

[18] Selecting an investment management firm or fund in which a Trustee has a financial interest, for example.

[19] The donor of a new building on campus or a partner in a firm in which a key investment office employee holds a financial interest, for example.

[20] Perhaps a major alumni fundraiser.

Excess Benefit Transactions. Having determined who is disqualified, an organization should next identify whether any disqualified person engaged, or will engage, in a transaction that confers excess benefits upon that person. Here it is important to note that an excess benefit transaction refers not only to compensation arrangements, but also to *business transactions* with disqualified persons. The transaction price, as it were, would be deemed reasonable and of fair market value to the extent that it "would ordinarily be paid for like services by like enterprises under like circumstances." If a transaction is found by the IRS to have conferred excess benefit upon a disqualified person, then an excise tax is levied upon that person, to the amount of 25% on the amount of the excess, and 200% in the event of delayed payment of the penalty. Other Trustees or managers participating in the decision to confer the excess benefit can be fined up to $10,000 each.

Sounds tough. On the other hand, there exists a **rebuttable presumption** that the transaction is not an excess benefit transaction if the organization follows certain prescribed procedures in approving the transaction. Clearly, it is imperative that the organization have such procedures in place, and that these procedural requirements be met in approving a potentially suspect transaction. Independent Sector suggests that even *some* procedures are better than *no* procedures, because the existence of documented procedures has come to be considered a "best practice" and, as such, can provide the best evidence that no excess benefit has been engaged in. Independent Sector further states that "the three procedural requirements for earning the **presumption of reasonableness** are as follows:

- The arrangement must be approved in advance by members of the Board or a Board-appointed committee, none of whom have a conflict of interest with respect to the proposed transaction [i.e., recusal];

- The Board or Committee must have obtained and relied upon '*appropriate data' as to the comparability* of the...fair market value of the consideration [italics added]; and

- The Board or Committee must document the basis for its determination adequately and contemporaneously."[21]

In its final report (June 2005) to the Senate Finance Committee, the Panel on the Nonprofit Sector, convened by Independent Sector, asks Congress to take the following step (among others):

> "Impose penalties on board members of charitable organizations who approve self-dealing or excess benefit transactions...not only if they knew that the transaction was improper but also if they 'should have known' that it was improper—that is, if they failed to exercise reasonable care, such as following the 'rebuttable presumption' procedures or other appropriate processes..."[22]

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[21] Independent Sector website, www.independentsector.org. See also Steven T. Miller, Director Exempt Organizations, IRS, *Rebuttable Presumption Procedure is Key to Easy Intermediate Sanctions Compliance,* www.irs.gov/pub/irs-tege/m4958a2.pdf.

[22] Panel on the Nonprofit Sector, *Strengthening Transparency/Governance/Accountability of Charitable Organizations: Final Report to Congress and the Nonprofit Sector,* June 2005, page 88.

When even the highest profile association of charitable organizations goes on record with this kind of aggressive position, then clearly a well thought-out conflict of interest policy—to establish a rebuttable presumption—is a necessity.

IRS Enforcement: Recent Step-up in Activity

Recently, IRS enforcement of standing legislation has significantly increased. IRS staffing has been increased, and certain IRS officials have spoken out to alert tax-exempt institutions to the heightened scrutiny. For example:

> *"Two types of nonprofit contracts are getting the closest scrutiny from federal tax auditors, according to IRS officials:* ***financial investments and real estate transactions.*** *'Those would certainly be among the top red-flag areas for the IRS,' says Sarah Wreford, IRS spokeswoman from Detroit. 'If we review a nonprofit's contractual agreements and we see contracts going to the businesses connected to that nonprofit's board members, that may merit further review.'*
>
> *…If violations are found, the nonprofit and its entire board—not just that one board member involved in the questionable transaction—could be penalized, according to IRS Commissioner Mark Everson."*[23]

This type of focus on investments appears to be a departure from previous language. However, a close reading of IRS Commissioner Mark Everson's March 30, 2005, detailed letter to the Senate Finance Committee—reviewing compliance issues with respect to tax-exempt institutions—reveals no particular focus on the kinds of investment decisions typically engaged in by Investment Committees. Instead, the letter lists the following as the most significant compliance issues: charities established to benefit the donor; abusive credit counseling organizations; regulation and reporting of political activity of nonprofits; misuse of charities for charitable deductions; abusive tax shelters; compensation issues; funding of terrorism; abusive retirement vehicles; and pension funding. There was no mention of investment issues *per se.*

In addition, versions of the IRS' *Model Conflict of Interest Policy,* tailored to various kinds of charitable organizations and developed in the late 1990s, remain posted on the website.[24] This model policy contains the familiar ingredients of disclosure, recusal from voting and discussion, due diligence with respect to alternatives, documentation, and enforcement. While there is attention to executive compensation and other areas often mentioned with respect to conflicts of interest, again there is no mention of investments *per se*.

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[23] Source: Council of Michigan Foundations, November 1, 2004, www.cmif.org/News_Detailed.asp?ID=529.

[24] See, for example, *Sample Conflict of Interest Policy (Revised 1999),* Appendix A of the Health Care Provider Reference Guide, available on the IRS website at www.irs.gov/pub/irs-tege/eotopicc04.pdf and referenced by *Foundation News & Commentary,* January/February 2005.

Of course, it is good to remember that if an investment decision redounds to the financial benefit of a board member, then the transaction might be covered by language relating to compensation. Moreover, the near absence of specific mention of investments could be the calm before the storm. Based on recent history, an observer can safely conclude that it would require only one investment-related "scandal" for *all* Investment Committees to attract the glare of special scrutiny and zealous enforcement. Such a scandal has not yet occurred.

Exhibit 1 provides a rough picture of the areas of particular scrutiny (thus far) with respect to conflicts of interest.

Developing a Conflict of Interest Policy: Other Risk Factors

The **legal liability risk**, both personal and institutional, is just one of many risks that must be taken into account by investment committee members when making investment decisions. Most immediate, of course, are **portfolio risk** and **shortfall risk**. But other, background risks are often taken into account, either implicitly or explicitly. These include:

- **Operating risk** level (ratio of fixed costs to variable costs) for the institution.
- **Revenue risk** (volatility of revenue stream, excluding endowment spending).
- **Business investment risk** (e.g., bets on "big science" in the construction of extensive laboratory facilities).
- **Debt downgrade risk** (e.g., debt rating agencies' concerns about certain types of investments).
- **Public relations risk** in the event of a soured investment.

