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# Trustee Intelligence: The Role of the Investment Management Consultant

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## EXECUTIVE SUMMARY

A trust is a legal relationship in which someone gives property to another to manage and hold. The trustee manages the assets of the trust for the benefit of the beneficiary or beneficiaries. A trustee is required under law to operate with a fiduciary standard of care. Understanding how to operate with a fiduciary standard of care requires understanding and implementing a complex array of regulatory compliance mandates, legal statutes and investment skills specific to the individual situation. This white paper examines fiduciary best practices based on the *Prudent Practices for Investment Stewards* by Fi360—how to organize, formalize, implement and monitor the fiduciary decision-making process and how to develop and evaluate an Investment Policy Statement (IPS). Additional topics, such as a description of the various roles and responsibilities of all parties involved in the investment management of a portfolio and how to select an investment management consultant are also included.

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### The Role of the Trustee

A trust is a legal relationship in which someone gives property to another (the trustee) who holds it for the benefit of others (the beneficiary or beneficiaries). If you are a named trustee, you have been given responsibility for managing the assets of the trust. Before you accept the responsibilities of a trustee, it is important to understand what this role entails.

Managing a trust as a trustee is similar to being the president of a company. The president of a company is assigned the responsibility of directing the organization so that it is in alignment with the company's business plan. The leaders of a company develop a business plan that is approved by the owners or the board of directors. After the owners approve the business plan, it is the president's duty to ensure that the daily activities of the business support and achieve the goals of the approved plan. Failure to run the organization in alignment with the approved business plan is potentially grounds for termination.

Much like the president of a company, the trustee of a trust is handed a "business plan" in the form of a trust document. The trustee's job is to manage the trust assets in alignment with the written trust document. Failure to do this is potentially a breach of fiduciary duty and may subject the trustee to a variety of undesirable consequences such as lawsuits from beneficiaries, legal action from the State Attorney General, negative public relations in the local media and numerous other unwanted situations. The most significant risk is making investment decisions that deviate from the instructions outlined in the trust document, which could lead to a judgment of fiduciary breach in the eyes of the court.

Private trusts are regulated primarily via legislation that is enacted by the states. The Uniform Prudent Investor Act (UPIA) is the primary legislation and the regulatory oversight for this legislation, provided by the State Attorney General. The Uniform Law Commissioners drafted the Uniform Prudent Investor Act (UPIA) to bring the fiduciary investment practices of trusts into uniformity with the modern investment practices that are continuously being developed and refined by investment management consulting firms. The Uniform Laws are developed by the National Conference of Commissioners on Uniform State Laws with the hope that all states will adopt these laws to provide uniformity in interstate commerce ([www.nccusl.org](http://www.nccusl.org)).

### Definition of Fiduciary Standard

Adhering to the highest standards of loyalty and care in the execution of the role of trustee is crucial when managing assets in alignment with the parameters of the trust document. Standards of excellence provide a consistent framework for interpretation and implementation between the various parties involved, such as the trustee, beneficiaries, advisors, money managers, and regulators. A trustee is required under law to operate with a fiduciary standard of care.

*"A fiduciary is someone acting in a position of trust on behalf of, or for the benefit of, a third party."*

Fiduciary Requirements of Foundation and Endowment Funds,  
*Brian P. Cunningham, CIMA, CFA*

*A fiduciary standard of care requires that the trustee act solely in the best interests of the trust without conflicts of interest.* However, understanding exactly how to go about acting in the best interest of the trust requires implementing a complex array of regulatory compliance mandates, legal statutes and investment skills specific to the individual situation. This can become a daunting undertaking for the trustee who is responsible for making decisions and selecting investment professionals, often without adequate training.

### Definition of Investment Fiduciary

The fiduciary obligations of a trustee responsible for an investment portfolio are detailed and explicit. Many investors do not understand the definition of an investment fiduciary. Many trustees may also be confused. The first step is to define the term *investment fiduciary*. An investment fiduciary is someone who exercises discretion or control over assets or renders ongoing investment advice. The Center for Fiduciary Studies estimates that there are approximately five million investment fiduciaries in the United States who manage 80 to 90 percent of the nation's investable wealth. With such a large percentage of wealth under the care of fiduciaries, it is important to define who is a fiduciary as it pertains to investment management.

