First Community Foundation Partnership
OF PENNSYLVANIA

Investment and Spending Policies

Approved by the FCFP Board, March 15, 2022

The purpose of the First Community Foundation Partnership of Pennsylvania's **Investment and Spending Policies (IS Policies)** is to support current as well as future grantmaking and administrative needs, while ensuring the inflation-adjusted spending power of the Foundation's charitable assets over time.

Because the Foundation is a community foundation, the vast majority of its assets comprise permanent endowments for unrestricted as well as donor-designated charitable needs. With an investment time horizon of essentially forever, the Board of Directors takes a long-term view in setting and monitoring the impact of these policies.

Fiduciary Responsibility

The Board of Directors has fiduciary responsibility for all funds of the Foundation, which are held subject to and in accordance with the Foundation's governing documents (namely its articles of incorporation and bylaws, as may be further amended from time to time).

The Foundation holds all of its assets in corporate form, whether managed as part of the Foundation's pooled investments or separately managed by a financial institution preferred by a donor.

All investment firms and banking institutions must be willing to manage assets subject to the Foundation's governing documents, IS Polices, and the fiduciary oversight of the Board of Directors to assure that our donor's funds, whether part of the Foundation's investment pool or separately managed, will qualify as a "component fund" of our community foundation as defined by the Department of Treasury and Internal Revenue Service (IRS).

Investment Committee

The Board of Directors has delegated supervisory authority over its Investment affairs to the Investment Committee of the Board. In carrying out its responsibilities, the Investment Committee (Committee) and its agents will act in accordance with IS Policies and all applicable laws and regulations. The Board reserves to itself the exclusive right to revise IS Policies, though it will look to the Committee for counsel and guidance.

The Investment Committee will include at least three Board directors, the Board Chairman as an ex-officio member, and the President as an ex-officio member. Members will be appointed by the Board with the goal of creating a diverse committee with expertise in both the financial and charitable fields. The Investment Committee has the following responsibilities:

- Submit to the Board, for approval, IS Policies outlining the objectives and guidelines for the Charitable Pool.
- Periodically review the Investment and Spending Policies and recommend appropriate changes to the Board.
- Include in its IS Policies a list of investment restrictions that the Committee believes are not appropriate for the Foundation.
- Recommend to the Board a spending policy for the Charitable Pool, taking into account sustainable payout rates.
- Monitor the Foundation's Charitable Pool on a quarterly basis and report to the Board at least annually on the status of investments.

- The Committee has chosen to hire an Investment Consultant and shall review them periodically.

In general, the purpose of the IS Policies is to outline a philosophy and attitude that will guide the investment management of the Foundation's funds toward the desired results. It is intended to be sufficiently specific to be meaningful, yet flexible enough to be practical. The Committee has considered the financial implications of a range of policies, and this statement describes the prudent investment process that the Committee deems appropriate.

Certain italicized terms in this document are more specifically defined in the Definitions section.

Total Return Approach

The Foundation utilizes a "Total Return" approach to guide its investing and spending, as allowed by Pennsylvania Codes 5547, 5548, and 5549 pertaining to the use and management of trust assets by nonprofit corporations, and as permitted by its governing documents. This approach allows the Board to establish an annual payout rate based on a percentage of the asset base over a five-year period. The payout amount may be more or less than the actual income earned by interest and dividends, with capital appreciation (and in rare cases principal) used to help meet the established payout when necessary. By using the total return approach, the Foundation is able to maintain and increase the value of donated assets while funding current needs at an appropriate level.

The benefits of total return include:

- The Foundation and its financial partners are not forced to focus investment strategies on required distributions from income alone.
- Because investments can be managed for both growth and income, the Foundation can better focus on current needs while assuring adequate funding for future needs.

A larger and more predictable flow of funds will be available since distribution will not be determined solely by changes in current investment income, interest rates, etc.

Spending Policy

Permanent Funds: The annual cash payout for grantmaking of all permanent funds will be 4.0% of the average fund balance. The average fund balance is calculated using the ending market values of the prior 20 quarters as of June 30 each year and excludes illiquid assets.

