

PRUDENT  
PRACTICES FOR

# Investment Stewards

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

Persons who have the legal responsibility for managing someone else's money, including trustees and investment committee members.

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**U.S. Edition**

## IT'S ABOUT EXCELLENCE

This handbook also defines a Global Standard of Excellence and what can be done to improve an Investment Steward's decision-making process. The excellence is established by twenty-two *Practices* which are intended to provide the framework of a disciplined investment process.

The twenty-two *Practices* are organized under a four-step Fiduciary Quality Management System. The steps are consistent with the global ISO 9000 Quality Management System standard, which emphasizes continual improvement to a decision-making process:

**Step 1: Organize**  
(Practices that begin with S-1. \_\_)

**Step 2: Formalize**  
(Practices that begin with S-2. \_\_)

**Step 3: Implement**  
(Practices that begin with S-3. \_\_)

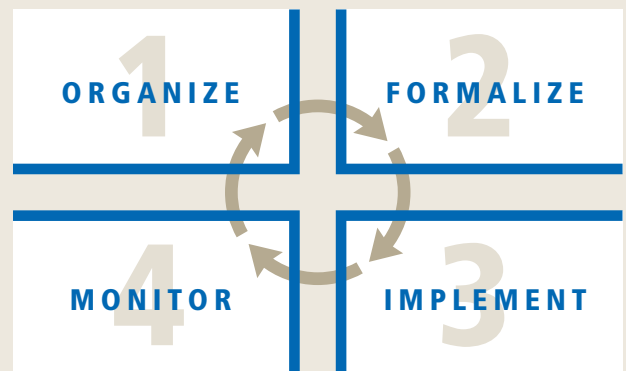
**Step 4: Monitor**  
(Practices that begin with S-4. \_\_)

For each of the twenty-two *Practices*, one or more *Criteria* are provided to establish the scope of the Practice, and to help define the details of the *Global Fiduciary Standard of Excellence*.

The *Practices* represent the minimum process prescribed by law; the *Criteria* represent the details of the Global Standard of Excellence.

### Fiduciary Quality Management System

(Consistent with the ISO 9000 QMS Continual Improvement Process)



### Components of a Standard



**THE ROLES AND RESPONSIBILITIES OF ALL INVOLVED PARTIES (FIDUCIARIES AND NON-FIDUCIARIES) ARE DEFINED, DOCUMENTED, AND ACKNOWLEDGED.**

A fiduciary is defined as someone acting in a position of trust on behalf of, or for the benefit of, a third party. Fiduciary status can be difficult to determine, and is based on *facts and circumstances*. In general, the issue is whether a person has effective control or influence over substantial investment decisions. It is not uncommon for fiduciaries to be unaware of their status.

There are numerous parties involved in the investment process, and each should have their specific duties and requirements detailed in the Investment Policy Statement, or otherwise documented in writing. This ensures continuity of the investment strategy when there is turnover, helps to prevent misunderstandings between parties, and helps to prevent omission of critical functions.

Each party involved in the investment process should acknowledge their defined duties and understand their role in the process. Those designated as fiduciaries need to acknowledge their level and understanding of fiduciary responsibility.

Stewards are responsible for the general management of the investments—in essence, the management of the twenty-two *Practices* presented in this handbook. If statutes and trust provisions permit, the Steward may delegate certain decisions to professional money managers, trustees (co-fiduciaries), and/or investment advisors and consultants. But even when decisions have been delegated to a professional, a Steward can never fully abdicate these primary responsibilities:

- Determining investment goals and objectives
- Approving an appropriate asset allocation strategy
- Establishing an explicit, written investment policy consistent with identified goals and objectives
- Approving appropriate money managers, mutual funds, or other “prudent experts” to implement the investment policy
- Monitoring the activities of the overall investment program for compliance with the investment policy
- Avoiding conflicts of interest and prohibited transactions

As mentioned previously in the Comments Section on the UPIA, the provisions of the UPIA are “default” provisions; i.e. the intentions and guidelines provided by the trust maker in the trust document delegates investment responsibility to, or otherwise appoints, an Investment Advisor other than the trustee to the trust, and the document clearly directs the trustee to allow such delegation, and absolves the trustee of such responsibility, then the trust document prevails.

**CRITERIA**

- 1.2.1 The roles and responsibilities of all parties are documented in the IPS.
- 1.2.2 All parties demonstrate an awareness of their duties and responsibilities.
- 1.2.3 All parties have acknowledged their status in writing.
- 1.2.4 Investment committees have and follow a defined set of by-laws.

**THERE IS AN IPS WHICH CONTAINS THE DETAIL TO DEFINE, IMPLEMENT, AND MANAGE A SPECIFIC INVESTMENT STRATEGY.**

The preparation and maintenance of the IPS is one of the most critical functions of the Investment Steward. The IPS should be viewed as the business plan and the essential management tool for directing and communicating the activities of the portfolio. It is a formal, long-range, strategic plan that allows the Steward to coordinate the management of the investment program in a logical and consistent framework. All material investment facts, assumptions, and opinions should be included.

