TIFF

Enhancing the investment returns of non-profit organizations

COMMENTARY

A Quarterly Report of THE INVESTMENT FUND FOR FOUNDATIONS

JUNE 30, 2002

Trustees

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About TIFF

The Investment Fund for Foundations (TIFF) is a non-profit cooperative founded in 1991 by a nationwide network of foundations. Its mission is to improve the investment returns of eligible organizations by making available to them (1) a series of multi-manager investment vehicles and (2) resources aimed at enhancing fiduciaries' knowledge of investing. Excepting TIFF's president, all TIFF trustees serve as unpaid volunteers.

Carefully Researched. TIFF's investment programs are based on years of extensive study into the investment needs of non-profit endowed organizations. The investment programs that TIFF administers enable member organizations to delegate selection and oversight of money managers and other essential vendors to experienced investment professionals whose personal and professional interests are highly congruent with the interests of TIFF's members.

Investment Vehicles. TIFF administers a variety of multi-manager investment vehicles that enable members to access a broad array of asset classes and strategies, including US and non-US marketable securities, venture capital, buyouts, real estate, natural resources, and absolute return-oriented strategies. For more information, please refer to TIFF's separate quarterly reports entitled *Marketable Investments* and *Alternative Investments*.

Critical Mass. TIFF currently manages assets in excess of $2.5 billion for 362 non-profit organizations worldwide.

Eligibility. The investment vehicles administered by TIFF are open to non-profits operating under section 501(c)(3) of the Internal Revenue Code plus their non-US equivalents. For more information, please contact TIFF at 434-817-8200 or visit our Website at www.tiff.org.

Essential Introspection. As these words are being penned, Tiger Woods is marching toward victory in this year's US Open — his eighth major title (and 32nd overall, excluding team events) in just six years as a professional golfer. In addition to his physical talents and mental toughness, what makes Mr. Woods such an estimable figure is that he is always honest — and never self-satisfied. The two traits go hand in hand, of course, because golf (like investing) is a pursuit in which perfection or anything close to it cannot be achieved. As imperfect as Mr. Woods's game is, it is good enough to make him the dominant golfer of his day. Yet he works harder than most of his competitors, pursuing purposefully his self-imposed goal of winning more major titles than any golfer in history. (Eleven more will do it.) Hard work, honesty, and rigorous introspection: if such traits were in more ample supply 30 miles to the west of where this year's US Open is being contested, perhaps Wall Street wouldn't be in such a funk — or a pickle. In sharp contrast to Mr. Woods, whose unceasing efforts to elevate his play are entirely self-motivated, Wall Street and the corporations whose securities it shuffles arguably need an occasional if not steady lash from others in order to perform satisfactorily. The point is arguable because the current backlash against Wall Street abuses began producing layoffs on the "Street" — and in corporate America — long before prosecutors began pursuing those who perpetrated such abuses. In light of such prosecutions — and the legislation they seem certain to engender — we'll never know the extent to which the corporate sector would have cleaned up its act on its own.

Dismal Performance. Strike that: we know with reasonable certainty that it wouldn't have gone far enough, with "enough" defined as the adoption of performance and disclosure standards that make all aspects of corporate life (including the sales and trading of corporate securities) truly meritocratic. How do we know this? Because some of the persons who dominate corporate boardrooms dominate non-profit boardrooms also, eschewing truly meritocratic standards as much in the latter as they do in the former. To be sure, America's private non-profits are the envy of the world, furnishing vitally important goods and services that other nations furnish more expensively — or not at all — via government agencies. But just as Tiger Woods seeks to improve his game despite being the world's best at it already, so too must America's voluntary sector seek to elevate its level of play. This is especially true in those rare and hence conspicuous instances when a major US charity and a major corporation are controlled by the same persons, as is the case today with respect to two organizations founded by the late Dewitt and Lila Wallace. This *Commentary* focuses a bright and therefore unflattering light on the fiduciaries in question. Why? Because their dismal performance has cost the non-profit sector embarrassment as well as substantial financial harm — and because this writer believes passionately that the best means of preserving the sector's vitally important independence is for those of us privileged to hold leadership positions within it to insist that the organizations we control adhere to the highest possible standards of performance and fair dealing.