It is worth noting that the risk of a public relations black eye when an investment decision leads to poor results is not necessarily related to the level of portfolio risk. That is because the general public frequently misunderstands the rationale for and role of any given investment choice. The risk of such misunderstandings, coupled with the dependence of most tax-exempt institutions on their ability to attract charitable contributions from the public, may make it advisable for Investment Committees to avoid conflicts of interest—because, when things go wrong with any single investment decision, such conflicts tend to become particular targets of the press. However, Investment Committees may have dramatically different levels of risk aversion when it comes to public relations risk.

The evolving risk picture is illustrated in Exhibit 2. Here it is evident that three major *non*-investment developments (growing regulation of tax-exempt entities, SOX legislation, and GuideStar posting of IRS 990 information) have heightened the risks associated with investment decisions. More recently, Congressional and state attorneys general have ratcheted the legal risks upward, such that any given

endowment investment decision invites more negative fall-out in the event of poor performance. Investment Committees must take all this into account, in addition to the other risks (which are generally beyond their purview) listed above.

In spite of all this, after considering and calculating the potential risks and rewards, an Investment Committee might nevertheless decide to make an investment that may be construed as involving a conflict of interest. Indeed, thus far, it appears that most legislation does not categorically rule out transactions involving conflicts of interest.[25] Instead, the legislation tends to dictate procedures and best practices to be followed in the handling of conflicts of interest. There are potentially many levels of rigor that can be put in place. For example, degrees of financial interest can be variously defined, as can "interested parties," degrees of materiality, breadth of voting on suspect transactions, potential benefits to the institution's investment portfolio, and so forth. Exhibit 3 is a simple illustration of the trade-offs between materiality of conflict and potential benefit to the institution. There may be other trade-offs to be considered.

When drafting a conflict of interest policy that applies to Investment Committee decisions, the Board can take one of two generic approaches:

- A categorical approach, in which certain situations and transactions are categorically ruled out and others deemed to be acceptable.

- A more probabilistic approach, in which case-by-case judgments are made in light of the broader risk picture (described above) as well as in light of potential rewards.

The latter approach offers more flexibility, but adherence to procedure becomes acutely important, to ensure that adequate judgment is applied to each questionable situation. Moreover, the probabilistic approach requires clear designation of a decision maker (usually the chief executive officer or the chairman of the Board) charged with making the judgment.

Exhibit 4 shows two types of conflict of interest policies. The typical policy is the probabilistic approach, shown on the left. A more rigorous or categorical policy is shown on the right. Of course, there can be many degrees of rigor.

In short: there can be no single policy prescription, nor an optimal conflict of interest policy, because what is optimal for one Board (and its organization) may not be optimal for another, given that the level of risk tolerance, as well as the broader risk picture, will vary from institution to institution.

[25] It is critically important, however, to check the relevant law of the state in which the tax-exempt institution is located.

Conclusion

The Panel on the Nonprofit Sector, convened in 2004 by Independent Sector in response to the deliberations and recommendations of the Senate Finance Committee has stated the following:

> "A conflict of interest arises when a board member's duty of loyalty to the charitable organization overlaps with a competing personal interest he or she may have in a proposed transaction. Some such transactions are illegal, some are unethical, and others may be undertaken in the best interest of the organization as long as certain clear procedures are followed. A conflict of interest policy helps protect the organization..."[26]

This statement is one of the latest pronouncements in the ongoing dialogue between Congress on the one hand, seeking significantly more federal regulation of tax-exempt entities, and nonprofit entities on the other hand, seeking enhanced self-regulation and federal regulation that is not excessive. While there is scant reference, thus far, to investment decisions, the "upgrading of federal standards for **prudent investment** [emphasis in original] of funds by charitable organizations to correspond to changes in state laws" is on the list of "work to be completed for a supplemental report" to Congress. Thus: stay tuned.

Ultimately, a good conflict of interest policy may be a matter of art and dedication over prescription. It must be specific enough to be effective, but not attempt to codify the handling of all situations that might conceivably arise, lest the process itself—the development and implementation of categorical distinctions—begin to stifle the objective: good governance and good judgment in light of overall risks.

[26] Panel on the Nonprofit Sector, *Strengthening Transparency/Governance/Accountability of Charitable Organizations: A Final Report to Congress and the Nonprofit Sector,* June 2005, p. 93.

EXHIBITS

Exhibit 1

CONFLICT OF INTEREST: FOCUS OF CURRENT LEGISLATION AND INVESTIGATION

By Type of Institution and Type of Conflict

Type of Conflict	Endowed Educ. & Research Institutions	Other Endowed Institutions	Private Foundations	Community Foundations	Non-Endowed Public Charities	Hospitals & Health Care Organizations
Executive Compensation[1]	X	X	X	X	X	X
Contracts	X	X	X	X	X	X
Real Estate[2]	X	X	X	X	X	X
Donor Issues[3]	X	X	X	X	X	X
Sponsored Research Programs	X					X
Grant-Making			X	X		
Conversion Transactions						X
Investments			X[4]			

Notes: Current IRS investigations extend beyond these fields, for example, into abusive tax shelters and retirement vehicles. The situation is rapidly evolving.

[1] Although less common, executive compensation can cover an “excess benefit transaction” with a board member.
[2] Real estate purchase, sale, valuation.
[3] Gift valuation, “abusive tax shelters,” gift terms, “supporting organizations,” donor-advised funds, etc.
[4] For example, “jeopardy investments.”

Exhibit 2

THE BROADER RISK PICTURE FOR INVESTMENT COMMITTEES

Rising Concern About Conflicts of Interest in Tax-Exempt Institutions

1. Legislation Affecting Nonprofit Entities

- State
- Federal
  -Tax Reform Act (1969)
  -Intermediate Sanctions (1996)

2. Legislation Affecting Publicly Traded Corporations

Sarbanes-Oxley (2002)

3. Increasing Disclosure of Board-Level Information

- Development of the "web"
- Guidestar posting of IRS 990 forms on the web
- Next: required disclosure of investments?

Ongoing Legislative and Enforcement Developments:

- Senate Finance Committee
- Other Congressional Committees
- Sharply increased IRS enforcement
- State AGs
- State legislation

→ ?

? ←

Risk Factors:

- Legal liability risk
- Public relations risk*
- Portfolio risk
- Shortfall risk
- Other risks:
  - Operating risk
  - Revenue risk
  - Business investment risk
  - Debt downgrade risk

Investment Committee Conflict of Interest Policy

* Risk that the future performance of the "conflicted" investment decision will become an embarrassment.

Exhibit 3

TRADE-OFFS BETWEEN CONFLICTS AND BENEFITS

Where to Draw the Line?

