

May 23, 2004 Sunday

SECTION: NEWS SPECIAL EDITION; Pg. 17

LENGTH: 3853 words

HEADLINE: MacArthur brass lives large -- frugal founder didn't

BYLINE: Cheryl L. Reed

HIGHLIGHT:

MacArthur ranks 1st among the nation's top 10 foundations in its ratio of expenses to payout

BODY:

Billionaire John D. MacArthur insisted on flying coach, wore shabby clothes, swore profusely, pocketed half-smoked cigarettes and often stayed in a modest apartment over his Northwest Side insurance office.

When he died in 1978, he left the bulk of his estate to a charity in his and his second wife's names. Since then, the John D. and Catherine T. **MacArthur Foundation** has distributed millions to Third World countries and funded affordable housing and community development in the United States. Yet the nation's 10th-largest charity, with nearly \$4 billion in assets, spends lavishly on salaries and perks for its own employees and board members -- supporting an opulent style that even MacArthur didn't allow himself.

For every dollar it doles out, the **MacArthur Foundation** spends another 40 cents for expenses, ranking it first out of the nation's top 10 charitable foundations in its ratio of expenses to payout. **MacArthur Foundation** officers enjoy some of the top salaries in the nonprofit world. Its chief financial officer pay of \$764,904 in 2002 -- the last tax year filed -- ranked fourth among top foundation executives in the nation.

MacArthur directors and spouses travel first-class -- domestically and internationally -- stay in luxury hotels, including the Four Seasons in Chicago, and take pricey fact-finding trips. In 2002, the foundation spent more than \$2.5 million on travel. One weeklong trip to Africa that year cost \$63,137 for five board members and one spouse. A six-day trip last year to Moscow cost \$73,723 for four board members and three spouses.

"Mr. Mac could have afforded such luxurious travel, and yet he never did. He never had private yachts or private jets," said radio commentator Paul Harvey, 86, one of MacArthur's closest friends who was the voice of Banker's Life & Casualty Co., MacArthur's insurance company, for four decades. "I don't think he ever did anything elegant."

Fortune grew quietly

Despite having a famous brother -- Charles MacArthur, who co-authored "The Front

Page" and married actress Helen Hayes -- John D. MacArthur led a relatively quiet life. He built his fortune by buying a bankrupt insurance company in 1935 for \$2,500 and began a wildly successful program of selling \$1-a-month policies by mail. Later, he became one of the country's biggest landowners with thousands of acres in Florida and many office buildings in Manhattan.

Harvey, who was handpicked by MacArthur to sit on the foundation's board, believes his conservative friend would have vehemently disapproved of its direction: "He would have been exasperated, embarrassed, frustrated and utterly unsympathetic. He would have loved to have banged some heads together."

MacArthur's grandson agrees: "If my grandfather were alive today, he would have utter contempt for the **MacArthur Foundation**," said John "Rick" MacArthur, president and publisher of Harper's Magazine in New York, a nonprofit literary magazine that was rescued in 1980 with \$12.5 million by the **MacArthur Foundation**. "There's no question that my father and grandfather wanted the lowest overhead possible."

Rick MacArthur's father, J. Roderick MacArthur was MacArthur's only son and among the foundation's first six board members, who also included Catherine MacArthur, Harvey and three business associates. But Roderick MacArthur disapproved of how the foundation conducted business and in 1983 filed a lawsuit charging that some new and original board members squandered hundreds of millions of dollars and paid themselves excessively. Roderick MacArthur dropped the lawsuit a year later, a month before he died of pancreatic cancer, the same disease that killed his father six years earlier.

"My grandfather preached the benefits of frugality," said Rick MacArthur. "He was daring in life and didn't want to be respectable. It was all a part of his shtick of mocking authority, mocking so-called 'respectable people.'"

In later years, MacArthur, who had an eighth-grade education, ran his insurance empire from a coffee shop at a dumpy hotel he owned near Palm Beach. Guests frequently mistook him for the maintenance man as he ran around fielding their requests.

