

Callan



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Asset Management Policy Statement (AMPS) Revisions

Finance Committee Meeting

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Consulting

Introduction

Presenter



Steve Center, CFA

- 9th year with Callan, 20th Year in the industry
- Senior Vice President, Callan Shareholder
- Holder of the right to use the Chartered Financial Analyst® designation
- Manager Search Committee Member

Agenda

Role of a Fiduciary

- What is a Fiduciary?
- Who is a Fiduciary?
- Recommended Conduct of a Fiduciary

Investment Policy Statements (“IPS”)

- Role of Investment Policy Statements
- Benefits of Documentation
- Typical Elements of an IPS

Recommended Revisions to the Asset Management Policy Statement (“AMPS”)

- Proposed Additions
- Proposed Revisions

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Role of a Fiduciary

What is a Fiduciary?

Generally, a fiduciary is...

- Someone entrusted with money or property who is charged with an obligation to **act in the interests of another party**;
- Determined by either legal designation OR their actions;
- Acting "...with the care, skill, prudence, and diligence, that a prudent person acting in like capacity and familiar with such matters would use";
- Largely **determined by actions** as much as by job **title or designation**; and
- Dedicated to a process, evaluating its outcomes and making successive changes to improve.



"Don't worry about doing the right thing. There'll be plenty of time for that when you're fired, retired, or reincarnated."

Historical Review

1830 Prudent Man Rule – Harvard College vs. Amory

1952 Harry Markowitz, Modern Portfolio Theory

1963 Studebaker bankruptcy and pension default

1972 Uniform Management of Institutional Funds Act

1974 ERISA (Employee Retirement Income Security Act)

1992 Prudent Investor Rule

1997 Uniform Management of Public Employee Retirement Systems Act

2006 Uniform Prudent Management of Institutional Funds Act
(revised the 1972 Uniform Management of Institutional Funds Act)

Four Central Duties of a Fiduciary

Duty of Loyalty

Fiduciaries are to act solely in the interest of plan participants and beneficiaries (both current and future) for the exclusive purpose of:

- Providing benefits for participants and their beneficiaries
- Defraying reasonable expenses of administering the plan

Duty of Care

Fiduciaries must act with ***“the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of a like enterprise with like aims.”***

1) Give “appropriate consideration” to facts and circumstances known at that time, including the role of the investment in the total portfolio, and (2) act accordingly.

Prudence requires that a process is followed and documented.

Duty to Diversify

The fiduciary duty “to diversify” means to

“...diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so.”

Duty to Follow Plan Documents

The fiduciary must discharge her/his duties

“in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the [other provisions of ERISA].”

Definition of “documents and instruments governing the plan” can be quite broad and include investment policies and guidelines, plan documents, committee charters, etc.

Who are the Fiduciaries?

Fund Sponsor/Board of Directors	Yes, even if it merely appoints third-party fiduciaries
Trustees	Yes
Finance Committee	Yes
Officers/Employees	Maybe
Investment Consultants	Probably
Actuaries	Probably not
Attorneys	Probably not
Auditors	Probably not
Investment Managers	Yes
Custodian Banks	Yes (in some instances)
Recordkeepers	Probably not

Who decides who is a fiduciary and who is not? Likely a judge or regulator.

Recommendations for Fiduciary Conduct

1. Prepare and periodically review written investment policies
2. Diversify portfolio assets with regards to the specific risk/return objectives
3. Use qualified professional managers (“prudent experts”) to make investment decisions
4. Control and account for all investment fees and expenses
5. Monitor the activities of all money managers and service providers
6. Document the process used to derive investment decisions
7. Engage expert legal counsel
8. Ensure persons involved in investment decisions have the requisite financial competencies



- Fiduciaries are entrusted with acting in the interests of the fund or plan’s beneficiaries, which can seem like a big responsibility
- In general, **process is the friend of fiduciaries** (along with lawyers!), who should establish sound processes that they follow and document to fulfill their duties
- Regulations change, so stay informed to ensure your fiduciaries are fulfilling their obligations and adhering to practices that protect the organization from potential litigation

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**Investment Policy Statements/
Asset Management Policy Statement**

The Benefits of Having an Investment Policy Statement

UPIA/UPMIFA do not require an investment policy statement (“IPS”), so why bother?

- Helps maintain the fiduciary’s focus on executing investment activities through policy lens—NOT the current investment environment
- Objectives, expectations, and processes are not “re-invented” every time an investment issue arises
- Serves as a playbook for new fiduciary members
- Regulatory and oversight entities can ask to see it
- Many public entities must link it to appropriate statutes



*With an investment policy statement,
it is not the thought
that counts...*

UPMIFA = Uniform Prudent Management of Institutional Funds Act (revised 2006)
UPIA = Uniform Prudent Investors Act

Investment Policy Statement Contents

Basic or full details?

