MASTER CLASS: DEVELOPING A PRUDENT INVESTMENT PORTFOLIO

Understanding Investment Policy & Developing a Prudent Investment Portfolio

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NORTHERN TRUST

Investment Strategy & Policy Development

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IPS BASICS – FIVE MAIN ELEMENTS OF A POLICY STATEMENT

1. **Statement of Purpose:** An articulation of the foundation's mission and objectives and how the mission is supported by the financial assets held – overall goals (growth vs. income), time horizon, and risk tolerance. The spending policy and investment approach should be compatible with the qualitative factors that are important to the family, institution or charitable purpose

2. **Statement of Responsibilities:** Define authority, roles and responsibilities – board, investment committee, staff, advisor, manager(s)

3. **Investment Principles & Objectives:** Investment Philosophy - Required return, risk limits, and time horizon. Asset allocation targets, review of impermissible investments/strategies or unique restrictions. If family is involved, include all generations in the discussion.

4. **Strategic Asset Allocation Targets:** Strategic asset allocation targets establish the risk/return profile of the asset pool. Ranges around these targets allow flexibility to address market opportunities and risks

5. **Reporting & Evaluation:** Create a benchmark for each asset class and for the overall portfolio; a discussion of the frequency and format of any periodic portfolio review including the benchmarks and criteria that are important.

ROLES & RESPONSIBILITIES

Legal Responsibility Rests on Board of Directors/ Trustees

- Clear line of authority and clear line of delegation is important

Investment Committee

- Board may delegate to a committee or staff
- Committee may include non-directors
- CFO of non-profit may serve on committee and often is the liaison with advisors and money managers
- Committees receive and review performance reports either written or in person.

Specific Responsibilities Tied to Prudent Investor Laws

- Adopt Investment Policies
- Screen Advisors Carefully
- Ensure Adherence to Policy and Review Investment Performance Regularly

Define Success

- Risk parameters, time frames and self assessment are all elements of determining success

LEGAL CONSIDERATIONS

"Prudent Investor" Standard:

- Generally common law and this standard are applicable for assets structured in a legal "trust" form. Prudent investors are required to invest "considering the purposes, terms, distribution requirements, and other circumstances of the trust." In satisfying this standard, the trustee "shall exercise reasonable care, skill, and caution."
- In the Not-For-Profit context, consider:
  - — Assets that are dedicated to a charitable purpose
  - — Maximize the resources available to the charity with appropriate levels of risk
  - — A trustee's investment and management decisions "must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust."
  - — Consider: general economic conditions; the possible effect of inflation or deflation; the expected tax consequences of investment decisions or strategies; the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property; the expected total return of the investment; needs for liquidity, and preservation or appreciation of capital; and an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

LEGAL CONSIDERATIONS

Uniform Prudent Management of Institutional Funds Act (UPMIFA):

- Applies to the management of all "non-trust" institutional pools of assets.
- Need to act prudently and Incur only reasonable costs / expenses.
- Make reasonable effort to check relevant facts before investing.
- Diversify portfolio and consider the whole portfolio in determining asset suitability.
- Mandates a **"total return"** approach.
- Review and dispose of unsuitable assets.

UPMIFA eliminated "historical dollar value" restrictions and requires Spending Policies to take into consideration organizational purpose, duration and preservation goals, general economic conditions, impacts of future inflation, expected total return, other resources for fund raising, and overall investment strategy – i.e. no bright line on spending limit.

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Also available as part of the eCourse
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