Best Practices for Investment Committees: A Four-Step Process

For most people, sitting on an investment committee or board is not a full-time job. Committee members also bring various levels of investment expertise to the table. Larger organizations tend to engage consultants to assist with decisions, while other organizations may not have that ability. Regardless, investment committees of all sorts are faced with similar considerations when it comes to their fiduciary responsibility and how it guides their process for investment policy statement decisions, asset allocations, manager selections and quarterly reviews.

Here, we’ve illustrated the four-step best practices methodology that we’re seeing successful investment committees use to address these considerations. Our hope is to help investment committee members understand the questions they need to ask of themselves, their consultants and their existing or potential managers – and how to get the answers.

**Step 1: Investment Policy Statement**

As your investment committee crafts or reviews your Investment Policy Statement (IPS), it’s easy to get caught up in discussions about constraints, exclusions, manager performance requirements, etc. right off the bat. Bring the focus back to the overarching objectives and goals.

Define the purpose of the plan. What kind of returns do you want to generate and how much risk are you willing to take to achieve those returns? If you want to make 10% in a given year, you might have to be willing to lose 20% in a given year. Can you afford that?

Define policies and procedures. How will decisions be made? Include rules for order at investment committee meetings and the roles of specific committee members. What happens if a committee member comes to a meeting and declares that going forward, your plan should only invest in gold?

Define your plan’s philosophy for selecting and monitoring investments. What is the procedure if a manager isn’t meeting expectations? Laying out the parameters for when and if a manager is placed on a watch list, for example, will help ensure consistency in your committee’s process.

A solid investment philosophy and procedure for decision-making should help guard your plan against any knee-jerk reactions to various market conditions.
Step 2: Asset Allocation

So now that your committee has outlined the goals of the plan, where do you want to be on the risk/return spectrum? The answer will inform your asset allocation in a diversified portfolio. If you are working with a consultant who presents various risk/return options to your committee, you need to understand what those options might look like in order to have a meaningful discussion and make an informed decision. Do you have a risk analysis procedure in place? Understand which market exposures are portfolio risk drivers. Having proper checks and balances across your portfolio is essential to effectively manage that risk.

It all comes back to your IPS – what is the objective of the plan? What asset classes should you invest in and why in order to meet those needs? And how can you back up your decisions? Arbitrary decisions could be hard to explain. What’s the justification for how you are allocating your investments?

Once you have your allocations set, you need to consider what investment vehicles or product types would serve you best. For example, you may be interested in investing in a certain type of hedge fund, but if you are a smaller plan, you might not be able to meet the minimum investment. Or maybe you are considering investing in private equity. What are your liquidity parameters? How long are you willing to have money tied up?

There is no one-size-fits-all answer. You need to consider what vehicles are best for your plan’s specific needs and goals.

Step 3: Manager Selection and Monitoring

Now it’s time to consider which managers are the most suitable for each specific asset class you have chosen. Do you want to use a boutique firm or a large firm? What about an active manager versus a passive manager? You need to decide which factors you are willing to potentially pay more fees for. Has this manager been true to their style over time?

Make sure if you hired them as a Large Cap manager that they are in fact investing in Large Cap stocks to avoid overlap with other parts of your portfolio.

Better understand what makes one manager different versus their peers. How can you confirm or analyze the story the manager has given you about what makes them unique? For example, the manager might say they are different because they take a top-down approach. What if every other manager in the finals round also takes a top-down approach? Do you have a process to make an objective decision?

Compare apples to apples. You have to balance the objective with the subjective. Do you have enough analytical findings or results to factor into your decision? If utilizing active managers, is there a process to review or negotiate fees? Ensure that your organization is getting the best deal for investment management services provided.

You need to have a robust, but repeatable process for ongoing manager monitoring. It’s important to understand not just how, but why a manager performs the way they do in different market environments. Is the manager adhering to the investment policy you set forth? Have there been any changes in the firm – did a key portfolio manager leave the team? What types of asset flows is the manager seeing? For example, a manager with very good performance is likely to receive inflows. Is that manager handling the volume well? Are they still able to give you the attention you need?
Step 4: Quarterly Review Meeting

The quarterly review meeting is the most important step in the process. Make sure committee members take this meeting seriously. This is your chance to see if the decisions and guidelines you set forth in your IPS are working. Did something not work as planned or intended? Maybe you took more risk than you ended up being comfortable with in practice. Perhaps the investment committee has decided to integrate ESG into the policy. This review meeting is the place to bring up those considerations and make decisions that will inform the IPS going forward.

A properly executed quarterly review meeting meets four objectives:

1. Your committee will be updated on the underlying investments in your portfolio, and can then communicate to other stakeholders in the organization. For example, a university’s investment committee can give an update to the board of trustees from data gleaned in a recent update meeting.
2. Your committee will identify areas of strength and weakness in the investment portfolio. Do certain managers need to be monitored more closely?
3. Your committee will be educated. Whether performed by a consultant, or organized by internal staff, it is critical that committees educate themselves with regards to industry trends, investment best practices and common pitfalls. This is especially true in the event that new committee members have joined the board since the last meeting. Nothing can derail an investment committee faster than a couple new members who misunderstand their role on the committee or interrupt agendas to raise their own issues.
4. Your investment policy statement will be considered. At the end of every meeting, a consultant or the meeting moderator should always have a list of any follow-up items. In constructing this list it is always helpful to ask “Do any decisions today impact our current in-force investment policy statement?” Many times, the answer will be “no,” but consistent IPS review is a critical step in proper investment committee governance.

eVestment can help you get the answers to many of these questions. Contact us today to learn about our intelligence and analytical tools for institutional investors.

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