It was at that hotel where Harvey often visited MacArthur. One night, two years before MacArthur's death, Harvey kept his friend up all night trying to wriggle out of him what he wanted his foundation to support.

"He kept evading the answer," recalled Harvey. "Finally, towards morning, in half exasperation, he said to me: 'I've seen too many men try to manage their affairs from their graves, and it just can't be done.'"

No breaks for anybody

MacArthur created his foundation because he despised inherited wealth and taxes so much he wanted to bypass his family and government, which would have levied hefty taxes on half his estate.

"The idea behind the foundation was as a tax dodge that he thought would allow his business executives to run his company forever," said Rick MacArthur. "He clearly didn't understand the tax laws."

Rick MacArthur, who often visited his grandfather in Chicago and in Florida, described him as "alternately avuncular to very distant."

"He made it clear that we were not going to inherit his money," he said. "He thought people should work for themselves. He wasn't going to cut anybody any breaks."

Despite being the second-richest man in the country, MacArthur lived a parsimonious life. The son of a preacher, MacArthur was said to be an atheist who made fun of organized religion.

His driving principal was not wasting a morsel. He even collected uneaten food off other people's plates to feed seagulls that would swoop down and perch on the old man's shoulders.

MacArthur adored animals, including his and Catherine's dogs, and once missed an important event because he was climbing around on his hands and knees trying to save a tiny bird.

But MacArthur also liked to shock people with outrageous claims, once bragging that he could castrate a calf with his teeth.

MacArthur had no retinue of servants, chauffeurs or public relations people. Instead, he rose at 4 a.m., cooked for himself and answered his own phone. His one luxury was a Cadillac he drove.

MacArthur's only direction to his foundation was a statement he made before his death: "I figured out how to make the money," he is reported to have said. "You fellows will have to figure out how to spend it."

And, indeed, the **MacArthur Foundation** seems to have had little problem spending money. At first the grants were traditional, like creating a state park near Palm Beach or endowing a university. But as the board expanded and included people unconnected to MacArthur, it began to support more diverse and liberal programs that focused on the "human condition" and international peace.

Now, the foundation ranks first for both its expenses-to-charity ratio and its investment costs -- topping even large foundations that run their own charitable programs. In overall expenses, it ranks fourth nationally.

MacArthur officials dismiss such comparisons and say a numerical analysis of spending doesn't factor in a foundation's complexity or mission.

In 2002, the **MacArthur Foundation** gave away \$195.5 million and spent \$77.7 million in operating and administrative expenses -- including \$52.8 million in investment management expenses.

Besides the foundation's internal investment department, the **MacArthur Foundation** paid \$34 million that year to more than 200 outside investment managers and consultants. In 2002, the foundation reported a net investment loss of \$135 million. In 2001, it reported a \$206 million investment loss.

"We have a strategy that includes investing in private partnerships," explained

Joshua Mintz, **MacArthur Foundation** vice president and general counsel, who said that in 2002, MacArthur had 30 percent of its assets in private investments. "People go into private equity because the return characteristics of that asset class is supposed to be great. So you pay higher fees."

Despite its losses and fees, Mintz says the foundation has had a 7.56 percent return on its investments over the last five years. Investors in the S&P 500 during that same time period would have had a loss of half a percent, according to Ibbotson Associates, a Chicago investment research firm.

"So that's a very, very strong performance," Mintz said, but he refused to release specifically how much money the foundation had netted in order to offset its expenses and losses. "We're constantly looking at it, and we think the expenses are appropriate for the kind of return we are getting."

Investment returns among the nation's top 10 foundations during the same time period varied. The Bill and Melinda Gates Foundation had the highest among reporting foundations with a 9 percent return, and the Pew Charitable Trusts had the lowest with 3.2 percent. Investment expense at Gates, though, was \$29 million -- nearly half of what the **MacArthur Foundation** pays but with eight times the assets. Investment expense at Pew was \$11 million, about a fourth of what MacArthur paid but with a similar asset size. Pew has 6 percent of its assets in private equity; Gates has less than 1 percent in private equity. Investments for both foundations are primarily handled through one investment firm.

