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Making a statement

Ian Creswick of Thesis Asset Management examines what should be considered when writing an investment policy statement for a trust.



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The Trustee Act of 2000 came into force in February 2001, but there are still trust investment portfolios with no written investment policy statement. The Trustee Act gave trustees much greater powers, but with power comes responsibility and one such responsibility is the legal obligation, set out in section 15 of the Act, for trustees to formulate and review such a policy with their discretionary investment manager. This requirement applies equally to charity trustees and is in addition to any "know your client" form or investment management agreement.

Ideally the investment policy should be drawn up before an investment manager is chosen. If care is taken drawing up the policy statement at the outset, it will make it that much easier for the trustees to

review the performance of their chosen investment manager, and the reasons for any failure to live up to expectations.

The main purpose of policy statements is to set out the context, guidelines and conditions under which the trust's portfolio is to be delegated.

I would suggest that it should contain the following:

Background

In setting out the terms of the trust and type e.g. discretionary or interest in possession etc, it may be useful to include any relevant brief facts about the beneficiaries, although some information, such as dates of birth might instead be included on the investment manager's know your client (KYC) form. It would also be prudent to summarise any relevant

clauses of the will/settlement.

Aims and Objectives

These may be fairly straightforward, such as providing an income for a widow with the residue ultimately passing onto their children, or as an estate planning exercise to provide future education where the main investment objective is to provide capital growth for the next few years. However the word "balance", seemingly quite innocuous, can require greater definition. Whilst the layman may feel that this implies a 50/50 split between income and capital growth, for many in the investment community an investment portfolio containing 75 percent equities might still be deemed as "balanced". Many stockbrokers and investment managers use the APCIMS Indices as benchmarks; their



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“balanced” index comprises 65 percent equities, 25 percent bonds and cash, with the remainder split between UK commercial property and hedge funds. To get closer to a 50/50 portfolio, the equivalent APCIMs benchmark is called “income” but still contains 55 percent equities.

Particular Preferences and Constraints

Most investment managers prefer not to have their hands tied, but there may be some specific requirements, perhaps set out in a Letter of Wishes, which may dictate specific e.g. ethical, geographical or income requirements. Being too prescriptive can limit an investment manager’s flexibility and ability to diversify risk. Ethical considerations, if not defined, can be problematic for an investment manager. Trustees should not in general impose their own moral views potentially at the expense of the charity or beneficiaries.

Taxation policy should be clarified, particularly as at the time of writing there is a wide difference between Income and Capital Gains Taxes. This is a grey area which is mostly discerned with hindsight, but an investment manager needs to know the likely impact of tax on the investment portfolio, particularly if there is a reduced exemption.

Risk Profile

As with a “balanced” portfolio, “risk” can be a dangerous topic. Many clients may

confuse “low risk” with “no risk”, or conversely wish to take a high risk approach until they start losing money! It is vital for the trustees and the investment manager to ensure that each has a clear understanding of what the other party means. Many investment managers have their own questionnaire, or guide to risk to help confirm this understanding.

If appropriate any timescales, such as for capital sums required, should be identified.

Benchmark

This should be appropriate for the aims and objectives, and as mentioned above, many investment managers suggest the FTSE APCIMS Indices, with the caveat to look at the asset allocation behind the name of the particular index. The benchmark should be discussed first with the portfolio manager so that both sides are happy with what is proposed. There is a risk otherwise that the benchmark becomes not the yardstick by which performance is measured but the driver behind portfolio composition with the managers afraid to deviate too far from the standard composition.

As well as any specific requirements which may have been included under previous categories, the trustees may wish to specify a level of cash reserves for a “cash float”.

Review

The investment managers will generally

provide the trustees with six monthly valuations and should report against the appropriate benchmark. If the managers are either lagging behind or beating this yardstick by several percentage points on a consistent basis then further questions need to be asked. Although it is obviously pleasing to be beating a benchmark, it might mean the manager is taking more risk than the trustees appreciate or desire. I would suggest that the investment policy itself should be reviewed at least annually, and the performance of the investment manager in complying with the policy on a three to five year basis. That is probably sufficient time for some of the ebbs and flows of markets to be evened out in assessing performance, yet not so long that if managers are seriously lagging behind, trustees are not too late in taking remedial action.

It is important that both sides work as a team in setting up and reviewing their investment policy. In today’s markets such instructions to investment managers must be both realistic and adaptable to rapidly changing circumstances, but equally it must not be forgotten that the trustees are in charge and are ultimately responsible to their beneficiaries. When markets are rising, you can get away with many things, but in a bear market you can expect a rise in disputes; whilst you and your investment managers may not be able to buck markets, at least make sure you have a satisfactory investment policy in place. ■