The available to grant is calculated as of June 30 and applied during the 1st quarter of the next calendar year. If a fund has been in existence for less than 20 quarters, the average of all available quarters is used. No grantmaking is available until a fund has at least 4 quarters of history on the date of the calculation (June 30). If the average fund balance is less than $10,000, no grants will be available for the next calendar year.

Nonpermanent Funds: Unless the fund document specifies payout amounts and/or timelines, the cash payout for grantmaking of nonpermanent funds will be the fund balance excluding illiquid assets.

Administrative Fees

In addition to the payout for grantmaking the Foundation will assess administrative fees to each fund per the administrative fee schedule in Appendix B of this policy.

Investment Objectives

Short Term Fund

The primary investment objective of this Fund is stability of principal. This fund is appropriate for non-endowed funds or other situations where funds can be withdrawn with little or no advance notice, and/or in situations where only minimal fluctuations to principal can be tolerated. Agencies and donors with time horizons under three years should consider this strategy. For performance evaluation purposes, the Committee will track one, two, and three-year period trailing returns as compared to money market funds.

Medium Term Fund

The primary investment objective of this Fund is to provide payouts with moderate year to year volatility. This Fund may experience some reduction of purchasing power over time due to inflation. This fund is appropriate for endowed funds that require minimal, or no, nominal growth (before inflation) after payouts, or non-endowed funds that have a time horizon that is between three and five years. This fund will most likely experience moderate fluctuations to principal. For performance evaluation purposes, the Committee will track trailing three and five-year period trailing returns compared to the "Conservative Allocation" reference point as compiled by Morningstar and more fully described in the Due Diligence Policy section of this IPS.

Long Term Fund

The investment objective of the Foundation's Long-Term Pool is to meet the payout percentage plus inflation. The Committee has agreed to tolerate the volatility of a growth-oriented asset allocation strategy that may offer the potential for greater Charitable Pool values and greater payouts in the future, understanding that this may result in a less stable payout from year to year.

As is consistent with a growth-oriented portfolio, the investment time horizon is over ten years. For evaluation purposes, discussed more fully in the Asset Allocation Section, the Committee will monitor performance and peer group rankings over the trailing three, five, and ten-year periods.

The Foundation's current Spending Policy of 5%, which includes the payout for grantmaking and the annual administrative fee, implies a target rate of return, before inflation, of 5.0% per year for the Charitable Pool.

To assist the Foundation in gauging the success of the return on investments, the Foundation shall employ as its investment return goal the following formula:

5-year Annualized CPI + Spending Policy (5.0%)

This target return is an average annualized return to be measured on a five-year trailing basis. This is the time period used to judge whether or not the portfolio is meeting its objective. Each individual year may be more or less than target.

Asset Allocation

Short Term Fund

To manage credit risk, investment vehicles used for the Short-Term Fund will be limited to the following:

- Money market funds rated "AAA" or "Aaa" by Moody's Investors Service and/or Standard & Poor's Ratings, respectively, which comply with Section 2a-7 of the Investment Act of 1940, and which maintain a $1 net asset value. Further, these funds must invest at least 90% of their assets in the instruments listed below.
- [Ultra-short bond funds that invest at least 90% of the assets in the instruments listed below, and otherwise meet the criteria of this section, but may have assets with maturities of not more than three years.]
- Short Term Fund assets must have a maturity of one-year or less at time of purchase.
- U.S. Government issues (known as "Treasuries")
- U.S. Government-Sponsored Enterprise Securities (known as "Agencies"), such as Farm Credit System, Federal Home Loan Bank System, Federal National Mortgage Association, and Student Loan Marketing Association, some of which are not explicitly backed by the full faith and credit of the U.S. Government.
- Repurchase agreements with collateralization of at least 102%.
- U.S. Bankers acceptances with ratings similar to those in this section.
- U.S. Bank deposits, including certificates of deposits and other deposits limited by amount and institution such that the principal is fully insured by the FDIC and only at banks rated 165 ("Excellent") or higher, as rated by the *Bank Financial Quarterly*, issued by IDC Financial Publishing, Inc.
- U.S. Commercial paper and short-term notes rated A-1/P-1 by Moody's Investors Service and/or Standard & Poor's Ratings.