Besides grants to promote international and domestic programs, the **MacArthur Foundation** in 2002 gave \$1.4 million to 138 MacArthur Fellows -- artists, writers and scientists who are deemed to show exceptional merit -- and 15 secret consultants who nominated them. The MacArthur Fellows is perhaps the foundation's most original and best-known program, commonly referred to as the "genius grants." Many Fellows receive \$500,000, distributed over five years with no strings attached. Some simply use the money to buy houses while others use it to support them while they take off work.

Surprisingly, the brainchild behind the MacArthur Fellows was Roderick MacArthur, who often felt frustrated that his father hadn't been more of a benefactor to him. Roderick MacArthur even lobbied to support the Fellows for life -- a concept that didn't find favor with the board, including Harvey, who admits he was not initially a fan of the Fellows program: "It got us laughed at."

Son 'was a headache'

Harvey said he got along with Roderick MacArthur, who wanted to make the foundation more international, but he believes MacArthur made a mistake by putting his son on the board.

"Some of his ideas turned out to be very good, but he was a headache and a very expensive liability for many years," said Harvey, who argued with MacArthur about how he treated his son.

"Had he been a little more respectful, appreciative and attentive, his son Rod would have turned out better, and that would have smoothed out a lot of things for our foundation."

Two years before his father died, Roderick MacArthur, also a self-made millionaire, formed his own foundation, known colloquially as "the Little Mac." Today, the J. Roderick **MacArthur Foundation** has \$19 million in assets and supports liberal causes, including the Death Penalty Information Center in Washington, D.C., and the MacArthur Justice Center at the University of Chicago Law School.

"We take the hard cases like coerced confessions, civil liberties and death penalty appeals. We take cases that even the ACLU won't take," Rick MacArthur said of the MacArthur Justice Center.

Loaded with New Englanders

Before his death in 1984, Roderick MacArthur managed to expand the board to include several academics and international heavyweights who pushed the foundation into more innovative programs.

"I used to fume with the foundation about some of its emphases, especially when I felt it was being loaded with New Englanders when MacArthur's roots had been in Chicago," Harvey said.

Harvey said he tried to get more Chicagoans on the board and supported two major Chicago landmarks that would have borne MacArthur's name: a performing arts theater and a lakefront park.

"I was not successful," he lamented. "There were too many on our board who preferred to finance esoteric studies of tsetse flies in Africa or political problems in Russia. Those to me seemed to be delusions of grandeur."

He added: "I was a numerical minority. I was just not that influential to move the board."

At some board meetings, Harvey and other original board members would roll their eyes and stare at the ceiling.

"We tried to imagine what John must be saying to St. Peter," said Harvey, who detailed a long scenario in which MacArthur would try to negotiate with God to let him return to Earth for a month, then a week, and finally a day.

"In desperation, John would say: 'Just let me go down there to one board meeting and set some things straight!'"

Harvey is careful not to criticize current foundation president Jonathan Fanton, whom he calls "wonderful, effective, efficient and unfrontational." [Fanton has been traveling in Nigeria for two weeks, and the **MacArthur Foundation** said he was unavailable to comment for this report.]

Since Fanton joined the foundation in 1999, Harvey believes that the board has turned around. But when asked for specifics, Harvey couldn't provide any.

The board still remains heavily weighted toward East Coasters. Only two current members, besides Fanton, live in Chicago.

"There's still a lot of board involvement in overseas things," Harvey acknowledged. "I never went on any of those trips because I didn't think that was an appropriate expenditure of his money."

Top-level talent among top paid

Despite its position at the bottom of the nation's top 10 foundations for giving, MacArthur ranks third in board and officers compensation -- \$3.5 million a year. Among the top charities in Illinois, five MacArthur employees make the top 10 list.