- The investment policy statement should reflect each organization's legal requirements and their particular approach to the investment program:
- Length can vary greatly; it should say what your committee wants to communicate to its intended audience
- Avoid "thou shalt" statements to give the committee flexibility to apply a set of beliefs to changing circumstances
- Multiple intended audiences
 - Managers
 - Consultants
 - Trustees
 - Staff
 - Beneficiaries
 - Regulatory authorities
- Qualified legal counsel should review the investment policy statement

Recommendations for Investment Policy Statement Sections

What to Define

- The asset pool
- The relevant parties (board, investment committee, staff, managers, consultants, custodians, etc.) and their respective responsibilities
- The risk/return/target allocation goals and objectives, as well as the process and timing for reviewing those objectives
- General investment guidelines
- Oversight/monitoring process
- Hire/fire process
- Special sections—spending policies, permitted or prohibited investments, etc.
- Review/oversight/approval process for investment policy statement changes



Recommendations for Investment Policy Statements



- Most important: recognize that the investment policy statement should be an honest appraisal of what is required to effectively manage the asset pool of YOUR organization
- Engage outside advisers and counsel to help identify areas of weak governance and change those areas
- The worst thing to do is to build an overly complex, aspirational investment policy statement that doesn't reflect your process and then **NOT** follow it



The IPS is a tool to provide consistency, structure, and repeatability to your investment oversight process. Use it!

- The investment policy statement (IPS) is essential for sound fiduciary management of the asset pool
- There is no single “best” IPS, just the one that works best for your plan or fund
- The only greater sin than not having an IPS is not following the one that you have
- Set aside time at least annually to thoroughly review the IPS
- Make sure that the IPS is central to any discussions or decisions relative to the asset pool

Asset Management Policy Statement Revision Proposals

Legislative Audit Report

Legislative audit report identified three concerns around existing Asset Management Policy Statement (“AMPS”):

- Need for an entity-wide perspective that addresses all Trust assets
- Need for guidance around the commercial real estate investment program
- Use of the Trust Land Office (“TLO”) as a real estate investment manager

Addition of Clearly Defined Roles and Responsibilities

- The current AMPS includes a glossary with some defined roles and responsibilities, though the list was incomplete.
- Callan has proposed adding a “Roles and Responsibilities” section to the AMPS, immediately following the “Background” section, which clearly defines the responsibilities of the:
 - Board of Trustees
 - Finance Committee
 - Resource Management Committee
 - Chief Executive Officer
 - Chief Financial Officer
 - Trust Land Office Executive Director
 - Trust Land Office
 - Alaska Permanent Fund Corporation
 - Department of Revenue
 - Independent Real Estate Advisor

Addition of Performance Benchmarks

- Callan has proposed adding performance benchmarks for the underlying investment pools within the Trust.
- The Current AMPS specifies a long-term performance goal for the Trust of 5% over the rate of inflation (“CPI + 5%”).
- Callan believes using market-based benchmarks to measure the return and risk of the Trust’s underlying investments is prudent.
- Benchmarks should be:
 - Investible
 - Measureable
 - Unambiguous
 - Appropriate for the underlying investments

Addition of Independent Oversight of Commercial Real Estate Investments

- Callan recommends hiring an independent real estate advisor to directly oversee the Trust's commercial real estate investments on a fiduciary basis.
- This firm will not replace the duties currently handled by the Trust Land Office, but rather will serve as an outside party reviewing the activity of the TLO as it relates to the commercial real estate properties.
- Services provided by the independent real estate advisor will likely include valuation, market research, property management assistance, and performance measurement.
- The independent real estate advisor will report directly the Finance Committee and Board of Trustees regarding the Trust's commercial real estate investments.
- Callan has already been retained by the Trust to assist in identifying a third-party real estate advisor, with a Request for Proposal scheduled to be released shortly.

Investment Manager Oversight

- Callan has proposed adding periodic review process in which the Finance Committee meets with the parties responsible for managing investments on behalf of the Trust.
- The revised AMPS will require the Finance Committee to meet at least annually with:
 - Alaska Permanent Fund Corporation
 - The third-party real estate advisor
 - Trust Land Office
 - Department of Revenue
- Note that these meetings may take place during the Trust's regular quarterly Board meetings or could involve members of the Finance Committee attending a quarterly meeting of the APFC Board of Trustees.

Additional Items

- Callan has added language requiring the AMPS to be reviewed at least annually.
- The current AMPS refers to the Trust's land and commercial real estate assets as "non-cash" assets, and all other investments as "cash" assets. Callan has proposed replacing these terms with "non-liquid" and "liquid" to avoid confusion. "Cash" typically refers to short-term, low-risk investments, which does not properly describe the assets held at APFC.

What Callan did not add:

- Callan considered adding asset allocation targets to the AMPS, which would outline target percentages to be allocated to APFC, TLO, etc. However, given the nature of the substantial illiquid land asset portfolio held by the Trust, and the Board of Trustees has little ability to control the percentage allocated to any one investment pool. For this reason, we chose to omit this section.
- While outside the purview of the AMPS, Callan recommends the Trust conduct a review of its spending policy on a periodic basis.

About Callan

An Overview of Callan LLC

Focus, Experience, Resources

Independent & Focused

- Established in 1973
- 100% employee owned
- Third generation of private ownership
- 89 current owner-employees

Experienced

- Over 40 years helping large institutional investors with asset allocation, designing/implementing multi-manager portfolios
- Over \$2.5 trillion in assets under advisement across more than 400 clients
- Experienced research specialists in all areas of plan governance and implementation

Fully Resourced

- Over 190 employees, mostly investment professionals
- 57 CFA and/or CAIA , FRM charter holders, and 65 advanced degrees
- Asset management effort fully supported by Callan's research, operations, and compliance groups, as well as our proprietary systems and databases

Callan has been the investment consultant for the Alaska Permanent Fund Corporation and Alaska Retirement Management Board for more than 20 years

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