Medium Term and Long-Term Fund

The Charitable Pool's risk and liquidity posture are, in large part, a function of asset class mix. Considering the Charitable Pool's investment objective, time horizon, risk tolerances, performance expectations, and asset class preferences, an appropriate portfolio allocation ranges have been identified, as shown in the tables below. The portfolio allocation ranges shown in the tables will not be changed without FCFP Board approval.

Long-Term Fund:

Asset Category	Minimum %	Maximum%
Global Equities	60	80
Investment Grade Fixed Income	10	30
Non-Investment Grade Fixed Income	0	15
Inflation Protection Strategies	0	15
Alternatives	0	10
Cash	0	5

Medium Term Fund:

Asset Category	Minimum %	Maximum%
Global Equities	20	40
Investment Grade Fixed Income	40	60
Non-Investment Grade Fixed Income	0	15
Inflation Protection Strategies	0	20
Alternatives	0	0
Cash	0	20

The Committee will determine specific target asset allocations within the Board designated ranges (above) to implement with the Investment Consultant via the Investment Management Agreement ("IMA"). These target asset allocations expressed in the IMA will not be changed without approval from the Committee. Following allocation implementation, the Investment Consultant is responsible for rebalancing the portfolio.

Investment Restrictions

When selecting mutual funds and *separate account managers*, the Investment Consultant will use due diligence criteria prescribed in the IS Policies (mutual funds and separate account managers will be referred to as "managers" unless specifically referenced).

With the exception of mutual funds chosen pursuant to the due diligence criteria prescribed in the IS Policies, separate account managers must seek permission to use *derivative instruments* as described in the definitions section of the IS Policies.

With the exception of strategies employed by mutual funds that are chosen pursuant to the due diligence criteria prescribed in the IS Policies no securities may be purchased on margin.

No "illiquid" investments may be purchased by a separate account manager or the Investment Consultant, such as private placements, limited partnerships, and hedge fund vehicles, among others. The Committee will consider illiquid investments on a case by case basis.

<u>Cash Management Policy</u>

From time to time the Foundation may maintain large cash balances in reserve for future needs and contingencies or for Non-Endowed Funds. The Consultant is authorized to manage these reserves for enhanced yields consistent with a conservative cash management policy. To manage credit risk, instruments used for cash management will be limited to the following:

- Government issues (known as "Treasuries")
- Government-Sponsored Enterprise Securities (known as "Agencies"), such as Farm Credit System, Federal Home Loan Bank System, Federal National Mortgage Association, and Student Loan Marketing Association, some of which are not explicitly backed by the full faith and credit of the U.S. Government.
- FDIC insured Certificates of Deposit, to be bought only in increments up to the maximum insured limit per bank to assure insurance coverage and only at banks rated 165 ("Excellent") or higher, as rated by the *Bank Financial Quarterly*, issued by IDC Financial Publishing, Inc.

Usually, no instrument will have a maturity at issue, or remaining maturity at purchase, of greater than twelve months. Generally, and depending upon the specific liquidity needs of the Foundation, a *ladder strategy* will be employed to further minimize interest rate risk.

Donor-Recommended Money Manager Policy

The principal objective of the First Community Foundation Partnership of Pennsylvania ("Foundation") is to establish permanent endowment funds and apply the growth from such funds to enhance the quality of life in north central PA. In order to meet this objective, the Foundation must prudently manage its endowment funds. This document establishes guidelines in situations where a donor desires to recommend a specific money manager to oversee his or her fund.

A. <u>Relation to Other Policies</u>

The Board of Directors ("Board") of the Foundation has established Financial, Investment and Gift Acceptance policies. This policy is intended to give donor(s) the ability to recommend a specific money manager to which the Board may delegate the responsibility and authority for investment of the donor's fund's assets. This policy works in conjunction with the other financial policies that the Board has established.

B. <u>Donor Recommendation</u>

A donor may request that the Foundation use a money manager, other than the fund managers the Foundation currently employs. The Board has established a minimum of $500,000 (aggregate of all donor funds) managed by a money manager (this minimum can be achieved over a 12-month period). The donor recognizes that the fees and expenses charged by his or her chosen money manager will be deducted from the total return of the Fund. The donor and the money manager recognize the financial policies (Investment and Spending policy and the Administrative Fee Schedule) of the Foundation apply to the donor's

Fund. The money manager will be requested to utilize mutual funds or other money management type products to achieve the required asset allocation as describe in the foundation's investment and spending policy or to be a part of the foundation's overall Charitable Pool's asset allocation.