Benefit to the Institution

Board Member's Financial Interest in the Investment

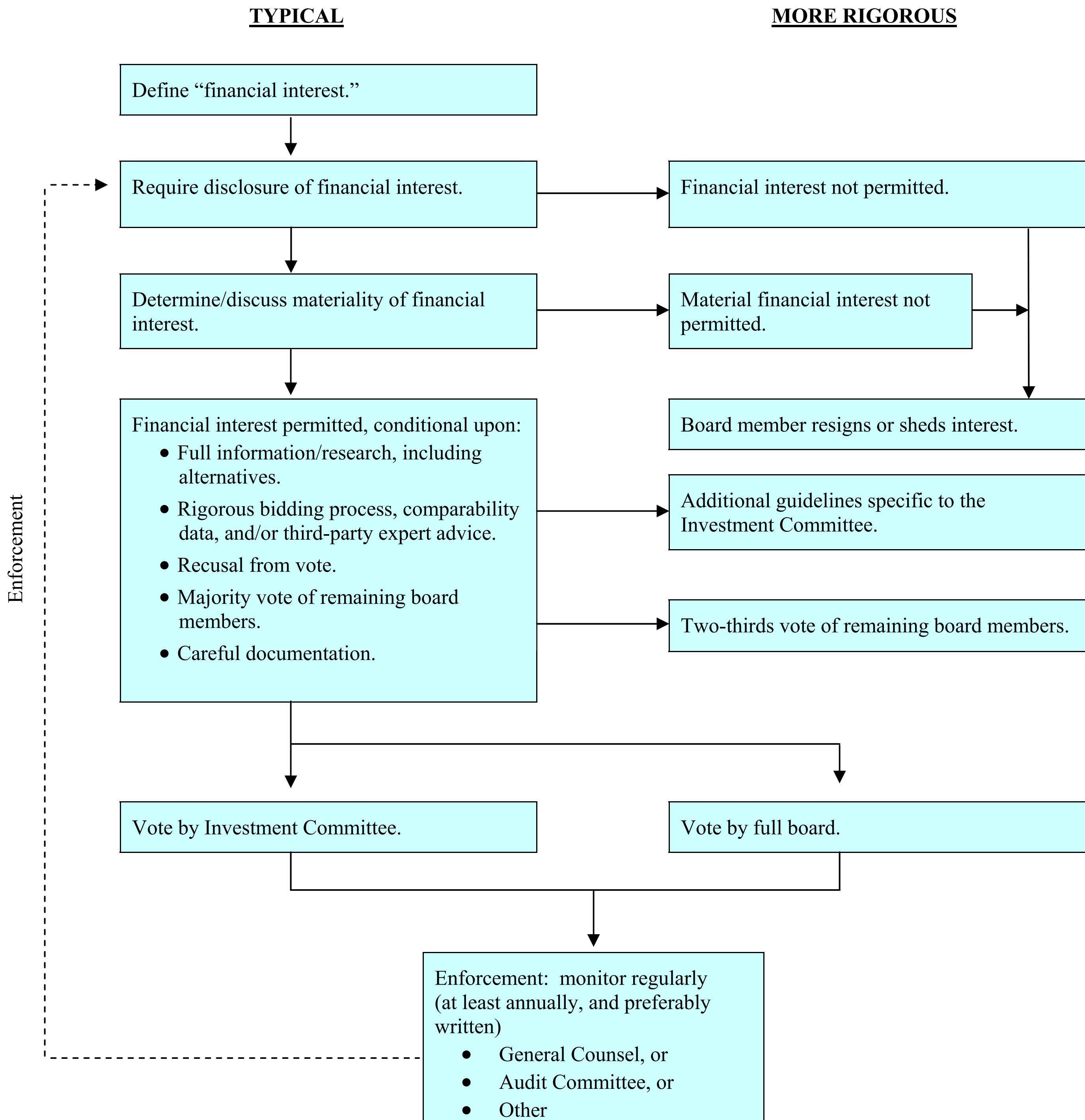
	Greatly Beneficial	Beneficial*	Neutral
Material	Acceptable?	Unacceptable?	Unacceptable
Not Material	Acceptable?	Acceptable?	Unacceptable
None	Acceptable	Acceptable	

Note: Shaded area shows where various conflict of interest policies might differ, depending upon a Board's risk tolerance.

*An investment, even if beneficial, can be misunderstood by the public on at least two bases:
(1) Failure to evaluate in terms of *long-term* expected return; and/or
(2) Failure to evaluate as part of the broader portfolio.

Exhibit 4

TWO KINDS OF CONFLICT OF INTEREST POLICIES



Notes: At every step there can be varying degrees of specificity. For example, the specific measures of "materiality" may be spelled out in the policy or left to a case-by-case discussion.

APPENDICES

Appendix A

A BRIEF CHRONOLOGY OF CONFLICT OF INTEREST AS IT AFFECTS NONPROFIT INSTITUTIONS

Historical	Based on common law and state and federal statutes, a board member's fiduciary obligations include a *duty of care* and a *duty of loyalty*, both of which are relevant to any conflict of interest situation.[1]
1969	Passage of the **Tax Reform Act of 1969**, the federal law regulating private foundations, including prohibitions on self-dealing. Henceforth, private foundations are generally subject to more rigorous regulation than other nonprofit entities.
1987	The American Bar Association develops the **Revised Model Nonprofit Corporation Act**, with the aim of increasing consistency among the states' statutes. However, not all the states' nonprofit corporation laws are derived from the Model, and all have variations. The Act sets a minimal standard for handling conflicts of interest: disclosure of the conflict and approval by board members without a financial interest in the transaction. Loans to directors and officers are prohibited.
Early 1990s	Prosecution of several high-profile cases of conflict of interest in nonprofit institutions and organizations.
1996	Congress legislates **"Intermediate Sanctions,"** opening the door to sanctions short of loss of tax-exempt status. This proves to be a very significant development, as it makes it possible to penalize a Trustee or key employee without employing the "nuclear option" of stripping the nonprofit institution of its tax-exempt status.
1998	The Maryland Association of Nonprofit Organizations issues its *Standards of Excellence: An Ethics and Accountability Code for the Nonprofit Sector*. Endorsed by the Carnegie Corporation, it has been adopted by nonprofit associations in other states. The *Code* advises adoption of a conflict of interest policy, although its remarks are limited to disclosure and recusal.
2001	The U.S. Treasury issues specific regulations pertaining to the **Intermediate Sanctions** previously authorized. Pursuant to IRC Section 4958, the IRS will levy monetary penalties on board members who gain from or who approve a related-party transaction in which there is "excess benefit" to an insider ("disqualified person").
2002	Passage of the **Sarbanes-Oxley Act**[2] sharply increases official scrutiny of conflicts of interest in publicly traded corporations, with particular focus on the board's Audit Committee. Two provisions apply also to nonprofit entities: whistle-blower protection and prohibitions on document destruction. Other provisions, however, begin to become a "best practices" template for nonprofits. Independent Sector issues a Sarbanes-Oxley "checklist" that states simply: "Establish a conflict of interest policy and a regular and rigorous means of enforcing it."

