The Dynamic Investment Policy Statement

How to craft an IPS that is responsive to change

As stewards of assets that benefit others – either presently or at some point in the future – tax exempt organizations have a clear fiduciary duty to thoughtfully and effectively manage investment assets. How well they accomplish that duty plays a crucial role in determining long-term outcomes, with the impact of strategic investment decisions rippling throughout the organization over the course of many years. A formalized process of adopting an investment policy statement (IPS) clarifies goals and expectations, articulates risk tolerances, and establishes decision-making processes.

At its core, an IPS allows your investment committee to define the purpose and goals of the investment portfolio, ensuring that they closely align with the long-term and short-term goals of the organization. Structurally, your IPS provides important portfolio guardrails by defining investment constraints, establishing appropriate investment ranges and target allocations, as well as setting guidelines for performance evaluation and risk monitoring. Operationally, it serves to delineate how specific roles and responsibilities are divided between the investment committee and outside investment advisors or managers. It clarifies when the investment committee acts directly and when it functions in an oversight capacity.

Decision-making processes and degrees of discretion are important investment policy elements that help organizations avoid confusion and establish accountability. The degree of discretion allowed – full discretion to no discretion – is a critical decision that the board must make based on how actively involved they plan to be in day-to-day investment decisions and monitoring.

While not applicable to all non-profits, the Uniform Prudent Management of Institutional Funds Act (UPMIFA) provides a valuable guide to best practices concerning the fiduciary stewardship of investment assets. One of the key expectations of the UPMIFA guidelines is a thoughtful and coherent investment policy statement which is regularly reviewed by the governing body of an organization [see our whitepapers, A Conversation About UPMIFA I and II, for a more thorough exploration of the fiduciary expectations for board members under the UPMIFA standard]. In section IV of UPMIFA, the Seven Standards of Prudence outlines expectations for the management of assets, and specifically references adherence to an institutional investment policy statement. A properly drafted IPS provides a road map that documents your organization’s commitment to prudent investing and reduces the risks of fiduciary liability. What qualities differentiate an exceptional IPS from an ordinary one? What considerations do you need to weigh and what steps should you implement? And perhaps most importantly, how do you begin to create an IPS that is properly aligned with your organizational mission, needs and objectives?

Structuring Your IPS

Before putting pen to paper to craft your institution’s IPS, your investment committee should carefully reflect on and discuss in detail the underlying mission and goals of your organization.

- *What are the short- and long-term objectives and what role will the investment portfolio need to play in funding those planned initiatives?*
- *What percentage of the overall operating budget does the portfolio need to fund?*
- *Are you currently running cash flow positive or negative?*
- *Are there large capital expenditures anticipated in the foreseeable future?*

How Does Your Nonprofit Compare?

98% of nonprofits have a formal, written IPS;

79% conduct scheduled, periodic IPS reviews;

44% made changes to their IPS during the past year; and

84% rebalance their investment portfolio at least annually.
The answers to each of these questions and the discussions that arise will significantly impact the structure and parameters of your IPS. This process will also assist you in identifying any potential gaps that may exist between current investment practices and best practices. For example, a charitable organization that’s heavily dependent on its investment portfolio and committed to several costly near-term capital projects will need to establish considerably more conservative IPS guidelines than an organization with strong positive cash flow and no significant short-term planned expenditures.

Ultimately, your goal is to provide investment guidance that is closely aligned with your foundation’s governance and investment philosophy. Keep in mind, however, that sometimes less can be more. Overly prescriptive investment policy statements can restrict decision makers from pursuing the best interests of the organization and delay the decision-making process.

Who’s Doing What?

Your IPS should delineate the various roles and responsibilities of key stakeholders both internally (e.g., the Board, the CIO, the investment committee and support staff) and externally (e.g., advisors, consultants, investment managers and custodians). At a minimum, you should strive to define who:

- Sets and oversees a “spending policy” to provide sufficient revenue to meet organizational goals, or to meet the IRS’s required minimum distribution for private foundations, while minimizing any erosion of portfolio assets;
- Establishes and oversees strategic allocation targets and tactical leeway as well as appropriate benchmarks;
- Identifies, hires and terminates investment managers;
- Monitors and reports on portfolio performance; and
- Periodically rebalances/reallocates according to established guidelines.

Investment committees and boards have taken note of heightened regulatory scrutiny, volatile financial markets and increasingly complex investment solutions. Many committees have shifted to a “fully discretionary” approach that appoints qualified fiduciaries to make day-to-day investment decisions on their behalf. The IPS must reflect such a delegation and speak directly to the formal responsibility of the committee to provide oversight, not implementation. With a fully discretionary model, the investment committee is able to focus on investment policy setting, core mission governance and investment oversight and monitoring.