C. **Board Discretion**

In all cases, the Board of the Foundation, having been designated as the perpetual steward of the fund and in fulfilling its fiduciary responsibilities, shall have the final approval regarding the investment of and disposition of funds received by the Foundation and the total return there from. The Board can revoke the privilege of the donor recommendation if, in the Board's sole discretion, it determines that the performance of the donor-recommended money manager fails to meet the Foundation's criteria for money management, the minimum amount managed is not reach during the first year or the service quality of the money manager is unsatisfactory in the opinion of the Board. If the Board executes revocation, funds placed with said money manager would be made available to the Foundation within 30 days' written notice and said Fund would be placed with a fund manager of the Foundation's choosing.

Due Diligence Policy

Introduction

For an asset allocation strategy to be effective, each asset class must be represented by using a manager that will best represent the class objective. Otherwise, the results will be much different than anticipated. This is particularly true during times of adversity or crisis.

A qualifying manager must be a registered investment advisor under the Investment Advisors act of 1940. In most instances the Committee will use managers that have established track records of at least five years. A ten-year track record is preferred, if possible. Professional management must be in place, with few major changes, for the period being evaluated. The Committee, with the assistance and support of the Investment Consultant, will decide which managers to use based upon their particular contribution to the portfolio. This often results in having more than one manager for the same asset class, each with a different bias and approach.

To identify managers who fit the implementation objectives, a rigorous research process is followed. The research process involves both a quantitative and qualitative review.

Quantitative Analysis

The quantitative analysis attempts to distill a large universe of managers into a small group of strong performers. Managers who pass this phase of the research process have a history of delivering above-average risk adjusted returns, as measured against their peers who fit the same asset class. Performance during multiple market cycles is observed. The goal is to not chase returns, but to look for consistent, long-term track records of at least five and preferably ten years. Also, a *returns-based style analysis* is performed to assure accurate asset class fit.

Qualitative Analysis

The qualitative analysis involves an in-depth review of the manager and its history. Several years of all published reports are reviewed for consistency of management style and stability of professional staff. A review of historical portfolios is performed for clues about the true style and risk posture of the manager over time. Personal interviews and on-site office visits may be made, as necessary.

Managers are continuously monitored, and new managers are reviewed in an attempt to find the most effective managers, in the judgment of the Investment Consultant.

Benchmarks (Reference Points)

Several evaluation benchmarks are required. One to measure the success of the allocation strategy and others to measure the success of the managers used to implement the allocation.

Growth Allocation Reference Point: This reference point, produced by Morningstar as "Moderate Allocation", invests in both stocks and bonds and maintains a relatively higher position in stocks. These managers typically have 50%-70% of assets in equities and the remainder in fixed income and cash.

The performance of the Foundation's Charitable Pool may be greater or less, depending upon how aggressive the asset allocation strategy is relative to the reference points.

Each manager will be measured against its specific peer group, using a category average of mutual funds with the same asset class focus.

Accounts Managed by Local Advisors

A list of allowable and prohibited securities and transactions for equity and fixed income accounts, managed by local financial partners, is available on request.

The Foundation and Investment Consultant are to be informed immediately by telephone of any significant changes affecting the investment management company or bank, its parent(s), management personnel, ownership, structure, or key personnel, including partners, principals, officers, strategists, and individual portfolio managers. This communication should be followed up in writing within seven (7) business days.

Other Considerations

In all cases, performance evaluations will focus more on trailing three, five, and ten-year performance measures (including risk and risk adjusted measures), rather than short term variances from the benchmarks. Managers are normally expected to perform at or above their peer group averages.

Program-Related Investments

Definition & Background: A Program-Related Investment (PRI) is an investment by a foundation to support a project or activity, which is of a charitable or community benefit nature, is typically beyond the scope of traditional grantmaking, and is viewed as an asset because the principal value of the investment (at a minimum) is expected to be returned. A PRI is similar to a recyclable grant: the repayment of a loan or the return of equity can eventually be recycled for another charitable purpose. PRI's may be made to a non-profit or a for-profit entity engaged in activities that demonstrate a clear community benefit within the parameters identified by the IRS.

