

Part 4: Investment Policies

Learning Objectives

- Distinguish the different characteristics of stocks, bonds, and other major asset classes
- Understand the risk involved in investing in certain asset classes
- Understand the basic elements of an investment policy statement and be familiar with their system's investment policy
- Understand the role of the trustee as it relates to investment decisions
- Be aware of potential conflicts of interest and how to avoid them
- Understand the basic elements of an investment policy statement and be familiar with their system's investment policy
- Demonstrate understanding of due diligence

State IPS Requirement

State law adopted in 1993 requires all State public retirement systems to adopt a written investment policy. The law does not mandate the type or ratio of investments. The written investment policy must be available to the public for review, and a copy must be filed with the Pension Review Board within 90 days of adoption.

Investment of Surplus

State Code «802.202

When, in the opinion of the governing body, a surplus of funds exists in accounts of a public retirement system over the amount needed to make payments as they become due within the next year, the governing body shall deposit all or as much of the surplus as the governing body considers prudent in a reserve fund for investment.

The governing body shall determine the procedure it finds most efficient and beneficial for the management of the reserve fund of the system. The governing body may directly manage the investments of the system or may choose and contract for professional investment management services.

Investment Policy

State Code «802.202

The governing body of a public retirement system shall:

- (1) develop and adopt a written investment policy;
- (2) maintain for public review at its main office a copy of the policy;
- (3) file a copy of the policy with the State Pension Review Board not later than the 90th day after the date the policy is adopted; and
- (4) file a copy of each change to the policy with the State Pension Review Board not later than the 90th day after the change is adopted.

The Investment Policy Statement

- The business plan for the portfolio.
- Addresses the management of each fiduciary duty
- Help develop standard by which to monitor professionals in achieving results
- Sufficient detail for a competent third party to implement.
- Is a mandate from the plan sponsor to all decision-makers.
- Allows entity to communicate goals to the community.
- Benefits of the IPS far outweigh their counterpoint arguments.
- Faithful execution is essential.

Benefits of an IPS

- Provides a paper trail to rely upon in the event of a legal challenge or dispute.
- Helps decision-making committee members, trustees and others evaluate decisions of their predecessors.
- Keeps investment process intact during market upheaval.

State Pension Review Board Guidance

- For many years, the State Pension Review Board has stressed the importance of written investment policies.
- Having written investment policies in place is a basic minimum requirement for funds to follow.
- Not only does having a written policy focus on a board's investment goals, it also provides an objective framework in which investment managers can operate and allows the board of trustees checkpoints for seeing that their policy is being carried out properly.

IPS Outline

- Executive Summary:
 - Identifying Information, Governing Law, Statement of Objectives, Safe Harbors
- Roles and Responsibilities:
 - Investment Committee, Consultants, Service Providers
- Asset Allocation and Rebalancing
- Due Diligence Procedures
- Monitoring Procedures:
 - Performance, Watch List, Costs, IPS Review
- Attachments:
 - Fund List, Fiduciaries

Executive Summary

Written Investment Policy Introduction

- Who is my Fund?
- Who are my beneficiaries?
- What are their needs?
- How is the Fund governed?
- What are the variety of legal statutes that constrain the Fund operation?
- Who do people talk to when they want to know more?
- What are we trying to achieve in this statement?

See: <https://www.prb.State.gov/resource-center/trustees-administrators/developing-an-investment-policy/>

Statement of Objectives

Investment Objectives *(These should be expressed as a percentage)*

- What are the actuarial assumptions or other minimum earnings rate that we must make in this plan in order to assure long-term growth?
- What is our overall asset allocation?
- How much will we have in government obligations?
- How much in corporate bonds?
- How much in stock, etc.?

See: <https://www.prb.State.gov/resource-center/trustees-administrators/developing-an-investment-policy/>

Statement of Objectives

What are the objectives of the total fund as measured in the following ways?

- Absolute rate of return
- Relative rate of return
- Risk adjusted rate of return
- Real rate of return (measured against inflation)
- What time series do we assign for achieving these objectives?

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Duties and Responsibilities

- Role of the investment committee
- Role of the investment advisor/consultant
- Duties of the custodian
- Duties of money managers

Investment Policy Test

As a “test” a Trustee should be able to read investment policies and answer yes to the following questions.

1. Is the policy carefully designed to meet the real needs and objectives of the retirement plan?
2. Is the policy written so clearly and explicitly that a complete stranger could manage a portfolio and conform to the desired intentions?
3. Would the retirement fund have been able to sustain a commitment to the policies during the capital markets that have been actually experienced over the past ten, twenty, fifty, or even sixty years?
4. Would the investment managers have been able to maintain fidelity to the policy over the same periods?
5. Would the policy, if previously implemented, have achieved the objectives and results desired?

