Practical Advice for Preparing an Investment Policy Statement

This paper sets out what should be included in an Investment Policy Statement (IPS) for an any organisation with a pool of investment assets to manage. This includes charitable trusts and foundations, Māori and Iwi investment organisations, superannuation and provident funds, and other board-governed investment entities. It provides helpful tips for Stewards who are preparing the IPS internally or adopting an IPS prepared by a financial adviser or fund manager.

For more information on this topic, please also refer to "The Importance and Common Pitfalls of Preparing a Governance-focussed Investment Policy Statement" available in the Learning and Development website.

Introduction

An Investment Policy Statement (IPS) must be governance-focused and owned by those who have responsibility for investment governance such as trustees or directors. A catch all term for people with these fiduciary responsibilities are Investment Stewards. The IPS must reflect the Stewards' investment beliefs and philosophies, the organisation's investment objectives and the strategic parameters the board has set for the organisation's investments. It must contain sufficient detail to define, implement and monitor the organisation's investment strategy and guide the behaviours and decisions of the Stewards in carrying out their fiduciary duties with respect to the investments.

The IPS will be one of the first documents beneficiaries and other stakeholders such as donors look to scrutinise Stewards. It is an important document for Stewards to get right and follow. It can be difficult for Stewards to know what should be included in an IPS and to identify the shortcomings of an IPS prepared by an external business provider.

What Should Be in an IPS?

An IPS sets out the governance framework within which Investment Stewards can make decisions regarding the investment portfolio of their organisation. A litmus test is that it should be detailed enough that it could be carried out by any competent third party (or parties), such as a replacement financial adviser or consultant. It must also be flexible enough that it can be implemented in a complex and changing financial environment. An IPS should not be so detailed that it must be changed regularly to stay up to date[1]. All facts, assumptions and opinions material to the investment portfolio should be included. Specifically, an IPS should include:

[1]Detailed information that can change frequently such as the names of Investment Stewards and other key figures, or capital markets assumptions used to develop asset allocations, can be included in appendices.

- an executive summary that outlines the total current assets of the portfolio, the origin of the asset base, and whether there are other assets not included in the IPS.
- the entity's background (for example, what kind of legal entity it is, its history, purpose and values), its required operational support, and its governance structure.
- a summary of the governing documents of the organisation (for example, a trust deed or other founding document, distribution requirements, any conditions of bequests – anything that affects how the trust must be run) and relevant legislation applying to the organisation that will affect investment governance.
- the roles and responsibilities of the parties involved, both fiduciary and non-fiduciary (for example, the Investment Stewards, Investment Committee, investment staff, external investment advisers, investment managers and custodians).
- the organisation's investment objectives (for example, to maintain the capital value of the portfolio, meet operational funding requirements, follow a particular spending policy or reinvestment strategy, or achieve a particular social or environmental outcome).
- the level of risk that is necessary to achieve its investment objectives, and tolerable for the Investment Stewards and stakeholders.
- the expected returns from the portfolio, referencing appropriate modelling of outcomes. The capital markets assumptions used as inputs in the modelling should be included in an appendix to the IPS.
- the cash flow and liabilities assumptions or 'time horizon' considerations of the organisation.
- diversification and asset allocation policies consistent with the risk, return and time horizon parameters. These should outline asset classes that will be specifically included or excluded in the investment strategy, range limits relating to each asset class, benchmarks for measuring performance in each asset class, rebalancing guidelines and any SRI, property or business considerations. It might also include prudential limits such as illiquidity, single asset, and single manager limits.
- due diligence procedures relating to investment opportunities and the selection of advisers, fund managers and products; or for reviewing the selections made by advisers. For example, the IPS might require that a managed fund product must have been in existence for a certain period of time, or that its total assets under management surpass a certain amount, or that its fees must not be in the bottom quartile (most expensive) of its peer group.
- procedures for ongoing monitoring of the investment service provider(s) and investments. These should include, for example, how often the Investment Stewards will meet to review whether the providers and investments continue to conform to the criteria by which they were selected, or assess any material changes to a provider's organisation, investment philosophy or personnel.
- how often the Investment Stewards intend to review the IPS itself.

- assessment procedures for reviewing the organisation's investment governance generally. Assessments should be against an investment governance standard. The assessment methodology we recommend follows the well-established and recognised approach of ISO19011 (International Organisation for Standardisation). This can be formal or informal, and carried out internally or by an independent party. Investment governance assessments have not been standard practice in the industry, but the current trend is to use assessments to show stakeholders that the IPS and other investment governance procedures are being effectively followed.
- procedures for controlling and accounting for investment fees and expenses.

Who Should Prepare an IPS?