After determining *who* is a fiduciary, you will need to understand *which laws* apply to your fiduciary entity. Some of the obvious categories of fiduciaries (by the relevant fiduciary laws) include:

- ERISA plan sponsors (plans under the Employment Retirement Income Security Act of 1974),
- board members of foundation and endowment funds,
- trustees of irrevocable trusts, and
- trustees of public pension funds like school district retirement funds, fire relief pension plans and police relief pension plans.

Both the investment fiduciary and the investment management consultant have to understand and monitor the relevant fiduciary laws that apply to their specific fiduciary entity. The primary role of the investment fiduciary is to manage a prudent investment process. Without a prudent process, the components of an investment plan cannot be defined, implemented, or evaluated. Many fiduciary investors confuse investment performance with successful fulfillment of their fiduciary obligations. The Center for Fiduciary Studies teaches the critical concept that “liability is not determined by investment performance, but rather by whether prudent investment practices were followed. It’s not whether you win or lose—it’s how you play the game” (Fi360).

The concept of an investment fiduciary is similar to the proverbial carrot and the stick. The “carrot” is aspiring to do a good job as a trustee and to demonstrate effective investment stewardship to your family members, friends, beneficiaries, regulators and other interested parties. The “stick” is that there are regulators who are concerned with how you invest the trust assets. Regulators want to ensure that you are overseeing the trust assets in alignment with the trust document and that you are managing the assets in the best interests of the beneficiaries of the trust.

Trustees may find it helpful to work with an investment management consultant. An investment management consultant who is trained in the fiduciary best practices for an investment fiduciary may be an impactful resource to help you to fulfill your obligations as a trustee, particularly in the investment decision-making process. The *Prudent Practices for Investment Stewards* handbook is another important resource to implement the prudent practices as you make investment decisions.

When it comes to fiduciary responsibility of a trustee under the law, ignorance of the law is not a defense when you get to court. The judge assumes that if you accept the responsibilities of trustee, that you also agree to learn about your fiduciary obligations to the trust under the laws of that state. The judge will also assume that you will manage the portfolio and make investment decisions that are in alignment the fiduciary laws of that state. The trustee will be held personally responsible for a breach of fiduciary duty (<https://www.justia.com/estate-planning/trusts/trustee-duties-and-liabilities/>).

### Fiduciary Investment Best Practices

The good news is that there is a third party resource that is available to help trustees learn more about their fiduciary duties. The handbook called *Prudent Practices for Investment Stewards*, first published by Fi360 in 2003, can help you implement a prudent investment decision-making process to fulfill your fiduciary obligations under the law and demonstrate effective investment stewardship to any interested parties. Other resources are also available from the State Attorney General's Office in the state of the domicile of the trust. Many State Attorney Generals provide free educational materials to educate trustees about their fiduciary responsibilities.

#### Core Objectives of Fi360:

Fi360 is an organization that offers training and software to investment professionals so that they can better serve their clients with a fiduciary standard of care. It was founded in 1999, based on three core objectives that have reshaped the investment profession through increased transparency, objectivity, and accountability.

**Standardization:** Fi360 has developed a checklist that defines a fiduciary standard of care applicable to any financial service professional providing investment advice.

**Education:** Fi360 provides training that explains the fiduciary standard of care and how to measure success in meeting this goal.

**Online tools:** Online tools such as the Fiduciary Focus Toolkit™ are available to help with the investment process.

Fi360 training is based on 21 *Prudent Practices*®. The 21 *Prudent Practices*® were created through extensive study of applicable laws, regulations, case law, and regulatory opinion letters. Feedback from students, the general public, the DOL and SEC also influenced the development process. The Prudent Investment Practices form the basis of the curriculum offered at the Center for Fiduciary Studies at the University of Pittsburgh, Katz Graduate School of Business. The classes are now the training component for the Accredited Investment Fiduciary® (AIF®) and Accredited Investment Fiduciary Analyst® (AIFA®) designations. The first designations were awarded in 2002 to 32 designees. By 2018, there were more than 11,000 designees.

