Three Pillars of Prudence©

Best Practices for Investment Committees

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What comes to mind when you hear the word PRUDENCE?
Best Practices for Investment Committees
Typical “prudent investor” language focuses more on **how** to act than specifically **what** to do.

To complicate matters, it is a standard of **relative behavior**.

We will explore three specific actions Investment Committees can take to **demonstrate prudence**.
Uniform Prudent Management of Institutional Funds Act

✓ requires assets be invested “prudently”

✓ “in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances”

✓ requires “prudence” in making investment decisions, incurring costs, and reviewing the actions of others
But What Does That Mean...?

✓ Invest prudently like a prudent person while exercising prudence

✓ Be skeptical; ask questions

✓ Act rationally; be consistent

✓ Make good choices
To act as a prudent investor means decisions are properly and thoroughly considered and that a reasonable determination was made at the time the action was taken that it was consistent with the investment program’s objectives.
Prudence is behaviorally-oriented rather than outcome-focused

Prudence is assessed by how the person acted in the selection of the investment, and not whether the investment succeeded or failed

Prudence is found in and demonstrated by the process
The Three Pillars of Prudence®?
Three Pillars of Prudence

- Make decisions using a Prudent PROCESS
- DOCUMENT actions to show the process was followed
- Perform OVERSIGHT at reasonable intervals
Three Pillars of Prudence

Pillar #1: PROCESS
Pillar #1 -- Make Decisions Using a Prudent PROCESS

Investment Committee should have a well-defined process in place to prudently implement the investment objectives and policies, and to support the actions and decisions made by Committee members.
Pillar #1 -- Make Decisions Using a PROCESS
Pillar #1 -- Make Decisions Using a Prudent PROCESS
Process = CREATE

① Committee charter, description of the overall goals of the investment program, key stakeholders, and their roles and responsibilities.

② Understand fundamental investment concepts related to asset classes, historical data, and the types of available investment vehicles.

③ Statement of investment objective, return requirements, risk tolerance, and asset allocation.
⑤ Address portfolio guidelines, eligible investments, restrictions. Establish, in writing, investment authority and fiduciary status.

④ Describes RFP process, how due diligence is performed and criteria used to retain and terminate. Delegating to a third party is a fiduciary action.

⑥ Identify all fees incurred, both direct and indirect, including transaction costs. Understand who receives final payments and verify for reasonableness.
Process = MONITOR

⑦ Review overall compliance with portfolio management guidelines and mandate. Verify reasonableness of transactions and note of any material events.

⑧ Evaluate manager results relative to their mandate the overall results in terms of the policy stated goals and objectives. Understand source of returns (attribution) and measures of consistency (luck vs. skill).

⑨ Verify soft dollar arrangements and proxy voting policy. Establish code of ethics and have it acknowledged in writing by those it covers.
Pillar #1 -- Make Decisions Using a Prudent PROCESS
Three Pillars of Prudence

Pillar #1
PROCESS

Pillar #2
DOCUMENT
Pillar #2 -- DOCUMENT to Show Process was Followed

✓ Documentation serves as the cornerstone for being able to demonstrate the existence of a prudent process

✓ Must be able to show that a decision was properly and thoroughly considered and that it was reasonably determined at the time to be consistent with the goals and objectives of the investment program
Investment committee meeting minutes provide the opportunity to show a process was followed when in making investment decisions.

Organized files provide supporting evidence that a reasonable and adequate basis existed for committee decisions.
Pillar #2 -- DOCUMENT to Show Process was Followed
Pillar #2 -- DOCUMENT to Show Process was Followed

Staying Organized

✔ Chronological

✔ Packet approach w/checklist and signoff

✔ Electronic files (save as PDF / CutePDF)
Consider including the following verbiage in Investment Committee minutes:

✓ Portfolio(s) were found to be in compliance with policies and guidelines

✓ Results were found to be consistent with achieving the long-term objectives of the fund
In addition to minutes, your files should include, but not be limited to:

Analysis and research materials, economic information, presentations, contracts, request for proposals (RFPs), due diligence files, custodial statements, manager reports, consultant reports, fee analysis, commission reviews...
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Pillar #1
PROCESS

Pillar #2
DOCUMENT

Pillar #3
OVERSIGHT
Investment Committee members are charged with high-level supervision of investment assets -- the day-to-day management of the assets is typically delegated to investment professionals...

...delegating responsibility to someone else, whether for investments or other services, is a fiduciary action...
…the Investment Committee remains responsible for ensuring the actions of these delegates have been in compliance with their mandates and is consistent with the objectives of the investment program.
How to verify whether or not your investment manager is a fiduciary...

GET IT IN WRITING!
What actions constitute adequate oversight?

✓ Review actions of delegates
✓ Committee meetings

Consider the evidence of oversight

✓ Reporting up to “parent” committee
✓ Initial and date key documents
✓ Checklists
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- Make decisions using a Prudent **PROCESS**
- **DOCUMENT** actions to show the process was followed
- Perform **OVERSIGHT** at reasonable intervals
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QUESTIONS?

- Make decisions using a Prudent PROCESS
- DOCUMENT actions to show the process was followed
- Perform OVERSIGHT at reasonable intervals

THREE PILLARS of PRUDENCE®

PROCESS

DOCUMENT

OVERSIGHT