INNOVEST Investment Consultants & Wealth Management Advisors

The Good and Bad of Investment Committees and Boards

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In working with over 100 investment committees in our careers and as sitting members of boards and investment committees for various non-profit entities, we have experienced the good and bad of committees. While committees vary in their responsibilities, consistent standards of conduct apply to all types of organizations that are responsible for fiduciary assets. For both retirement plans and non-profit investment committees, the following principles apply.

Eliminate conflicts of interest

While conflicts of interest are a seemingly obvious danger for a board or investment committee, they are surprisingly common. If a committee member, his or her family, or business receives an economic benefit by being a member or by any committee decision, they are conflicted. Further, a conflict exists if a decision may benefit any other organization with which they are associated. It is not uncommon for board members of community foundations to join other non-profit boards to encourage the movement of those assets to the community foundation. This is a conflict of interest, and simply abstaining from voting after the wheels are greased is unethical.

Case study

A non-profit board member frequently traveled the country to investment conferences, often on the dime of the non-profit organization. Ironically, the trustee had a side business doing consulting for hire as a fiduciary expert. Was this a conflict? We think so. The marketing of oneself as a trustee or fiduciary expert, and leveraging off the plan encourages self-dealing. A solid code of ethics policy should prohibit use of funds that might personally benefit an individual trustee.

Give authority to the investment committee

Nothing is more frustrating than being delegated a task, only to find out that you do not have the authority to complete it. We frequently find this problem in investment committees. Investment committees are typically comprised of members with investment expertise, yet in many cases, the boards to which they report retain all authority to make investment decisions. Board members are asked to vote on investment policy, asset allocation changes and investment products, even though they are often removed from the investment committee's research and analysis. We believe this approach is not prudent. We recommend that boards set objectives and then delegate investment policy, asset allocation and investment manager decisions to an experienced investment committee.

Case study

The investment committee of a not-for-profit had experienced tremendous turnover. The in-depth exit interviews determined that many committee members were frustrated by what they experienced as second-guessing by board members. They felt that their value in the current structure was non-existent and a waste of their time.

The bylaws of many of our clients are in the process of being revised to give more authority to the investment committees since they are the closest to the analysis and usually have the most investment expertise. The board retains fiduciary responsibility to periodically monitor and supervise the investment

committee's work; however, the committee has the authority to make decisions. This approach to delegation is the model used in UPMIFA (Uniform Prudent Management of Institutional Funds Act).

Define detailed objectives

A defined benefit pension plan has an advantage in that specific objectives are defined by the actuary. With a non-profit board, the objectives are based on the spending policy, grant making and fundraising abilities. Essentially, the healthier an organization and the better the fundraising, the more risk a portfolio can undertake. Risk is a difficult subject for many investment committee members to evaluate, and has become much more complicated with the poor markets over the last 10 years. We believe that an ideal way to evaluate risk is to quantify a portfolio's potential downside loss in a one-year time frame. There are plenty of data points in the last 20 years to calculate a reasonable downside estimate. By understanding return objectives, downside risk tolerance, time horizon, spending, and fundraising, the components are in place to design a fiduciary prudent portfolio.

Case study

Trustees of a non-profit organization retained a number of managers and brokers to independently manage portions of a foundation portfolio. While all managers were given the guideline of "safety with growth," implementing this vague goal was carried out in a variety of ways according to each manager's personal interpretation and preferences. Consequently, the overall portfolio was haphazard, with strategy overlap, lack of diversification in some areas, and high expenses. After the recent difficult markets, the board took a step back and quantified expectations based on grant making expectations, fundraising, and downside risk tolerance. A diversified, efficient, and cohesive portfolio was designed to meet these expectations, and the committee was able to reduce fees in the process.

Ensure a diverse board

A single perspective can unduly influence a board's thinking. Whenever possible, we recommend that a board be comprised of people from various departments, position levels, and backgrounds. Having representatives from finance and human resources on the retirement plan board is a must, but having an all-finance or all-H.R. board is a mistake. Many studies indicate that diversity results in better decisions.

Case study

One of the most difficult non-profit investment committees that we've worked with was comprised entirely of stockbrokers. Overconfidence (90% of all automobile drivers think they are better-than-average drivers) in calling markets and selecting products and strategies based on back-testing dominated the committee's discussions. While having investment professionals on a committee is generally positive, their experience and expertise could be complemented nicely by a CPA, a banker, a money manager, a donor, a fundraiser, and experienced investment committee members from outside the investment business. Decisions by diverse committees tend to be more grounded and better aware of the impact of their decisions on the organization's budgeting, grant making, and fundraising.

Tone down overly dominant members

The dominant member of a board may be one of its senior members, the highest level executive, and/or a large benefactor to the charity. Effective boards recognize that their policy of "one vote per member" can be essential in not being sway toward poor decisions.

Effective leadership in decision making ensures that all sides of the issues are reviewed and analyzed, including the related benefits and detriments. Volunteer boards are often comprised of senior executives who typically lead with "type A" personalities. An effective chair will lead the group to consensus after allowing all sides to give their points. Jim Collins, author of Good to Great, has written about the huge difference between for-profit and non-profit leadership. The role of the non-profit's chair is not to force-feed his or her personal view, but to lead to agreement. If the "bully" board member is the chair, the board and the organization will suffer. All board seats should have term limits, with possible re-election or re-appointment, and a required code of conduct.

Case study

A director of a large department in a company was elected by plan participants to become a retirement plan board member. This new board member considered himself to be an investment "guru," offered his personal investment advice to plan participants and wanted to extend his "expertise" to the whole plan. The board felt that it was fiduciarily risky for its individual members to give advice and could be construed as coming from the entire board. The board passed a "code of conduct" that prohibited its members from giving personal investment advice, effectively stopping the problem.

Violation of these aforementioned principles is common, and is almost always detrimental to the board and often to the organization. Focusing on and abiding by these principles will help ensure success for the boards and committees responsible for fiduciary assets.

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