Rich Lynch, director of Fi360, helped to shape and guide the organization from the beginning. His twenty-year Coast Guard career influenced his approach. He held many roles with the Coast Guard, including operations officer, executive officer and commanding officer. In the Coast Guard, an aircraft would not be launched or a ship would not get underway without completing a checklist. A checklist guards against complacency and prevents small, but important details from being forgotten. In the same way, the Prudent Investment Practices serve as a “fiduciary checklist” for the investment decision-making process to help investment professionals offer objective advice rooted in the fiduciary standard of care.

Fi360 has strived to remain objective by not taking money from clients or directly advising clients. Their focus is to support advisors and other investment professionals through training and access to online tools.

### Investment Decision-Making Process

The *Prudent Practices* have been divided and organized into a four-step decision making process that addresses many of the basic compliance issues and responsibilities of a trustee. It also provides direction for how trustees should approach developing an Investment Policy Statement, making investment decisions, hiring other professionals, and monitoring effectiveness of the IPS.

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### Four Step Investment Decision-Making Process:

1. Organize
2. Formalize
3. Implement
4. Monitor



#### Step one: Organize.

The first step in the fiduciary investment decision-making process is to get organized. *Prudent Practices for Investment Stewards* states that the “Investment Steward demonstrates an awareness of the fiduciary duties and responsibilities” (page 20). Your first task as a new trustee is to identify the applicable fiduciary investment laws that apply to your trust. It is also important to recognize yourself as having fiduciary status and being subject to all of the fiduciary requirements and legal precedent.

It is not only important to recognize your own role as a trustee, but to also understand the various parties involved in the process and how each relates to the other. Some of these roles include investment advisor, custodian, investment manager and beneficiary. You may need to hire professionals to help you with the trust, such as investment management consultants, attorneys and CPAs. One of the primary duties of a fiduciary is to avoid conflicts of interest. As much as possible, it is also important to try to make sure that there are no conflicts of interest between any of the other parties involved. Understanding the duties and contributions of the other parties is especially crucial as you may strongly rely on the information you get from these professionals. When hiring professionals, it is advised that all agreements be made in writing to define the scope of the involvement and ensure that all actions will be carried out in accordance with the trust document and with a fiduciary standard of care.

You will be responsible not only for achieving a fiduciary standard of loyalty and care, but also for safeguarding the assets from theft and embezzlement. Appropriate insurance, security measures against cyber attack, and other safety precautions must be implemented. There are many details in becoming a trustee. Professional advisors help “close the gap” between the trustee’s current *knowledge* of fiduciary law and the *actual* fiduciary law as it applies to the trustee. Choosing an advisor that is a fiduciary, who actively takes measures to avoid conflicts of interest, will help you implement the prudent practices.

#### Step Two: Formalize.

The second step in the fiduciary investment decision-making process is to formalize the investment policy. A primary responsibility of the trustee is to identify the time horizon for the portfolio. To establish the time horizon, the trustee must prepare a schedule of the portfolios anticipated cash flows and have an understanding of expected liabilities. In addition, the trustee must define the risk level of the portfolio and recognize the potential level of exposure to volatility. Third, the trustee must develop a reasonable and prudent diversification strategy for the trust investment portfolio that is in alignment with the time horizon and return objectives. The trustee does not need to predict the future returns, but must be able to articulate the assumptions used to develop the expected return objectives. Studies show that no matter where your assets are invested over time, the key driver of portfolio returns has been the asset allocation decision—your mix of stocks, bonds and cash (Brinson, Hood & Beebower, 1991).

According to *Prudent Practices for Investment Stewards*, a trustee is expected to be familiar with the investment risk management techniques that are defined in Modern Portfolio Theory (MPT). Understanding



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these concepts will help you to introduce the practical applications of Modern Portfolio Theory (MPT) and the disciplined processes that will help you to fulfill your fiduciary obligations as a trustee. Professional advisors can help reduce the gap between the trustee's current knowledge of investment risk management techniques and concepts of Modern Portfolio Theory (MPT) that are being taught in the nation's leading business schools and the practical application of these concepts in the real world.