[1] A third duty, less often cited, is the *duty of obedience.*
[2] Also known as the American Competitiveness and Corporate Accountability Act of 2002.

Appendix A (continued)

A BRIEF CHRONOLOGY OF CONFLICT OF INTEREST AS IT AFFECTS NONPROFIT INSTITUTIONS

2003

Front-page local newspaper coverage of executive compensation issues at a prominent California foundation vaults to extended national publicity and thus alerts journalists nationwide to strong public interest in such issues, and also to the new availability of IRS 990 forms on the Internet (via Guidestar). See Exhibit A-1 for an example of the kinds of investment-related information now available on the Internet. (Note that there are calls to disclose all investments in IRS 990 filings.)

The Better Business Bureau's Wise Giving Alliance issues *Standards for Charity Accountability* (20 guidelines). Guideline #5 states: *"No transaction(s) in which any board or staff members have **material** conflicting interests with the charity resulting from any relationship or business affiliation.* Factors that will be considered when concluding whether or not a related-party transaction constitutes a conflict of interest and if such a conflict is material, include, but are not limited to: any arm's length procedures established by the charity; whether the interested party participated in the board vote on the transaction; if competitive bids were sought and whether the transaction is one-time, recurring, or ongoing." This is one of the more detailed advisements on conflicts of interest to date.[3]

2004

The Senate Finance Committee begins inquiries into whether reforms are needed at nonprofit organizations. In late June it releases a **draft white paper** with a long list of proposed regulations, including IRS 990 reporting (and web posting) of: conflict of interest policies; a summary of "conflicts determinations" made during the year; and "partnership interests." Investments would have to be made public, upon request. The IRS would have authority to remove any board member for violation of self-dealing rules, conflicts of interest, and "excess benefit" transaction rules.

Various states' attorneys general begin reviews and investigations of the nonprofit sector (principally in New York, California, Massachusetts, and Minnesota, but not limited to these). Some claim jurisdiction beyond their borders (see below).

Legislative proposals modeled on Sarbanes-Oxley legislation are circulated in some states. California's Nonprofit Integrity Act of 2004 claims that the state's attorney general has power to enforce adherence to this law by any nonprofit entity doing business in the state, including out-of-state entities soliciting donations from California residents.

The IRS launches the **Tax Compensation Enforcement Project**, targeting "excessive benefits," executive compensation, and "other insider transactions." Loans and property sales are particularly scrutinized, as well as the accuracy of Form 990 reporting by nonprofits.

[3] Interestingly, Guideline #10 states: "*Avoid accumulating funds that could be used for current program activities.* To meet this standard, the charity's unrestricted net assets available for use should not be more than three times the size of the past year's expenses or three times the size of the current year's budget, whichever is higher." This is followed by a description of some possible exceptions to this guideline.

Appendix A (continued)

A BRIEF CHRONOLOGY OF CONFLICT OF INTEREST AS IT AFFECTS NONPROFIT INSTITUTIONS

2005

The Senate Finance Committee opens hearings. **The Panel on the Nonprofit Sector**, convened by Independent Sector and consisting of leaders of major nonprofit institutions, presents its "Interim Report." The Panel is attempting an organized effort to provide self-regulation in lieu of the far more restrictive proposals contained in the draft white paper of the Senate Finance Committee. The Panel's final report is expected by this summer.

The IRS Commissioner, Mark Everson, presents to the Committee a "Strategic Plan" for enforcement of the tax law over the next five years. This includes expansion by 30%, this year, in the number of IRS personnel auditing tax-exempt organizations. Particular areas of investigation include "abusive tax shelters," undue donor control over donated assets, "supporting organizations," charitable trust abuses, misuse of nonprofit organizations for charitable deductions, and compensation issues.

The House Ways and Means Committee launches an overview of the tax-exempt sector, focusing on hospitals, universities, and the profit-making activities of nonprofits. A Government Accounting Office report on this is expected in the summer.

The Joint Committee on Taxation focuses on reforming rules for charitable contributions of property, estimating that reform could generate $2.5 billion in tax revenues to the U.S. Treasury through 2014.

In late June, the **Panel on the Nonprofit Sector** presents its 112-page Final Report to the Senate Finance Committee. Titled *Strengthening Transparency/Governance/ Accountability of Charitable Organizations*, it strongly endorses the adoption of a conflict of interest policy by all tax-exempt organizations. The report ends with a list of "work to be completed by the Panel for a Supplemental Report." The list includes "upgrading federal standards for **prudent investment** of funds" [emphasis in original].

Exhibit A-1

DISCLOSURE OF INVESTMENT-RELATED INFORMATION ON IRS 990 FORMS

July 2005

Institution	Compensation of Internal Investment Personnel[1]	Investment Managers Listed Among Highest Paid Independent Contractors	Information on Asset Allocation[2]
1	X	X	X
2	X	X	X
3	X	X	X
4	X	X	X
5	X	X	
6	X		X
7	X		X
8	X		X
9		X	X
10	X		
11			X
12			X
13			X
14			X
15			X
16			X
17			X
18			X

Note: Data are from 18 major research universities.

[1] Those listed are among the top five highest paid officers, or top five highest paid employees, of the university.
[2] Includes mainly broad asset classes.

Appendix B

SAMPLE CONFLICT OF INTEREST POLICIES

At the present time, few conflict of interest policies deal with the conflicts that might arise for Investment Committee members or Investment Office staff. However, with the rise in public scrutiny and regulation, it is likely that more and more policies will come to include sections that refer specifically to investments.

Accordingly, here are five sample policies that deal with investments. All but one of these policies are available on the Internet. Four of the sample policies apply to Investment Committee members, and one to Investment Office staff (note, however, that ordinarily the same policy would be expected to apply to both groups). Three of the policies are in place at foundations and two at universities.

The policies are presented in order of length and complexity, starting with a one-page policy and ending with an investment-related excerpt from a considerably longer policy that includes the forms that must be signed by Trustees and staff for the purposes of enforcement of that policy.

Authority for judgment in the execution and enforcement of the policies varies from Investment Committee Chair, to President, to Chief Operating Officer, to Audit Committee Chair, to General Counsel.

As noted earlier, conflict of interest policies must conform to prevailing state and federal law.

Exhibit B-1

CONFLICT OF INTEREST RESOLUTIONS

The Investment Board is charged with fiduciary responsibility for managing and investing the endowment of the University. In order to ensure that all investment decisions are made without any suggestion that the Investment Board or any of its members has a conflict of interest or any appearance of a conflict of interest, the second and third portions of this resolution shall apply with respect to the Investment Board and its members.