Busy Board. Mr. Wallace founded the Reader's Digest in 1922. He and his wife Lila also founded numerous charities, endowing them with shares of Reader's Digest Association (RDA). When Mrs. Wallace died in 1984 (three years after her husband passed on) control of the then-private RDA passed formally into the hands of two grantmaking foundations, one named after her and the other named after him. The assets of these foundations, and indeed the assets of no fewer than 13 other charities endowed with RDA shares, were controlled in subsequent years by a self-selected board chaired by a Reader's Digest executive named George Grune. Though no longer employed by RDA, Mr. Grune still serves on the Wallace Funds' board, although he's bumping up against the Funds' mandatory age cutoff for trustees (forced on them by New York regulators) and will be forced to quit its board in the near future. The Wallace Funds' trustees are or rather should be busier than most foundations' trustees, because they still effectively control a multi-billion dollar public company, despite statements to the contrary by both Wallace Fund and RDA officials. We'll return to this cardinal point later, after noting that the assets overseen by the board that Mr. Grune has dominated for almost two decades have shrunk materially in absolute and relative terms — far beyond any slippage they would have displayed due to the hundreds of millions of dollars in grants that the funds have distributed since Mrs. Wallace died. They've shrunk absolutely because New York's attorney general succeeded not long ago in his efforts to compel Mr. Grune *et al.* to give up control over the investable assets of more than a dozen private foundations created by the Wallaces, each for the benefit of a specific operating charity. Why did New York's attorney general intervene in this manner? Quite apart from any personal ambitions he may harbor (he's the same fellow who's been pushing Merrill Lynch and other stock peddlers to clean up their acts), he moved on the Funds because the company they have controlled 'lo these many years has performed dismally, leaving the 13 charities in question (all organized under New York law) much poorer than they'd have been if they'd diversified out of RDA in a more timely manner. They are diversifying their assets as rapidly as possible, but considerable if not irreversible damage has been done: now trading below their initial public offering price in February 1990, RDA shares have produced a post-IPO total return of just 22% (as of mid-June 2002). Over the same dozen or so years, the broad US stock market (as measured by the Wilshire 5000) has produced a total return exceeding 280%.

Fig Leaf. The underperforming shares just mentioned are RDA's "A" shares, issued when the Wallace Funds floated RDA in 1990 and held now by a diverse array of holders (including at least one hedge fund in which this writer's favorite fund of funds holds a small stake). The Wallace Funds themselves hold "B" shares; the "Bs" get a vote while the "As" do not. Amazingly — and depressingly to those of us who think non-profits should be as scrupulously honest in their dealings and utterances as Tiger Woods is in marking his own scorecard — RDA's executives and Wallace Fund lackeys have argued publicly that the Funds no longer control the company and have not done so since they gave up the unilateral right to name most of its directors a few years ago. (Today they have the unilateral right to name just two of RDA's 10 board members.) The argument that the Funds no longer control RDA is absurd, saying less about the company's sorry governance and more about the trustworthiness of those making such specious claims. With a 50% voting stake (controlled via "B" shares representing a mere 6% of RDA's equity capital) plus compliant RDA management that controls voting shares held by RDA employees, the Funds can block corporate actions requiring shareholder approval that they don't favor and ram through actions that they do. Indeed, they can even block the RDA board from mustering a quorom, the company's by-laws stipulating that the board can't officially convene unless the Funds' representatives are present. It's hard to see what the Funds gain by disclaiming control of the company, except perhaps a fig leaf to cover up their flagrant abuse of their fellow shareholders.

Characteristically Selfish. These words may seem harsh, but consider the facts: under an agreement announced by RDA in mid-April that will be subjected to shareholder approval around the time this essay gets published, RDA will borrow $100 million to repurchase more than half the Funds' voting shares at a 24% premium. The company will also collapse both existing classes of shares into a new class of voting stock, swapping the "A" shares on a 1:1 basis and the "B" shares on an egregiously more favorable 1:1.24 basis. The 24% premium that the Funds will pocket is egregious on multiple counts. The $100 million that RDA must borrow to finance the repurchase will weaken further a balance sheet already crippled by RDA's recent cash purchase (for a staggering $760 million) of 12 lifestyle magazines. This acquisition must generate very large profits to produce a competitive return for RDA shareholders, its consummation having caused RDA's once-sacrosanct investment grade credit rating to plummet to junk status. Endorsed if not handpicked by the Funds' representatives on the RDA board, the company's CEO swore for years that he would protect the company's lofty credit rating at all costs. He also swore that he would not countenance actions that treat "As" and "Bs" differently — a pledge whose violation has caused the "B" shares to outperform slightly the even worse-performing "A" shares. RDA's board knows or has reason to know that the CEO (a smooth-talking fellow named Ryder) has made materially misleading statements — behavior that it has **rewarded** by placing Mr. Ryder (and the Wallace Funds' president Christine deVita, a former RDA employee) in the last class of a newly staggered board. The board's new term structure, coupled with other by-law changes, will help ensure that an entrenched management remains that way for years to come.