Modern Portfolio Theory has greatly impacted finance and investing.

“The father of Modern Portfolio Theory, Nobel laureate Harry Markowitz, unknowingly set out on a course one day in 1950 that would change the nature of investing forever. That day also marked the beginning of a long process in which an understanding of the nature of financial markets and investing increased exponentially, aided especially by the rapid acceleration in computing power. An important outcome of this process was the great reformation in the law of trusts in the 1980s, 1990s, and 2000s. Modern Portfolio Theory quite literally caused an evolution in the law of trusts” (Simon, 2019).

### Investment Policy Statement

After the preparation of the investment policy is complete, the Investment Policy Statement (IPS) can be drafted. The Investment Policy is a formal, comprehensive, strategic investment plan. *Preparing and maintaining the Investment Policy Statement (IPS) is one of the most important functions of the trustee.* The IPS is the “business plan” for managing the investment portfolio and must be aligned with the trust document. The IPS should also cite the governing laws (i.e. ERISA, UPIA, UPMIFA, and UMPERSA) and be in compliance with these laws.

The IPS informs and directs all activities and decisions related to the trust. The IPS should be detailed enough that a third party could implement and monitor the investment strategy, yet flexible enough to be relevant in a complex and changing environment. Developing an effective IPS will help establish a bar to measure compliance and success while helping to minimize disagreements and mistakes.

### Things to consider when drafting an Investment Policy Statement:

- Composition and backgrounds of the trustees
- Investment decision making criteria of trustees
- Current investment management consultant and their role
- Current asset allocation
- Spending Policy and needs
- Investment Policy Statement
- Statement of Purpose
- Definition of Covered Assets
- Objectives of Investments
- Assumptions for investment policy
- Capital market assumptions
- Time horizon for investments
- Operating policies for investment pools
- Investment quality and concentrations guidelines by category
- Laws governing investment activities
- Duties and responsibilities of all involved parties
- Procedures for controlling and accounting for investment expenses
- Criteria for monitoring vendors

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### Step Three: Implement

The third step in the fiduciary investment decision-making process is to execute the investment policy. The implementation of the IPS will reveal if due diligence has been followed and if the process is effective. Many types of decisions will need to be made during this stage. For example, the trustee may need to select service providers, such as custodians and investment managers or choose investment vehicles. All decisions should be made with the fiduciary standard of care and the decision-making process must be well documented.

### Step Four: Monitor

The fourth step in the fiduciary investment decision-making process is to monitor the portfolio. Careful review of the first three steps is critical to evaluate if the execution of the plan is effective. You (the trustee) will need to compare portfolio performance with IPS benchmarks and objectives. You must periodically evaluate the service providers that were hired and the service agreements. You will also need to review if investment related fees and expenses are fair and reasonable.

## How to Document the Process

The primary role of the fiduciary is to manage a prudent investment process, but it will be critically important for someone to document the fiduciary's investment decision-making process. This will become more apparent to the fiduciary when they learn that a fiduciary auditor may make a future visit to audit their decision-making process. Fiduciary auditors could originate from the regulatory authorities (i.e. the State Auditor wanting to audit the investments of a public fund, the Department of Labor examining ERISA plan documents or the State Attorney General wanting to review the investment decision-making process of a trustee). The fiduciary audit could also be ordered by the fiduciary entity itself to identify weaknesses in their current investment management process. Either way, the fiduciary auditor always asks for the documentary evidence to make a determination about any gaps in the investment process.

Most trustees want help in the documentation of their decision-making process. Some examples include the documentation of the asset allocation decision, the written investment policy statement, due diligence research on investment managers, service agreements with the investment managers and quarterly performance reports. Fiduciary auditors are currently being trained to look for specific evidence of the fiduciary's investment decision-making process. The documents most likely to be requested by a fiduciary auditor are listed below. The investment management consultant can be one of the primary financial professionals to assist the client with the preparation and organization of these documents that record the fiduciary's investment decision-making process.