Implementing a Flexible Strategic Asset Allocation

Excessive specificity can hamper portfolio returns by constraining agility. At its core, your IPS provides a blueprint of the risks that your organization is willing to take to earn a competitive return.

We live in a fast-moving digital information age where the ability to quickly and flexibly respond to changing market dynamics is essential in order to capitalize on emerging opportunities and mitigate newly identified potential risks. At SunTrust, we encourage our tax exempt clients to think in terms of ranges rather than focusing solely on targets when considering portfolio allocations. The broader the range, the more flexibility the discretionary managers will have to make tactical adjustments. A limited range of a few percentage points on either side of the target affords little flexibility for maneuvering in response to market dynamics and fails to consider asset class appreciation.
In addition to mandating the review and affirmation or modification of allocation ranges on an annual basis, your IPS should clearly define an investment manager review process. What are the precise performance expectations for each manager (e.g., maintaining a ranking in the top 50% of their peer group)? Over what time periods will performance be measured (e.g., 3-5 years)? What will trigger a manager replacement and what are the specific steps that will be undertaken to identify and hire a suitable replacement?

Lastly, periodic rebalancing is essential to appropriately manage risk and keep your portfolio aligned with its goals. In discretionary relationships, rebalancing should be undertaken at the discretion of the investment advisor, but should be periodically reviewed (ideally on a quarterly basis) by your investment committee. Your IPS should outline this process.

**Measurement, Monitoring and Rebalancing**

Your IPS should establish a framework for evaluating performance both at the individual manager level as well as the total portfolio level. The all-important question is, “how are we doing?” The answer can be framed in absolute terms, in relative terms compared to specific benchmarks, or in relative terms compared to peer organizations. Market indices and peer group benchmarks such as Morningstar and Lipper can provide a clear measurement of the value-add generated by your individual investment managers. At the total portfolio level, many nonprofits create a goals-based absolute return benchmark that measures portfolio performance against a target level of return necessary to sustain the organization’s mission. Each of these comparisons contributes to the board’s understanding of the effectiveness of the investment policy and the impact of its implementation.

**How Do Your Investment Committee and IPS Stack Up?**

Whether UPMIFA or peer nonprofits are your guide, the following provides a short list of IPS best practices.

- Meet at least twice annually;
- Ensure that you have a signed IPS that is no more than 3 years old;
- Annually review your organization’s mission, vision, and strategic plan to ensure alignment with IPS;
- Annually review and ensure that your IPS aligns with the organization’s spending policy and liquidity needs;
- Discuss the impact of portfolio volatility on your organization’s ability to meet its mission;
- Assess your portfolio’s ability to meet long-term spending needs for 3 years or longer;
- Assess the alignment of your asset allocation with long-term performance expectations;
- Define and evaluate strategic asset allocation targets and ranges to achieve both diversification and flexibility;
- Assess risk tolerance and compare to current investment objective;
- Define and evaluate primary and/or secondary benchmarks as measures of comparative performance;
- Review the impact of significant strategic or tactical shifts over the past 12 – 24 months; and
- Compare your portfolio’s performance to a defined set of peers.
At a Minimum, Your IPS Should Include All of the Following:

1 Overview
   a. Mission
   b. Goals
   c. Investment Objective
   d. Time Horizon
   e. Spending Policy

2 Delineation of Duties/Responsibilities
   a. Board
   b. Investment Committee
   c. Outsourced CIO (if applicable)
   d. Investment Managers
   e. Custodian(s)

3 A Strategic Allocation Framework
   a. Target Allocations
   b. Strategic Ranges
   c. Rebalancing Strategy
   d. Liquidity Policy
   e. Appropriate Benchmarks

4 Manager Selection, Oversight & Review Process
   (including a description of allowable investment vehicles that are reasonably suited to the institution’s needs as referenced in UPMIFA)

5 Risk Management Guidelines and Restrictions

Your IPS is a dynamic document. It should be reviewed annually to ensure that it reflects your organization’s mission and goals as well as to determine whether any meaningful market or economic events warrant modification.

SunTrust has created a sample IPS template along with a host of other useful tools and templates as part of our Investment Committee Toolkit which can be accessed at www.suntrust.com/toolkit.

For more information about creating or revising an IPS for your organization, contact your SunTrust relationship manager or investment advisor or call us at 866.223.1499.

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2 Raffa Wealth Management “Study on Nonprofit Investing,” April 2013
3 As of September 30, 2016

For more information about the SunTrust Foundations and Endowments Specialty Practice, please visit us at www.suntrust.com/foundationsandendowments or www.suntrust.com/nonprofitinsights

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