PRI's may include, but are not limited to, loans & financing arrangements, loan guarantees to share risk with a traditional lender, pooled or venture capital funding, stock purchases in certain local enterprises, and certificates of deposit with community reinvestment banks. The Foundation may make PRI's directly or may disburse funds to an intermediary organization that then lends or invests the funds for the benefit of qualifying projects. PRI's are not intended to compete with or substitute for traditional for-profit financial resources available within the area, but instead to bridge the gap between traditional funding sources and clearly identified financial needs within the community.

The IRS provides that all investments that qualify as PRI's are exempt from classification as "jeopardizing investments." The IRS defines a PRI as satisfying the following three tests:

- *Its primary purpose is to further some aspect of the foundation's charitable mission;*
- *The production of income or the appreciation of property is not a significant purpose of the PRI (i.e. it is structured to produce lower-than-market returns on a risk-adjusted basis); and*
- *It may not be used to support any lobbying or political campaign activities.*

PRI's are most frequently used to support economic and community development projects but can be used to assist a wide range of public benefit and charitable opportunities. Examples include: neighborhood redevelopment projects, land conservation or historical preservation efforts, job training & development, small-business start-ups, sustainable farming operations, nonprofit capital needs, etc.

The benefits to the Foundation of using PRI's include:

- *Recycled Resources – PRIs can be used to advance program goals and, once they are repaid, can be re-used for new projects*
- *Large Projects – When a desirable project requires funding that exceeds the Foundation's typical grant size, PRIs can sometimes provide the needed capital*
- *Varied Partners & Leverage – PRIs may attract other lenders to the project and leverage additional funds from banks, corporations, or government.*
- *Visibility – PRIs may help support a particularly important local project that requires capital investment.*

The benefits of PRIs for potential recipients include:

- *Applicant Pool – Applicants that may not qualify to apply for a grant from the Foundation, may qualify for a loan or equity investment.*
- *Administrative Strength – PRIs can help foster management capacity and produce a more "bankable" organization over time by helping to establish a credit history.*
- *Large Projects – PRI's can help raise capital in addition to grant resources for larger projects.*

- *Long-Term Relationships – PRIs help establish productive relationships with the Foundation and/or an intermediary funder by creating a partnership with mutual financial and programmatic objectives.*

Spending Limits: The Foundation may use up to 1.5% (cumulative) of its assets to make Program-Related Investments. In determining that percentage, the Foundation will use a 20-quarter or 5-year trailing average market value, exclusive of illiquid assets (such as real estate and other property) and exclusive of any designated funds where PRI's may, in the judgment of the Board, be considered imprudent or impractical. Such investments may be made from the annual payout used for unrestricted grantmaking or may be made from the invested corpus of its assets. Because PRIs funded from corpus and in excess of the 5.0% annual payout may affect the overall total rate of return, such PRIs will not be included when calculating total return. However, performance measures will be established and monitored for all PRIs and reported to the Board at least annually.

Nature & Type of PRI: The decision to make a PRI will be made on a case by case basis by the Board of Directors and shall be consistent with IRS parameters for PRIs and community priorities identified by the Foundation. When necessary, the Foundation shall seek legal counsel from an attorney or attorneys knowledgeable about federal and state regulations as they pertain to PRIs.

Interest Rates, Terms, & Structures: Interest rates on PRIs may vary from zero percent to just below the prevailing market rate. The IRS requires rates to be below-market on a risk-adjusted basis. Typically, rates are calibrated to each borrower's capacity and to the project's ability to make principal and interest payments, return equity, etc. The Foundation's desire to generate interest income from its PRIs may also determine or affect rates, provided earnings are not a significant reason for making the PRI. Generally, PRIs will only be made where there is a likelihood of 15% or less that the PRI will default, although the Board may approve a higher level of risk where warranted.