Ownership (both preparation and maintenance) of an IPS is one of the most important fiduciary functions of Investment Stewards, and it is the Stewards who must be able to understand and closely follow its terms. However, Investment Stewards do not necessarily prepare their IPS. In larger investment organisations investment policies are typically written by investment staff. Alternatively, Stewards may appoint an external fiduciary consultant to prepare an IPS, or adopt one written by their investment advisor or fund manager.

Regardless of who Investment Stewards engage to prepare their investment policies they must carefully oversee the preparation process to help ensure it is governance-focused and includes all information the Steward needs. This is important because problems and potential liability arise for Stewards when they have an IPS that is written by an investment service provider, from that provider's point of view, and in that provider's favour. For example, failing to include due diligence procedures for the selection of providers, and failing to set out the roles and responsibilities of all parties, are common omissions in provider-written policies. Using the fi360 investment governance standard as a reference point, and/or engaging an independent party to review the policy are ways to ensure policies meet the Steward's requirements.

The following table includes a few tips for Investment Stewards and other parties often involved in preparation of an IPS to help Stewards obtain an IPS that is of high quality from a fiduciary and governance perspective.

Investment Stewards	Financial Advisers / Fund Managers
While Stewards do not need to be investment experts themselves, they must have a reasonable understanding of how investment markets work and appreciate generally accepted investment principles to ensure the strategy, due diligence and monitoring criteria in the IPS are appropriate.	Ensure the IPS is focussed on governance rather than regulatory compliance.
Set out practical and realistic portfolio objectives that relate to the investing entity's operational, growth or distribution requirements.	Ensure the IPS does not include investment mandate and operational details.
Ensure the IPS reflects the collective investment beliefs of the Stewards (e.g. regarding passive management vs active management or the complexity of investments) as this will guide the selection and monitoring criteria for investment providers.	Ensure the IPS is not too specific to particular managers or products such that no other provider could implement it – it must be tailored to the investing organisation itself.
Think carefully about the spending policy in the IPS in terms of how and when distribution decisions will be made and the magnitude of these. For example, consider whether they will be based on income or total return from the portfolio.	Include relevant peer groups and benchmarks for assessing performance and qualitative approaches for assessment of all providers (including yourself).
Consider identifying content that may be redacted if the IPS is to be published on a public website.	Include risk-adjusted performance measures for the products used so that Stewards know that comparative analysis has taken volatility risk into account.

For charities with uncertain or lumpy donation receipts, make some reasonable assumptions based on track record over, for example, the last three years and document the considerations for clarity when reviewing income expectations.	Avoid restricting due diligence or monitoring criteria as this may invite criticism of your role in preparing the client's IPS.
When setting portfolio risk, most charitable entities should focus on achieving the overall objectives. Then the qualitative perceptions and tolerances of Stewards should be taken into account. Where these conflict (e.g. the Stewards are very conservative but the charity requires high returns) consider how to reconcile these.	Ensure any modelling input assumptions are reasonable to avoid later criticism of the client by its beneficiaries who might be concerned about results coming in below stated expectations.

Maintaining an IPS

As is best investment governance practice, Investment Stewards should review the IPS regularly. It is best to review it at least annually, although a review may also be triggered by particular events.

Stewards should remember that the IPS is a living document - changes in circumstances should be reflected in the IPS. The key here is to make sure the IPS always reflects what is happening in practice. This means that sometimes changes to investment implementation by advisers or managers will need to be immediately reflected in the IPS, provided, of course, that the Stewards consider the changes to be appropriate – Stewards should avoid letting the 'tail wag the dog'. Maintaining an IPS in this way on an ongoing basis ensures Stewards know what the service providers are doing and are happy with it, as reflected in the IPS.

Changes to an IPS might be high-level and administrative, such as reflecting a provider's name change or updating the figure for the total assets of the entity, or changes might be more in-depth and substantive, such as changing asset allocations or the spending policy. The reasoning behind any such change should be recorded in board documents. More substantive changes might then reveal and drive the strategic focus of Stewards for the next period.

A scheduled review of an IPS might be a short or long process, depending on the number of necessary changes. The important thing is the act on of Steward's considering the substance of the IPS and making a conscious decision to change or not to change it.

Conclusion

An IPS is a key governance document that aids Investment Stewards in fulfilling their fiduciary obligations. It is a business plan that Stewards must work to and be accountable for. It ensures that Stewards understand how any investment staff and external service providers are managing the assets Stewards oversee; and that providers understand the investment beliefs and objectives specific to that client. It is a living document that should be prepared with Stewards' governance considerations in mind, referred to when making investment decisions and reviewed regularly.

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