"It's our policy to recruit and retain top-level talent," said foundation spokesman Raymond Boyer.

The foundation has five officers and 13 board members. All board members were contacted for this story and either declined to comment or did not return phone calls. Board members are paid between \$22,000 and \$42,000 a year to meet four times in Chicago and serve on one to two committees.

Board members, though, don't seem to have a problem with the expense afforded them. Last November, in a Sun-Times interview, board Chair Sara Lawrence-Lightfoot, a renowned Harvard education professor, described her luxurious Four Seasons room on North Michigan Avenue as her "home away from home."

Critics say glitzy rooms at the Four Seasons hardly seem appropriate for tax-exempt, nonprofit personnel. Corporate rates start at \$385 a night for single occupancy and go to \$570, the hotel reported.

When asked why the foundation felt it necessary to incur those kinds of expenses, spokesman Boyer replied, "It's a fine Chicago hotel. It's a great place to stay."

He also defended the foundation's policy to fly board members and their spouses first-class: "We believe for this group of people and what we ask them to do, it's an appropriate policy."

Legislative watch

Foundation watchdog Rick Cohen, executive director of the National Committee for Responsive Philanthropy, insists that such luxuries are unnecessary and eat away at money that is supposed to be going to charities.

"We think that many foundations do quite well with less than five-star hotels and less than first-class travel," Cohen said.

Last year, a proposal in the U.S. House would have stopped foundations from counting their administrative expenses as part of the 5 percent of assets they are required to give away each year. That language, though, never made it into the bill. Foundations pay an excise tax of 1 to 2 percent of their investment income, depending on their generosity.

Foundation advocates argue that its charities have to compete with corporations in attracting qualified applicants. But academics who study foundation compensation say that there seems to be no connection between nonprofit executives' ability to increase assets and their pay.

"Foundations have a sense of entitlement," said Pablo Eisenberg, a senior fellow at the Georgetown Public Policy Institute. "The purpose of tax-exempt dollars is to go to the organizations that do the work to provide public service and social services. It's not for the care and feeding of the board and its fantasy island trips," he said, noting that the MacArthur board members once had a meeting in the Amazon forest.

"There are boards that do not pay their trustees anything, and they are just as good, if not better, than the MacArthur board."

Among the nation's largest foundations, the Bill & Melinda Gates Foundation -- which at \$24 billion has the most assets of any foundation in the world -- actually had the lowest board and officer compensation and one of the lowest top salaries. In 2002, its chief operating officer made \$381,114 and its executive director, a medical doctor, made \$472,358.

MacArthur Foundation officials bristle when questioned about its spending and refused to let a Sun-Times photographer take a picture of MacArthur's bust in the foundation's lobby.

"It is what it is," said Boyer when asked to describe the foundation's complexity. He pointed out that the foundation gives \$25 million a year to programs in Chicago -- about half of what it spends in investment expenses a year.

According to its 2002 annual report, the foundation supports work in 80 countries. Its grants are primarily focused on international peace and security, human rights, the environment, population, urban renewal, affordable housing and public education reform, juvenile justice and mental health.

When asked how the foundation felt it was carrying on MacArthur's philosophies, Boyer said: "John MacArthur when he established the foundation was unique in the degree of latitude that he gave to the initial board of directors."

But Rick MacArthur insists his grandfather would never have supported the kinds of liberal programs favored by the **MacArthur Foundation**, with which he has not had contact since his father's death in 1984.

"After my father's suit, it was pretty bad blood between us," said Rick MacArthur. "I've never gotten a dime from them, and I wouldn't even think of asking for money."

Legacy: 'To be forgotten'

Even MacArthur's dying wishes were not heeded. In his will, MacArthur ordered that his body be donated to a medical school "in order to spare my friends and relatives the inconvenience involved in attending a funeral." He further insisted that no money from his estate be spent on a memorial.

"He didn't want a funeral. No sermons, speeches or eulogies," said Rick MacArthur.