A professional investment management consultant can help a trustee to create and document a fiduciary file which contains important documents which chronicle the investment decision-making process for a trustee.

### Fiduciary File Documents from the four steps which may be requested in a Fiduciary Audit:

1. **Organize:** trust document, income tax returns,
2. **Formalize:** investment policy statement, spending policy statement
3. **Implement:** due diligence research on investment managers, investment manager contracts
4. **Monitor:** brokerage statements, quarterly performance evaluation reports



### Roles and Responsibilities

In your Investment Policy Statement for the trust, you will need to create a description of the roles and responsibilities of all parties involved in the investment management of a portfolio. You may benefit from focusing on the “big picture” investment policy decisions with the help of professional investment management consultants. The details could be delegated to professional investment managers.

**Trustee:** As a fiduciary, the primary responsibilities of the trustee(s) are to work with the investment management consultant (advisor) to do the following:

1. Prudently diversify the portfolio’s assets to meet an agreed upon risk/return profile.
2. Prudently select investment options.
3. Control and account for all investment, record keeping and administrative expenses associated with the portfolio.
4. Monitor and supervise all service vendors and investment options.
5. Avoid prohibited transactions and conflicts of interest.

**Investment Management Consultant (Advisor):** If the trustee(s) retains an objective, third-party investment management consultant (advisor) to assist in managing the overall investment process, the specific duties and responsibilities of the investment management consultant (advisor) are:

1. Assist the trustee(s) as requested in the preparation, implementation and maintenance of the Investment Policy Statement.
2. Provide investment options (mutual funds or portfolio managers or separately-managed accounts) with supporting research to the trustee(s) to assist in making prudent selections.
3. Assist in the implementation of the diversification and asset allocation strategy as directed by the trustee(s) in accordance with the guidelines described in this Investment Policy Statement.
4. Meet with the trustee(s) quarterly to review the Investment Performance Reports and assure compliance with the Investment Policy Statement relative to asset allocation and performance expectations.

**Investment Managers:** As distinguished from the investment management consultant (advisor), who is responsible for *managing* the investment process, the investment managers are responsible for *making* investment decisions (security selection and price decisions). The specific duties and responsibilities of each investment manager are:

1. Manage the assets under their supervision in accordance with the guidelines and objectives outlined in their respective service agreements, prospectus or trust agreement.
2. Exercise full investment discretion with regards to buying, managing, and selling assets held in the portfolios.
3. If managing a separate account (as opposed to a mutual fund or a commingled account), seek approval from the trustee(s) prior to purchasing and/or implementing the following securities and transactions:
  - Lettered stock and other unregistered securities; commodities or other commodity contracts; and short sales or margin transactions.
  - Securities lending; pledging or hypothecating securities.
  - Investments in the equity securities of any company with a record of less than three years continuous operation, including the operation of any predecessor.
  - Investments for the purpose of exercising control of management.

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4. Vote promptly all proxies and related actions in a manner consistent with the long-term interest and objectives of the portfolios as described in the IPS. Each investment manager shall keep detailed records of the voting of proxies and related actions and will comply with all applicable regulatory obligations.
5. Communicate to the investment management consultant (advisor) all significant changes pertaining to the fund it manages or the firm itself. Changes in ownership, organizational structure, financial condition, and professional staff are examples of changes to the firm in which the trustee(s) is interested.
6. Effect all transactions for the Portfolio subject “to best price and execution.” If a manager utilizes brokerage from the portfolio assets to effect “soft dollar” transactions, detailed records will be kept and communicated to the trustee(s).
7. Use the same care, skill, prudence, and due diligence under the circumstances then prevailing that experienced investment professionals acting in a like capacity and fully familiar with such matters would use in like activities for like portfolios with like aims in accordance and compliance with the Uniform Prudent Investor Act and all applicable laws, rules, and regulations.
8. If managing a separate account (as opposed to a mutual fund or a commingled account), acknowledge co-fiduciary responsibility by signing and returning a copy of this IPS.