RESOLVED, The University will not invest in any investment fund or vehicle in which a Trustee has an interest unless, in the opinion of the Trustees' Compensation Committee, all of the following conditions are met:

1. The investment opportunity was initially brought to the attention of the Investment Board, any of its members, or the Investment Office by someone other than the Trustee or Trustees having the financial or other interest.

2. The University is persuaded that the investment decision: (1) is in the best interest of the University; (2) is available on terms which represent or exceed fair market value; (3) involves an investment that is sufficiently compelling to offset any appearance of a potential conflict of interest; and (4) has not been influenced by the affected Trustee or Trustees having the interest.

3. No communications by the University with those representing the investment fund or other vehicle include the Trustee or Trustees having the interest, but rather are between the University and other representatives of the investment vehicle or fund.

4. Any Trustee or Trustees having the interest formally recuses himself or herself from the vote of the Trustees or any committee on the matter and otherwise plays no role in the University's decision-making process.

FURTHER RESOLVED, The Investment Board shall not consider or invest in any investment opportunity that involves a fund or other investment vehicle in which one or more Investment Board Members have either a significant financial interest, as an investor or general partner (or the equivalent); have a significant role in management, hold a significant position with the sponsor, or all of the above (collectively, "an interest").

FURTHER RESOLVED, The Investment Board shall not retain any Investment Board member to serve as an investment manager, nor shall it retain any firm or other entity in which an Investment Board member has an interest to serve as an investment manager or to serve in any related capacity.

Exhibit B-2

INVESTMENT ACTIVITY: SUPPLEMENTAL CONFLICTS OF INTEREST AND DISCLOSURE POLICY

The Foundation's Investment and Finance staff ("Investment and Finance Staff") and Trustees on the Investment and Finance Committee (collectively, "Investment Persons") should strictly abide by the general principles and practices set forth in the Foundation's Conflict of Interest and Disclosure Policy in recommending, hiring, reviewing, or terminating investment advisors and/or managers, making investment decisions, and/or otherwise carrying out their financial management duties. The following supplemental policy is intended to provide some additional, non-exhaustive guidance in determining when a conflict of interest or an appearance of a conflict exists in investment activities.

- Investment Persons should not directly or indirectly trade in, or advise that anyone else (including the Foundation) purchase or sell any financial instrument, if that purchase, sale, or advice occurs while the Investment Person is in possession of any material, nonpublic information about a publicly traded company. Moreover, Investment Persons sitting on the Board of a publicly traded company and/or in the possession of material, nonpublic information about a publicly traded company should not participate in any Foundation discussion or decision regarding an investment related to such a company. Finally, Investment Persons should not pass any material, nonpublic information learned through affiliation with the Foundation to others, including other Investment Persons.

- Heightened scrutiny should be applied to any co-investment situation. Investment Persons, their Family Members, and any entities in which they hold more than 35% of the voting power, profit interest, or beneficial interest should not participate in or dispose of any investment in which the Investment Persons, Family Members, and/or such entities directly or indirectly receive an identifiable benefit that other co-investors do not receive from the Foundation's investment (e.g., reduced management fee or opportunity to participate at a reduced minimum). The same considerations should apply to investments in anticipation of a Foundation investment.

- No Investment Person should receive a placement fee or other personal benefit from a Foundation investment.

- All confidential information acquired in the course of managing the Foundation's financial assets should be kept strictly confidential, disclosed only to those within the Foundation with a need to know, and not used for purposes other than managing the Foundation's assets. This confidentiality obligation shall remain in effect permanently, including after separation from service to the Foundation, until such confidential information becomes publicly known through no fault of the Investment Person.

Because of the Investment and Finance Staff's day-to-day oversight of the Foundation's investments and regular contact with the Foundation's investment managers and advisors, the following additional guidelines apply to such staff:

- Investment and Finance Staff should not participate in any limited partnership or other investment opportunity not generally available or known to the public in which the Foundation has made or is considering making an investment or that is not generally available or known to the public that is suggested by a current or prospective investment manager.

- Investment and Finance Staff should not purchase, directly or indirectly, any equity security in an initial public offering.

Exhibit B-3

INVESTMENT OFFICE CONFLICT OF INTEREST POLICY

This Conflict of Interest Policy is to provide guidelines for ethical and appropriate behavior for Investment Office staff members. Every staff member should exercise care to avoid any potential conflict of interest or appearance of conflict of interest between his/her personal, financial, or business interests and the interests of the University. Any issues not specifically addressed by this policy or where there is ambiguity between the policy and a specific issue should be brought to the attention of the Chief Investment Officer for discussion and guidance.

I. Compliance

Investment Office staff members will comply with all applicable federal, state, and local laws. In addition, Investment Office staff members will act in accordance with the Code of Ethics and Standards of Professional Conduct of the Association for Investment Management and Research.

II. Personal Investing

The following relate to personal investing by Investment Office staff members. These restrictions and disclosure requirements apply to a staff member's personal accounts as well as accounts over which the staff member has control or substantial ability to influence investment transactions. These restrictions and disclosure requirements do not apply to accounts and investments acquired and held prior to the adoption of this policy nor do they apply to accounts that unexpectedly become the responsibility of a staff member after adoption of the policy. For example, as a result of health issues, a family member might relinquish investment-making decisions for his or her accounts to an Investment Office staff member. The staff member would not have to disclose or liquidate any prohibited investments, but the prohibited investments and disclosure requirements would apply to future investments in the account as long as the staff member continued to make the investment decisions.

Investments in the following are prohibited:

1. Any privately offered investment which is not available in the general market place and in which the University has invested, plans to invest, or is considering for investment;

2. Any privately held companies in which the University has an interest;

3. Any investment manager or advisor, fiduciary, or key provider to the University's Investment Office;

4. Any investment that would compete, in a significant way, with the University's investment strategy;

5. Any investment based upon "inside" or material, nonpublic information, characterized generally as information which has not been disclosed to the public relating to a company's business operations or securities, the public dissemination of which would likely affect the market price of any of its securities or would likely be considered important by a reasonable investor in determining whether to buy, sell, or hold the securities; and

6. Any investment that would be considered "front running," i.e., a personal investment made prior to the execution of a University transaction whereby the staff member benefits from advance knowledge of the University's transaction. This would include any real estate the University is considering to purchase for campus- or research-related activities.

Any personal, specific investments that are considered as a result of information or recommendations by a broker, dealer, or investment advisor or limited partnership that does business with the University Investment Office or is seeking to do business with the University Investment Office, must be disclosed in advance of execution to the Chief Investment Officer, or in the case of the Chief Investment Officer, to the Executive Vice President and Chief Financial Officer. This could include opportunities to invest in private investment vehicles the University considered but elected not to invest in. The Chief Investment Officer, or in the case of the Chief Investment Officer, the Executive Vice President and Chief Financial Officer, may choose to prohibit such investment.