Because his body was riddled with cancer, it was rejected for medical research. Instead, his family had his body cremated and then held a private memorial service. Afterward, Roderick MacArthur borrowed a plane and, while playing a tape of Paul

Harvey's broadcast about his father, spread his ashes over the Atlantic Ocean near Palm Beach.

In 2002, Harvey, MacArthur's last living confidant, retired from the MacArthur board.

"I'm the last survivor," he said.

Harvey believes that MacArthur's legacy in Chicago is simply "to be forgotten."

"It won't matter to him," Harvey said. "He was not one to write his name in lights."

CHARITABLE EARNING //

The top 10 highest-paid executives at Illinois-based foundations and public charities

u Lyn Hutton, **MacArthur Foundation**, vice president and CFO: \$764,904 *

u Jonathan Fanton, **MacArthur Foundation**, president and director: \$525,161

u Paula Banks, BP Foundation, president: \$445,042 *

u Joshua Mintz, **MacArthur Foundation**, vice president and general counsel and assistant secretary: \$399,157

u Steven Nasatir, president, Jewish United Fund and Jewish Federation: \$399,041

u Arthur Sussman, **MacArthur Foundation**, vice president and secretary: \$373,793

u William Lowry, **MacArthur Foundation**, vice president: \$359,377

u Richard Behrenhausen, McCormick Tribune Foundation, president; Cantigny Foundation, president, and Cantigny First Division Foundation, president: \$345,594.

u Gary Smith, National Association for the Exchange of Industrial Resources, president and CEO: \$337,619.

u Donald Stewart, Chicago Community Trust, president and CEO: \$325,862.

SOURCE: Federal tax reports for 2002 for the top 10 giving foundations and nonprofits in Illinois. Totals include all salaries and benefits.

*Those who have left

SHARING THE WEALTH //

The top 10 national foundations by giving

Foundation Giving Expenses

Bill & Melinda Gates \$1.158 billion \$148.3 million

Lilly Endowment \$571.8 million \$22.3 million

Ford \$509.7 million \$130.3 million

Robert Wood Johnson \$359.3 million \$133 million

David and Lucile Packard \$350 million \$27.9 million

Bristol-Myers Squibb Patient Assistance \$297.1 million \$9.3 million

Pew Charitable Trusts \$238.5 million \$37.2 million

Andrew Mellon \$222.6 million \$33.1 million

Starr \$209.3 million \$3.4 million

John D. and Catherine T. MacArthur \$195.5 million \$77.7 million

SOURCE: The Foundation Center database and 2002 federal tax returns

TOP PAY FOR TOP SPOTS //

Top pay and position at nation's top 10 foundations

u Lilly Endowment chairman and director: \$1.2 million

u Robert Wood Johnson Foundation president: \$1.025 million

u Ford Foundation Vice President and CIO: \$884,345

u John D. and Catherine T. **MacArthur Foundation** vice president and CFO:
\$764,904

u Pew Charitable Trusts president and CEO: \$682,149

u Starr Foundation president and director: \$627,314

u Andrew Mellon Foundation president: \$627,045

u David and Lucile Packard Foundation president & chief executive: \$538,549

u Bill & Melinda Gates Foundation executive director: \$472,358

u Bristol-Myers Squibb Patient Assistance Foundation: \$0; (administration is handled through the Bristol-Myers Squibb Co.)

SOURCE: Federal tax returns 2002. Includes all salaries and benefits.

Charities take investment risks // Hedge funds and private equity funds are private investment funds that cater to high-net worth individuals, pension plans, charities and endowments, explained David Handler, partner at Kirkland & Ellis. They are often in the form of limited partnerships, as opposed to publicly traded securities.

Many hedge funds use investment strategies usually prohibited in other types of funds. Techniques include selling short, borrowing money and using options. They

offer investors the possibility of very high returns with above-average risk. Many funds are run by "celebrity" managers who may charge higher fees for their expertise and take a cut of the profits.