Re-Payment: PRIs are to be taken seriously and are intended to be repaid. All applicants and projects will be carefully screened, including review of financial status, management capabilities, potential for long-term self-sustainability, credit and community involvement histories, other funding sources, proposed use of funding and relation to identified community needs, risk of default, etc. Written agreements shall be developed for each PRI. When appropriate and possible, the Foundation will work with an intermediary organization – such as financial institution, governmental entity, major nonprofit service provider, etc. – which can reduce the level of risk by drawing on the intermediary's expertise.

Accounting: Foundation staff will work with the Foundation's auditor to track and report on PRIs. In the year that a PRI is made, its entire value will be reflected as a qualifying distribution from the Foundation, as is the case with traditional grants. Outstanding PRIs will remain on the Foundation's balance sheet as a separate asset category until they are repaid or forgiven. Periodically, adjustments may be made to the carrying value of PRIs, based on the likelihood of collection. Interest income from PRIs is treated like interest on any other foundation investment.

Definitions

Derivative Instruments - In general terms, the value of a derivative instrument depends on, or is derived from, the value of an underlying asset, interest rate, index, or other economic benchmark. Examples are options, futures contracts, options on futures contracts, and interest rate swaps, among many others. In addition to typical investment risks, there may be unique risks to these instruments, such as delivery failure, default by the other party, or the inability to close out a position because the trading market becomes illiquid. This definition is not a complete list of the derivative instruments currently available and it is not a complete list of the risks involved.

Separate Account Manager – An investment firm, registered with the SEC, that manages a portfolio of stocks or bonds that is held in a separate account in the name of the Foundation. In brokerage and consulting language, these arrangements are often called "Separately Managed Accounts" (SMAs).

Returns Based Style Analysis (RBSA) – RBSA is a quantitative approach to determining a manager's investment style and evaluating its consistency. The effective asset mix can be determined by comparing actual portfolio returns to the returns of indices (given a sufficient length of portfolio history and a robust mathematical technique).

Local Advisors – The Foundation has advisors located within the community that it may desire to maintain for the foreseeable future.

Ladder Strategy – For cash management purposes, maturities of instruments are spread at regular intervals, usually 90-day intervals. No instrument should have a maturity beyond 360 days.

Appendix A

Duties and Responsibilities of the Investment Consultant

The duties and responsibilities of the Foundation's Investment Consultant include the following:

1) Assist in the development and implementation of investment policies, objectives and guidelines.

2) Prepare an asset allocation analysis and a recommendation of an asset allocation strategy with respect to the Foundation's objectives. Committee approval is required to change the asset allocation strategy; however, the Investment Consultant has discretion to rebalance the portfolio to maintain the asset allocation using the methodology approved by the Foundation's Investment Committee.

3) Supervise and direct the investment of the Charitable Pool as specified in this IS Policies. Supervision is continuous, with limited discretion.

4) Review of Investment Managers – including search, selection and related recommendations. The Investment Consultant has discretion to change managers as required by the Due Diligence Policy described the IS Policies. However, under no circumstances does the Consultant have the discretion to terminate, or reduce investments held with local financial partners.

5) Prepare and present quarterly performance evaluation reports. Each evaluation report will measure performance of the portfolio and each manager within the portfolio, with comparisons to benchmarks and reference points as described in the Due Diligence Policy section. Also, this report will illustrate actual asset allocations as compared to the targets set by the IS Policies.

6) Attend Investment Committee meetings to present performance reports, asset allocation reviews, investment manager searches, etc.

7) Notify the Foundation promptly of any changes in key personnel or ownership of the consulting firm.

8) Assist the Foundation with special projects.

9) Provide the Foundation with a copy of Part II of their Form ADV on an annual basis.

10) Acknowledge and agree in writing to their contractual agreement to fully comply with the entire Investment and Spending Policies set forth herein and as modified in the future.

Appendix B

Administrative Fee Schedule

Permanent (Endowed) Funds **1.0% of Average Fund Balance**

- Fees are calculated annually.
- All funds subject to a minimum annual fee of $250.
- The average fund balance is calculated using the average of the ending market values of the prior 20 quarters as of June 30 each year. The fee is calculated and applied during the 1st quarter of the next calendar year. If a fund has been in existence for less than 20 quarters, the average of all available quarters is used.
- No fee is charged unless a fund has at least 4 quarters of history on the date of the calculation (June 30).
- Organizational endowments that have been split into two funds for FAS 136 reporting will be treated as one fund for Administrative Fee calculations

Non-Permanent Funds **5.0% of the Gift Value**

- Fees are calculated and deducted at time of gift.
- Includes pass-through and other types of funds in which the assets are not permanently endowed.
- No annual fee is charged for the first 3 years of existence of the fund. After 3 years it is expected that the fund will be closed, or the assets will be transferred to a permanent fund.