Opportunities to purchase securities in an IPO that are extended to a staff member by a broker, dealer, investment advisor, or limited partnership that does business with the University Investment Office or is seeking to do business with the University Investment Office must be disclosed to the Chief Investment Officer or in the case of the Chief Investment Officer, to the Executive Vice President and Chief Financial Officer, prior to the staff member making an investment. The Chief Investment Officer, or in the case of the Chief Investment Officer, the Executive Vice President and Chief Financial Officer, may choose to prohibit such an investment.

Investments in bank accounts, open-end mutual funds, government and municipal securities, and University-sponsored retirement plans are exempt from this policy. Transactions executed for the accounts of staff members or members of their household by investment advisers or brokers with discretionary authority to execute transactions without prior notification to the client are also exempt, provided the client has no knowledge of the transaction prior to execution. Also, the Chief Investment Officer may exempt transactions of a member of the staff member's household where preclearance is not feasible, as where the household member regularly executes securities transactions as part of his or her business and without prior knowledge of any of the Investment Office staff.

III. Disclosure of Confidential Information

Any confidential information obtained through Investment Office activities may not be used by staff members for personal gain, or disclosed to others outside the Investment Office, including family members. This includes any material, nonpublic information regarding a publicly traded company, which if used, would be considered insider trading.

IV. Involvement with Outside Organizations

Prior to participating on any boards of directors or advisory committees for either for-profit or not-for-profit organizations, Investment Office staff must request approval in writing from the Chief Investment Officer, or in the case of the Chief Investment Officer, from the Executive Vice President and Chief Financial Officer. Participation may be disallowed if the Chief Investment Officer, or in the case of the Chief Financial Officer, the Executive Vice President and Chief Financial Officer, determines that it would interfere with the staff members' duties and responsibilities to the University.

If approval is granted to participate on the Board or committee, and if it is determined and so noted in the written approval that participation on such Board or committee provides a benefit to the University's investment program, then the staff member will be covered by the University's directors' and officers' liability insurance and all compensation paid to the staff member will be paid to the University.

V. Good Judgment

In addition to the above guidelines, the Investment Office staff member should always use good judgment so that any activity does not compromise his or her independence or objectivity.

Exhibit B-4

PERSONAL INVESTMENT POLICY

Purpose. We want to prevent any actual or apparent conflict of interest between our investment program and your personal investments and other business. These conflicts can hurt the financial interests and reputation of the group and you and, in some cases, break the law. Complying with this policy will help protect the group and you against these problems.

Principles. Our policy (a) assumes that the risk of problems is low; (b) relies on disclosure rather than categorical investment restrictions to prevent problems; and (c) adopts a case-by-case approach to their resolution. We believe that the risk is low because (i) the group seeks and attracts people with high ethical standards, and (ii) our investment style and our reliance on outside investment managers shift risks, such as insider trading, outside the group. We can afford the flexibility of a case-by-case disclosure-based approach because our investment team is small and few of its members exercise investment discretion. A change in this environment, for example, a major investment staff expansion and a move to managing money in-house, might require a different policy.

Coverage. In general, this policy applies to the Investment Committee, the Senior Management Team, and all Investment, Operations, and related support staff. It also applies to you if you have been asked to sign and return a copy of the policy. The policy covers any investment decision that you make or influence where an ownership, beneficial, or other interest in the investment is held by (a) you; (b) a member of your family or household; or (c) a charity or other organization, if you and members of your family or household constitute a majority of its directors or Trustees or can exercise equivalent control. The policy does not apply to any other organization advised by you unless the failure to apply the policy would create an actual or apparent conflict of interest, for example, as discussed under "Investment Opportunities" below.

Exempt Personnel. In general, this policy does not apply to outside directors and Trustees who are not investment committee members. In part, the policy does not apply to them because their lack of information about our investments limits risk. Accordingly, you may not disclose information about our investments to people who are not covered by the policy, except to directors and Trustees to the extent required by their fiduciary duties.

Golden Rule. You must manage your personal investments ethically and lawfully at all times. This rule applies to all conflicts of interest and improprieties even if they are not described in this or other group policy statements. Consequently, you must use your judgment. You should disclose all potential conflicts and problems, even if they become apparent only after an investment, recuse yourself from all related decisions, and, in general, err on the side of caution.

Restricted Companies List. To assist you in complying with these rules, we maintain a list of restricted companies. You may not trade any stocks, bonds, or other securities issued by the restricted

companies or any derivative of these securities unless you get an approval, as described below under Approval Procedures. You will be asked to disclose your ownership of restricted company securities annually, and you may be required to divest these holdings at any time to avoid the appearance of impropriety. The restricted companies list changes with our investments. We maintain the current list on the intranet at [ ].

You must check this site before trading securities that may be listed. If you do not have access to this site and you are unsure whether you have an up-to-date list, you must contact the Chief Investment Officer for the current version before trading.

Investment Opportunities. If you learn of an investment opportunity primarily through your work with us, the investment opportunity belongs to the group. You may not invest or encourage others to invest if the investments would adversely affect the group opportunity. Conversely, the group will refrain from an investment that would adversely affect an opportunity for you or others if the group learns of the opportunity primarily through you and you are (a) an Investment Committee member, or (b) an Investment Staff member who in turn learned of the opportunity primarily through an advisory committee or similar service for another organization. You should confer freely with the Investment Committee and the Chief Investment Officer to resolve these capacity limitations, but, given their inherent ambiguity, there is no obligation to disclose or seek approval for these investments as long as you make a good faith effort to allocate capacity fairly.

Co-Investment. In general, you may make the same investments as the group, subject to the other requirements of this policy. However, you need approval for a hedge fund or private equity fund co-investment. Your approval request must (a) disclose your personal relationship and transactions with the fund, its affiliates, and their sponsors; (b) disclose any terms of your investment that vary from those set forth in the fund's offering documents; and (c) confirm that the terms of your investment do not depend on any aspect of the group investment. If you receive an approval and co-invest in the fund, you must give prompt notice of any material change in the information provided in your approval request. You may dispose of a fund co-investment (i) after the group; (ii) at the same time and on substantially the same terms as the group; or (iii) before the group for reasons unrelated to the performance of the fund, but only if (x) the group is not contemplating the disposition of its own investment; (y) your disposition will not adversely affect the group's investment; and (z) you obtain an approval. Approvals are required for investments by the group and you in the same fund at different times as well as investments in different funds with the same sponsors.

Front-running. You may not engage in front-running. Front-running means making a personal investment in anticipation of a related transaction by the group or one of its fund managers if the related transaction will affect the value or market for your personal investment. A related transaction means that the personal investment and the group or fund investment represent interests in the same or a similar company, regardless of whether the interests are the same.

