



PRUDENT
PRACTICES FOR

Investment Managers

**Defining a Global Fiduciary Standard of
Excellence for Investment Managers**

Organizations that manage separate accounts, mutual funds, unit trusts,
and commingled trusts.

Written by

Centre for Fiduciary Excellence
Fiduciary360

Worldwide Edition

THERE IS A FORMAL STRUCTURE SUPPORTING EFFECTIVE COMPLIANCE.

The success of an investment management business depends upon the investors' trust in the organization. It is therefore important that compliance, both regulatory and from client mandates, be a major emphasis of the organization. The company should support a strong compliance culture and have appropriate resources dedicated to monitoring adherence to those policies. It is important that compliance issues be well documented—typically through a compliance manual.

Some indications of effective compliance are that the firm should not have had a regulatory or compliance breach, nor have been involved in litigation, in the past five years. In cases where there has been a breach, the firm must be able to demonstrate that substantial steps have been taken to ensure similar lapses do not occur again in the future.

Even quality compliance policies and procedures lack effectiveness if there is not centralized enforcement. The organization needs to have an experienced industry executive to serve as Chief Compliance Officer (CCO). The CCO should report directly to the CEO, and have independent access to external management.

The role of the CCO is to:

1. Be the primary watchdog to ensure that the firm complies with all applicable rules and regulations;
2. Stress-test the firm's policies and procedures in order to determine whether the firm is at risk of violating any rules and regulations;
3. Serve as the firm's expert on compliance;
4. Ensure that the firm's operations are conducted in the best interest of the investing public.

In addition to in-house compliance, there should be a system of legal review for interpreting regulation and compliance. All compliance issues should be communicated throughout all levels of an organization.

CRITERIA

- 1.7.1 The organization has compliance policies and procedures manuals, which are kept current.
- 1.7.2 The organization has a designated CCO who is an experienced, senior-level executive.
- 1.7.3 All compliance issues are reported directly to the office of the CCO, regardless of where they originate.
- 1.7.4 The CCO has direct access to the CEO and external management.
- 1.7.5 There is compliance training for all new employees and ongoing training to emphasize changes in both regulations and internal policies.
- 1.7.6 Compliance breaches are documented, reported to the board and appropriate regulators, and procedures are in place to reduce the risk of future non-compliance.

THE PORTFOLIO MANAGEMENT PROCESS FOR EACH DISTINCT STRATEGY IS CLEARLY DEFINED, FOCUSED, AND DOCUMENTED.

The portfolio construction and balancing process produces buy and sell decisions.

There should be rules-based technology to check:

- Investable cash levels (new cash which requires investment as a result of interim contributions or securities income)
- Holdings constraints by: (a) type of security (socially-responsive mandate screens, low-basis or restricted stock) and (b) percentage in a particular security and/or industry
- Manager-defined risk metrics with supporting systems (value at risk, style analysis, market event simulation, integration of the order book with risk measurement indicators, and trade simulation)

A tactical style allocation should be consistent with the investment team's stated strategy, and there should be documented evidence that it adds value to the strategic long-term strategy.

The Manager should have a defined time horizon policy that affects its portfolio turnover, and demonstrate that it has been applied in a consistent way.

CRITERIA

- 3.4.1 An investment committee is in place to set strategy and boundary constraints on the Investment Manager.
- 3.4.2 There is a formal review process of portfolios to ensure adherence to policies and mandates.
- 3.4.3 The portfolio management process for each distinct strategy is clearly defined, focused, and documented
- 3.4.4 The portfolio manager has adequate technical support to plan investment actions and monitor portfolio constraints.
- 3.4.5 The Manager has a defined portfolio turnover strategy and can show that it adds value over time.
- 3.4.6 Tactical asset allocation is consistent with the investment team's stated long-term goals of strategy, client mandate, and risk parameters.

STEP 4: MONITOR

PRACTICE M-4.1

THERE IS A DEFINED PROCESS FOR THE ATTRIBUTION AND REPORTING OF COSTS, PERFORMANCE, AND RISK.

To make informed investment decisions, investors must have easy-to-understand, comparable information. This information includes gross return information, as well as the costing structure of the vehicle they are investing in. Therefore, the investment management team should be in compliance with the CFA Institute's Global Investment Performance Standards (GIPS), which assures comparability of information between investment management companies.

Attribution analysis is central to understanding how an investment system can add value in a consistent way. Although analysis can be applied all the way down to the level of each security held, the traditional approach of risk and return attribution was restricted to investment selection and still applies poorly to fixed-income investments. Technology has improved to a point where cost, integrating transaction cost analysis (TCA), and structural factors (such as sales and marketing strategies and fund flow volatility impacting on cash reserves and rebalancing requirements) are now part of a more general discipline of attribution.

The investment management team should conduct performance attribution analysis and demonstrate that it understands and is actively managing every component which impacts investment risk and return.

CRITERIA

- 4.1.1 The organization conducts comprehensive performance attribution analysis.
- 4.1.2 The organization accurately calculates and verifies portfolio performance.