The IPS should focus on the big picture, stating such things as asset allocation, types of allowable investments rather than specific investments, and rate of return objectives. Trustees can refer to their IPS and make adjustments annually.

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Investment Policy Philosophy

Do you believe in a growth philosophy or a conservative income philosophy? Do you believe in long-term, intermediate bonds, or comparing the bonds against an index?

Would you like to address:

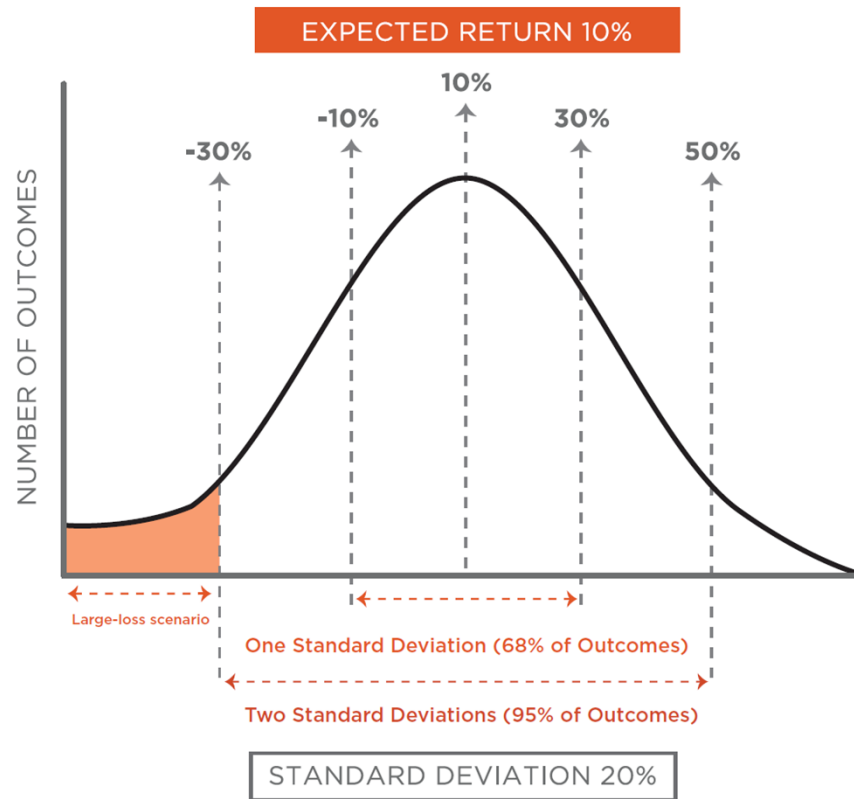
- liquidity issues
- diversification
- preservation of principal
- risk of loss
- restrictions / prohibited transactions
- legislation

See: <https://www.prb.State.gov/resource-center/trustees-administrators/developing-an-investment-policy/>

Time Horizon, Risk, and Return Parameters

- Single portfolios:
 - IPS language should specify time horizon, risk, and projected return parameters

“Large Loss” Scenario



Examples of Investment Assets

- Stocks
- Bonds
- Cash
- Commodities

Examples of Investment Strategies

- Hedge Fund
- Absolute Return
- Active/Tactical
- Leveraged Value
- Opportunistic

Typical Policy Portfolio

Asset Allocation

Lower Threshold

Strategic Allocation

Upper Threshold

Asset Allocation	Lower Threshold	Strategic Allocation	Upper Threshold
Domestic Large-Cap Equities:			
Value	8%	10%	12%
Blend	8%	10%	12%
Growth	8%	10%	12%
Mid-Cap Equities	8%	10%	12%
Small-Cap Equities	8%	10%	12%
International Equities	8%	10%	12%
Intermediate-Term Fixed Income	28%	35%	42%
Cash Equivalents	4%	5%	6%

Also define those asset classes that were excluded.

Rebalancing

- Purpose:
 - keep tracking risk/return profile
- Underlying Philosophy:
 - sell high, buy low
- The Key:
 - sound process consistently applied

Due Diligence

- Track record
- Stability of the organization
- Assets under management
- Portfolio composition consistent with asset class
- Style consistency
- Expense ratio relative to peers
- Risk-adjusted performance relative to peers
- Performance relative to peers on an absolute return basis

IPS Review

Investment Manager Review Procedure

- How often is the manager to be measured?
- Against what indices?
- In the event of extreme circumstances in the investment markets, what should the manager do?
- How will the performance be measured?
- Who will do it?

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IPS Review

- Review at least annually
- Evaluate underlying assumptions, results, and circumstances and adjust as necessary