Safe Harbor Investments. Nothing in this policy prevents you from investing in any money-market equivalents, government or agency securities, index futures, blind trusts, or mutual funds or similar investment pools that are generally open to retail investors.

Insider Trading; The Rules. The violation of securities laws can result in heavy civil and criminal penalties for employees and their employers. These laws bar the trading of stocks, bonds, and other securities issued by a publicly traded company and their derivatives while aware of material, nonpublic information about the company, whether from an inside source or from an outsider who has misappropriated it. The laws also forbid passing this information to others (also known as "tipping"). Information about a company is material if its public release is likely to affect the price of the company's securities, and it is nonpublic if it is not generally available in the marketplace. Information is from an inside source if the company disclosed it in confidence, for example, to a shareholder, director, officer, employee, or financial or legal advisor. Information has been misappropriated if it was obtained or communicated in violation of an expectation of confidentiality.

Insider Trading; Prevention. You are unlikely to encounter inside information in the course of your work for us because we outsource investment management and instruct our staff to limit discussions with our managers strictly to information that is publicly available. Nevertheless, it is possible. In that event, you must (a) advise the Chief Investment Officer and the Senior Vice President, Operations promptly; (b) refrain from trading securities until one of them has advised you that this information has become stale and dated or generally available in the public domain; and (c) refrain from passing the information to others. If you acquire inside information from a source unrelated to your work at Atlantic, you may not share it with anyone in the group and must recuse yourself from any related investment decision.

Approval Procedures. Submit your approval requests to the appropriate person below. Use the alternate only if he or she is unavailable.

APPROVAL REQUEST BY:	APPROVAL DECISION BY:	ALTERNATE
Staff	CIO	SVP
CIO	IC Chair	Another IC Member
SVP	IC Chair	Another IC Member
IC Member	IC Chair	Another IC Member
IC Chair	Another IC Member	Another IC Member

Note: IC means Investment Committee; CIO means Chief Investment Officer; and SVP means Senior Vice President, Operations.

Approval requests must certify the relevant facts, and approvals must set forth any conditions or qualifications. The requests and approvals must be in written or electronic form and should be copied to the Chief Investment Officer and the Senior Vice President, Operations. The group has no obligation to give approval, and it is your responsibility to make requests for approval well in advance of any planned transaction.

Sanctions. We may require you to rescind any transaction that violates this policy. Violations of this policy are also subject to the sanctions set forth in our Code of Ethics.

Annual Acknowledgment. You should make the disclosures required by this policy and confirm that you will comply with its terms by annually signing the Acknowledgment and Disclosure Form attached to our Code of Ethics and submitting it to our General Counsel.

ACKNOWLEDGMENT AND DISCLOSURE FORM

I understand and will comply with the Personal Investment Policy. To the best of my knowledge, the attached disclosures are accurate and complete.

ACCEPTED AND AGREED:

By: ___________________________
(Signature)

Name: ___________________________
(Print)

Date: _________________, 200_

Exhibit B-5

CONFLICT OF INTEREST POLICY

Philosophy. The possibility of conflicts of interest or the appearance of such conflicts arise in any organization's decision-making processes, including a private foundation. The purpose of the Foundation's conflict of interest policy is to protect the Foundation's interests when it is contemplating entering into a transaction or arrangement that might potentially affect the personal or organizational interests of a director, officer, or staff member in another capacity.

In adopting the Policy, the Board of Directors and management are mindful that the appearance of a conflict can be as damaging to the Foundation as the existence of an actual conflict. For this reason, Foundation Decision Makers must strive to avoid to the greatest extent possible even the appearance that an individual with a conflict has exercised improper influence on a Foundation decision. Overall, the objective of each Foundation Decision Maker must be honesty, fairness, and integrity in all aspects of business and personal conduct, with full disclosure—erring on the side of caution—in any situations that are, may become, or may be perceived as conflicts of interest. No written policy or guide can cover every situation; individual responsibility must be fulfilled through compliance with the spirit as well as the letter of the law governing private foundations, and by careful and thoughtful adherence to a strict code of ethical behavior.

The standards set out in this policy statement are, accordingly, guiding principles, which must be used along with one's good judgment.

This policy is intended to cover and supplement but not replace any applicable federal or state laws governing conflicts of interest applicable to nonprofit and charitable corporations.

A conflict of interest exists when:

> A Foundation Decision Maker takes part in a Foundation decision in which he or she is unlikely to remain impartial or maintain objectivity in choosing between the interests of the Foundation and his or her personal interests.

While a situation involving an actual conflict of interest is relatively easy to identify, a situation involving a potential or perceived conflict of interest can be more difficult to recognize. It is essential, therefore, that all potential or apparent conflicts of interest be disclosed as soon as they become evident regardless of how innocuous they may seem, and that Foundation Decision Makers involved refrain from any action that might constitute a violation of this policy statement until the President has made the appropriate analysis.

The Directors acknowledge that defining and resolving actual or apparent conflicts of interest are often matters of degree and judgment. The President is authorized to interpret and apply these guidelines to individual cases and to resolve other issues that may arise relating to real, potential, or apparent conflicts of interest involving Foundation Decision Makers.

In any situation where the President is the person who may be involved in an actual or perceived conflict, the Chairman of the Board shall act in lieu of the President.

Approach. The Foundation's policy emphasizes (a) disclosure rather than prohibition of conflicts or potential conflicts of interest, and (b) case-by-case resolutions rather than categorical conclusions. This approach combines ethical safeguards with operational flexibility, but its success depends on conscientious self-policing.

Coverage. This policy covers all Foundation Directors and staff.

Acceptance of Gifts. No Foundation Decision Maker or any member of his or her family may accept any gratuitous payment or article of significant value or uncompensated service from a grantee, grant applicant, or supplier, except nominal hospitality. In circumstances where refusal to accept a gift would be ungracious, they may be accepted, provided that the value of the gift does not exceed $75. Gifts made under circumstances arising out of a personal, professional, or not-for-profit relationship with any such grantee or supplier not related to the operations of the Foundation and not intended or likely to influence any grant decisions or engagement of a supplier by the Foundation are not within the purview of this policy. In general, Foundation Decision Makers should make every effort to decline to accept significant gifts on behalf of the Foundation, but in cases where it would be considered ungracious to do so, the Foundation Decision Makers should make clear that the gift is being accepted on behalf of and will be given to the Foundation. (Note: A member of a Foundation Decision Maker's family, when referred to in this Policy, shall include his or her spouse, domestic partner, children, parents, siblings, and spouses or domestic partners of children and siblings.)