Scott's Law. None of this had to be. On at least two occasions, Mr. Grune and his cronies on the RDA board have spurned offers that would almost surely have left all RDA shareholders (including the Wallace Funds) wealthier than they are today. According to former RDA executives, Mr. Grune and his henchmen effectively blocked a sale of the company in the mid-1990s at a price that, if invested in the Wilshire 5000 rather than RDA over the intervening years, would have produced perhaps twice as much terminal wealth as of this writing. More recently, Mr. Grune and his fellow Wallace Fund trustees spurned an offer to sell the Funds' "B" shares for a large premium to an

Room for Improvement *concluded*

activist investor (with a sterling track record as an effective allocator of capital) that proposed to collapse all of RDA's shares into one class of stock with equal voting rights. The latter offer wouldn't have transferred as much wealth from RDA's other shareholders to the Funds as the 24% premium deal described above; indeed, it wouldn't have cost these other holders anything, except the continuing opportunity (if it can be called that) to have their capital stewarded by the same ne'er-do-wells who have made RDA a poster child for corporate — and thus also eleemosynary — mismanagement. To some observers, the Funds' recent maneuvers may seem unobjectionable, RDA's pending offer for their "B" shares promising to enrich these foundations (and hence their future grantees) to a greater extent than the aforementioned offer from an activist holder of "A" shares. But praising such behavior is akin to praising a teenager who washes the family car without being asked after damaging it materially in a crash that was entirely his fault. Treasury Secretary Paul O'Neill clearly went too far when he offered the following solution to the escalating crisis of big-business misconduct: " … [T]he people who have abused our trust, we ought to hang them from the very highest branches." (He **did** say this, to a gathering of small business executives in mid-June.) Whether or not our legal system ends up penalizing acts of omission or commission by Messrs. Ryder and Grune and their allies on the RDA and Wallace Funds boards, these individuals merit criticism if not derision, Scott's Law notwithstanding. Scott was the fellow who said, "No matter what goes wrong, it will probably look right." Despite their sanctimonious attempts to rationalize their behavior, the latest machinations of Mr. Grune *et al.* fall far short of sensible standards of fiduciary conduct. One can only hope that the Wallace Funds' grantmaking programs have been more effective than their trustees' stewardship of the company that the Wallaces left in their care. Come to think of it, such programs could hardly be less so. ■

Membership Summary

	Number of Members	Assets under Management
TIFF Membership	**362**	**$2,503 mm**
▪ Private Foundations	166	$1,116 mm
▪ Community Foundations	36	$294 mm
▪ Educational Organizations	22	$210 mm
▪ Other 501(c)(3) Organizations	138	$883 mm

Aiming High

Superbly Qualified. Consistent with its long-standing rotation policies, TIFF's board recently bid adieu to one highly valued board member and elected a very savvy endowment chief — Jane Mendillo — to fill the resulting vacancy. Currently chief investment officer of Wellesley College, where she supervises investable assets exceeding $1.2 billion, Ms. Mendillo is a long-time and highly respected member of the endowment community. Prior to assuming her current post, Jane served as vice president and head of external manager relations for the investment subsidiary of Harvard University. A graduate of Yale University, from which she earned both her bachelor and MBA degrees, Jane has also worked in Yale's investment office and for the consulting firm Bain & Co. We are delighted that Jane has accepted TIFF's invitation to serve and look forward to working with her in coming years.

Exemplary Service. Ms. Mendillo's election coincided with the rotation off TIFF's board (pursuant to long-standing board rotation policies) of Ann Brownell Sloane. TIFF's longest-serving board member, Ann devoted countless hours to the cooperative, serving with distinction and her characteristic grace as TIFF's board chair for the last year. Mindful that someone as talented and dedicated as Ann cannot be replaced, trustee Will McLean has answered the board's call and has agreed to succeed Ann as TIFF board chair. Currently chief investment officer at Northwestern University, Will was first elected to TIFF's board when he held a similar position at the John D. and Catherine T. MacArthur Foundation. We are grateful that Will has agreed to serve in this capacity and forever grateful to Ann for her exemplary board service. ■

THE INVESTMENT FUND FOR FOUNDATIONS

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