The IPS should have sufficient detail that a third party would be able to implement the investment strategy; be flexible enough that it can be implemented in a complex and dynamic financial environment; and yet not be so detailed it requires constant revisions and updates. Addendums should be used to identify information that will change on a more frequent basis such as the names of board members, accountants, attorneys, actuaries, and Investment Managers; and the capital markets assumptions used to develop the plan's asset allocation.

The Steward is required to manage investment decisions with a reasonable level of detail. By reducing that detail to writing (i.e., preparing a written IPS) the Steward can: (1) avoid unnecessary differences of opinion and the resulting conflicts; (2) minimize the possibility of missteps due to a lack of clear guidelines; (3) establish a reasoned basis for measuring their compliance; and (4) establish and communicate reasonable and clear expectations with participants, beneficiaries, and investors.

One of the challenges of writing an IPS is to create investment guidelines specific enough to clearly establish the parameters of the desired investment process, yet provide enough latitude so as not to create an oversight burden. This is particularly true when establishing the portfolio's asset allocation and rebalancing limits.

Rebalancing is required to maintain proper diversification, where the goal is to ensure that the portfolio does not stray far from its targeted levels of risk and return. An optimal portfolio only can be maintained by periodically rebalancing the portfolio to maintain the intended diversification.

A well-written IPS can serve to insulate the Investment Steward from the temptation to chase the latest top-performing asset class or "hottest" Investment Manager. By establishing specific asset allocation parameters and money manager (or mutual fund) selection criteria, it is much easier to determine whether a prospective manager fits into the approved investment program.

The Steward should investigate the qualities, characteristics, and merits of each Investment Manager and identify the role each plays in the implementation of the investment strategy. However, such an investigation and the related analysis cannot be conducted in a vacuum—it must be within the context of the needs of the investment strategy. Once the needs have been defined and the general strategies developed, specific Investment Managers should be chosen within the context of this strategy.

## CRITERIA

- 2.6.1 The IPS defines the duties and responsibilities of all parties involved.
- 2.6.2 The IPS defines diversification and rebalancing guidelines consistent with specified risk, return, time horizon, and cash flow parameters.
- 2.6.3 The IPS defines due diligence criteria for selecting investment options.
- 2.6.4 The IPS defines monitoring criteria for investment options and service vendors.
- 2.6.5 The IPS defines procedures for controlling and accounting for investment expenses.

### THERE IS AN IPS WHICH CONTAINS THE DETAIL TO DEFINE, IMPLEMENT, AND MANAGE A SPECIFIC INVESTMENT STRATEGY.

The fiduciary duty to monitor the performance of Investment Managers and other service providers is inherent in the obligations of Stewards to act prudently in carrying out their duties. Specific performance criteria and objectives should be identified for each Investment Manager.

The Steward must establish procedures for controlling and accounting for investment expenses in order to fulfill the obligation to manage investment decisions with the requisite level of care, skill, and prudence; and to fulfill the specific obligation of the fiduciary to pay only reasonable and necessary expenses.

#### Substantiation

##### Employee Retirement Income Security Act of 1974 [ERISA]

§402(c)(3); §404(a); §406(a)(1)(C); §408(b)(2)

##### *Regulations*

29 C.F.R. §2550.404a-1(b)(1)(A); §2550.404a-1(b)(2)(i); 29 C.F.R. §2550.404a-1(b)(2)

##### *Case Law*

*In re Unisys Savings Plan Litigation*, 74 F.3d 420, 19 E.B.C. 2393 (3rd Cir.), *cert. denied*, 510 U.S. 810, 117 S.Ct. 56, 136 L.Ed.2d 19 (1996); *Morrissey v. Curran*, 567 F.2d 546, 1 E.B.C. 1659 (2nd Cir. 1977); *Harley v. Minnesota Mining and Manufacturing Company*, 42 F. Supp.2d 898 (D.Minn. 1999), *aff'd*, 284 F.3d 901 (8th Cir. 2002); *Whitfield v. Cohen*, 682 F. Supp. 188, 9 E.B.C. 1739 (S.D.N.Y. 1988); *Liss v. Smith*, 991 F.Supp. 278 (S.D.N.Y. 1988); *Leigh v. Engle*, 858 F.2d 361, 10 E.B.C. 1041 (7th Cir. 1988), *cert. denied*, 489 U.S. 1078, 109 S.Ct. 1528, 103 L.Ed.2d 833 (1989)

##### *Other*

Interpretive Bulletin 94-2, 29 C.F.R. §2509.94-2; Interpretive Bulletin 75-8, 29 C.F.R. §2509.75-8; Interpretive Bulletin 96-1, 29 C.F.R. §2509.96-1(e); H.R. Report No. 1280, 93rd Cong. 2d Sess. 304, reprinted in 1974 U.S. Code Cong. & Admin. News 5038 (1974)