Investment Activities. Foundation Decision Makers associated with the Foundation's investment program have a paramount obligation to make all decisions affecting that program solely on the basis of the Foundation's best interests. This requires that they be alert to situations in which a conflict or potential conflict of interest could arise and apply the strictest ethical standards in determining whether such a conflict exists and resolving any real or apparent conflicts. To make such scrutiny possible, Foundation Decision Makers are required to promptly disclose to the President any present or past business connections they or their family members have or have had with any present or proposed manager of the Foundation's assets or any other organization or individual with which the Foundation has, or considers having, an investment relationship. Such disclosure is not necessary when the relationship mutual fund with an investment manager is purely through ownership of shares in a public mutual fund managed by the firm in question, where such shares constitute less than 2% of the total outstanding.

Foundation Decision Makers should not wrongfully use or disclose confidential investment information obtained in the course of Foundation service.

Foundation Board Membership. Service as a Director of the Foundation or as a member of any of its Committees shall only be offered to individuals based upon that individual's personal attributes and professional qualifications. Each such individual should be independent of and not beholden to any other

director or officer. Any director or officer having continuing personal, professional, business, or not-for-profit relationships with any candidate for the Board or existing board member should disclose such relationships to the President.

Compliance

Enforcement.

1. Reporting. Directors who believe that someone has violated a Foundation policy should promptly express their concerns to the Chairman of the Audit and Compliance Committee, or to the Chairman of the Board of Directors if appropriate. Staff should promptly report the issue to the Foundation's Executive Vice President & COO (who is responsible for bringing it to the attention of the President). If management is unresponsive or has itself violated the policy, staff should report their concerns directly to the Chairman of the Foundation's Audit and Compliance Committee.

2. Investigation and Confidentiality. The Foundation will thoroughly investigate reports of violations, and all those involved are required to cooperate with such investigations. The need to be thorough means that the Foundation cannot promise complete confidentiality, but it will act as discreetly as reasonably possible, providing information to individuals on a "need to know basis." When the Foundation completes its investigation and if it concludes that there is a problem, it will promptly take corrective action.

3. Retaliation. The Foundation will not discharge or discriminate against individuals for their allegations or participation in any investigation, and it will strongly discipline anyone who threatens or retaliates against such. Staff should act reasonably and in good faith during any complaint and investigation process.

4. Compliance Officer. The Foundation's Executive Vice President & COO is the compliance officer and is responsible for policing and enforcing the Code and related Foundation policies. Should this officer be deemed compromised in fulfilling his/her duties by the Foundation in its sole discretion, the Chairman of the Audit and Compliance Committee will serve as compliance officer.

Discipline.

Violating Foundation policies may lead to discipline up to and including immediate termination of employment.

CONFLICT OF INTEREST REVIEW – (2004)

MEMORANDUM OF DISCLOSURE

Please answer all questions. If you have nothing to report, answer "none" or "not applicable." An affirmative response does not necessarily imply that the relationship you describe is improper or that it should be terminated. Your responses will assist the Foundation in the proper management and minimization of actual, apparent, or potential conflicts of interest.

I hereby certify to the Foundation that I have read the Conflict of Interest Policy adopted by the Foundation on November 9, 2004 (the "Policy"). I understand its provisions and agree to be bound by them.

1. I serve on the Board of Directors of the following for-profit and not-for-profit entities. (Add attachment if necessary.)

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2. Excluding the Board relationships described above, I am employed by or have received consultancy fees, stipends, or other compensation from the following persons or organizations in the past 12 months. (Please briefly state the nature and extent of services rendered. Add attachment if necessary.)

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3. I have the following family members who have been employed by or rendered services as independent consultants to the Foundation at any time during the past 12 months. (Please note the relationship and in what capacity the relative is employed or has been consulted.)

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4. The following members of my family are affiliated with the following for-profit and not-for-profit entities as a director, officer, Trustee, or other capacity with responsibility for the management or operations of such entity. (Please note the relationship and in what capacity the relative is employed.)

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5. During the past 12 months, there were no contracts, loans, leases, grants, or other financial transactions between the Foundation and myself, including my family members, as well as organizations in which I or a family member is a board member or employee, or has a financial interest, except as stated below. (If a contract or similar transaction, identify the contracting parties and dollar value. If a loan, please state the amount of the loan, interest rate, and amount of the loan outstanding. If a grant, please briefly state the amount of the grant, the name of the organization receiving it, and the organization's connection with you or a family member.)

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6. To my knowledge and unless otherwise indicated below, no person, firm, corporation, or organization with which the Foundation does a material amount of business, has made any personal loans or extensions of credit to, or guaranteed the obligations of, myself or any family member in the last 12 months (except ordinary banking relationships and ordinary consumer credit transactions.) Please briefly describe the amount of the obligation, and, if applicable, the interest rate and the amount outstanding.

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7. In the last 12 months, I (including my family members) have accepted the following gifts, payments, discounts, rebates, entertainment, travel, or other personal benefits from the following persons or organizations with which the Foundation does a material amount of business or to which the Foundation has awarded a grant. (Include an estimate of the dollar value of each such benefit. Benefits of nominal value—less than $75—may be excluded. Directors may exclude any speaking honoraria or service recognition gifts presented publicly.)

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8. To my knowledge and unless otherwise indicated below, neither I, nor any family member, are or have been affiliated with a grantee organization of the Foundation as a director, officer, Trustee, employee, donor, fundraiser, or any other relationship over the last 12 months.

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9. To my knowledge and unless otherwise indicated below, neither I, nor any family member, are or have been affiliated with a significant supplier of goods or services to the Foundation or any individual or organization with which the Foundation does a significant amount of business over the last 12 months.

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10. To my knowledge and unless otherwise indicated below, neither I, nor any family member, have or have had any business connections over the last 12 months with any manager of the Foundation's assets or any other organization or individual with which the Foundation has an investment relationship. (Exclude any connection which consists of ownership of mutual fund shares constituting less than 2% of the total outstanding of a fund managed by an investment manager employed by the Foundation.)

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11. Unless otherwise indicated below, neither I, nor any family member, own more than 35% of the total combined voting power or interest in profits in any corporation, partnership, or other business entity.

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12. The following are material relationships (other than as an employee or director) not already described above that I or a family member have with the Foundation, either directly or as a director, officer, Trustee, employee, donor, fundraiser, consultant, partner, or shareholder of an entity that has a relationship with the Foundation. (If none, state "none.")

Note: A material relationship can include, but is not limited to, commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships.

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The statements provided by me in this Memorandum of Disclosure are accurate and complete to the best of my knowledge. I will promptly notify the Secretary of the Foundation of any changes in such statements which may occur subsequent hereto.

Dated:____________________ By:____

(signature)

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(printed name)