Trusteeship of Charitable Remainder Trusts, Gift Annuities and other Misc. Funds

- Use above endowment fee schedule as the basis, with the understanding that fees will be negotiated based on the anticipated value of the remainder interest to FCFPA as well as the complexity and likely duration of the trust.

Exceptions to this policy may be granted at the discretion of the President and CEO. The Board of Directors will be notified of exceptions.

Appendix C

Treatment of Excess Business Holdings

Under the Pension Protection Act of 2006 (PPA), the private foundation excess business holdings rules now apply to donor advised funds as if they were private foundations[i]. That is, the holdings of a donor advised fund in a business enterprise, together with the holdings of persons who are disqualified persons with respect to that fund, may not exceed any of the following:

- Twenty percent[ii] of the voting stock[iii] of an incorporated business
- Twenty percent of the profits interest of a partnership or joint venture or the beneficial interest of a trust or similar entity

Ownership of unincorporated businesses that are not substantially related to the fund's purposes is also prohibited.

Donor advised funds receiving gifts of interests in a business enterprise after the date of the PPA's enactment (August 17,2006) will have five years to divest holdings that are above the permitted amount, with the possibility of an additional five years if approved by the Secretary of the Treasury. Funds that currently hold such assets will have a much longer period to divest under the same complicated transition relief given to private foundations in 1969[iv].

What is a business enterprise?
A "business enterprise" is the active conduct of a trade or business, including any activity which is regularly carried on for the production of income from the sale of goods or the performance of services. Specifically excluded from the definition are:

- Holdings that take the form of bonds or other debt instruments unless they are a disguised form of equity
- Income from dividend, interest royalties and from the sale of capital assets
- Income from leases unless the income would be taxed as unrelated business income
- "Functionally-related" business and program-related investments
- Businesses that derive at least 95% of their income from passive sources (dividends, interest, rent, royalties, capital gains). This will have the effect of excluding gifts of interests in most family limited partnerships, and other types of holding company arrangements.

What is a disqualified person?
Donors and persons appointed or designated by donors disqualified persons if they have, or reasonably expect to have, advisory privileges with respect to the donor advised fund by virtue of their status as donors. Members of the donor's and advisor's families are also disqualified, but the section does not define "family" and does not cross-reference either section 4958 or 4946 for the definition. Finally, the term includes 35 percent controlled entities as defined in section 4958(f)(3).

FCFP policy with regard to assets categorized under the PPA as "excess business holdings"

FCFP will identify and monitor any new gift to a donor advised fund of any interest qualifying as an "excess business holding" under the PPA. FCFP will exercise its best effort to dispose of the contributed interest at the best possible price within five years of the date of the gift, as required under the PPA. In any event, FCFP will dispose of any excess business holding prior to the five-year time limit, except in the event that the Treasury Department grants an additional five-year holding period. FCFP will notify potential donors of such interest of this requirement prior to the contribution of such interest.

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[i] The language is clear that it is only the donor advised fund-not the sponsoring charity- that is to be treated as a private foundation. Accordingly, it appears that this section does not apply to assets held by the sponsoring charity's investment pools, or assets held by funds that are not donor advised.

[ii] Thirty-Five percent if it can be shown that persons who are not disqualified have effective control of the business.

[iii] Additionally, the donor advised fund will be barred from holding non-voting stock of an incorporated business unless the disqualified persons collectively own less than 20% of the voting stock. Under the *de-minimis* rule, the donor advised fund could continue to hold an interest that did not exceed two percent of the voting stock and two percent of the value. Additional rules apply to cover situations such as mergers, redemptions, and acquisitions.

[iv] Excess holdings acquired by purchase must be disposed of immediately. If purchases by disqualified persons cause the donor advised fund to have excess holdings, the donor advised fund will have 90 days to dispose of the excess.