**Custodian:** Custodians are responsible for the safekeeping of the portfolio’s assets. The specific duties and responsibilities of the custodian are:

1. Maintain separate accounts by legal registration.
2. Value the holdings.
3. Collect all income and dividends owed to the portfolio.
4. Settle all transactions (buy-sell orders) initiated by the investment manager.
5. Provide reports that detail transactions, cash flows, securities held and their current value, and change in value of each security and the overall portfolio since the previous report.

## The Role of the Investment Management Consultant

**Investment Management Consultant:** An investment management consultant is an advisor who helps investors with their long-term investment planning. An investment management consultant, unlike a *broker*, does more in-depth work on formulating clients' investment strategies, helping them fulfill their needs and goals. The idea behind an *investment* management consultant is that they be engaged as an important part of the client's investment strategy for a long period of time. The investment management consultant is focused on helping investors to build broadly-diversified investment portfolios managed by independent investment management firms. The investment management consultant's job is to actively monitor the trustee’s investments and continue to work with the trustee as goals change over time.

The two primary players in the fiduciary investment management process that need to be defined for the trustee are the professional investment manager and the professional investment management consultant. We like to use the medical profession as an example of the generalist-specialist relationship that is used in the fiduciary investment management process. The investment management consultant is the “generalist” who works with the trustee on the overall investment process, which includes the prudent investment practices. The professional investment managers are the “specialists” who manage investment securities within a specific asset class or a specific style of investment management. The investment management consultant assists the trustee in the process of selecting and monitoring their investment managers. The professional investment manager focuses their attention on specific security selection and also on the various sectors of the market that they want to overweight or underweight based on their analysis and the market outlook.

## Trustee Intelligence: The Role of the Investment Manager Consultant

Many trustees understand that they may not be prudent experts when it comes to security selection so they choose to hire professional investment managers to select individual securities for their portfolios. But a common problem develops when a trustee hires a professional investment manager directly without the assistance of a professional investment management consultant. Trustees can become unhappy with the professional investment manager, which may have nothing to do with the expertise and competence of the investment manager, but more so to do with the missing steps of the investment process and the related prudent investment practices. Often the trustee chooses to hire the professional investment manager directly because they do not see the value provided by the professional investment management consultant.

The professional investment management consultant adds a great deal of value to the trustee as a fiduciary investor. The role of the professional investment management consultant is to guide the trustee through each of four steps in the investment management process. The investment management consultant is positioned to assist the trustee with all of the prudent investment practices. As an investment fiduciary, a trustee could search for a professional investment management consultant who is knowledgeable about the prudent investment practices and has developed an investment consulting practice that helps the trustee to meet their fiduciary obligations.

In contrast to the investment management consultant, the investment manager has a narrowly defined role to select market sectors and individual securities for a part of the trust's investment portfolio. The comprehensive, four-step investment management process is more efficiently and objectively supported by a professionally trained investment management consultant who can focus on the whole portfolio.

The value added by a professional investment management consultant is represented in the following areas:

- Four Step Investment Decision-Making Process based on the Prudent Practices
- Organizing the trust documents
- Drafting investment policy statement
- Due diligence research on independent investment managers
- Performance monitoring, evaluation and rebalancing
- Comprehensive and objective advice

## How to Retain an Investment Management Consultant

As a trustee, you may need to learn how to successfully search for and hire a professionally trained investment management consultant. The simplicity of the four P's of manager selection can be applied to both investment managers and to investment management consultants. The four P's are Process, Philosophy, People and Performance. These are the types of questions that are recommended for trustees to ask as they look to hire a professional investment management consultant:

1. **Process:** Does the investment management consultant have a defined investment management consulting process? Is the investment management advice comprehensive or ala carte?
2. **Philosophy:** Does the investment management consultant have a defined investment philosophy? Is it based on generally accepted prudent investment practices for fiduciaries?
3. **People:** How many years of consulting experience do they have? What professional consulting associations do they belong to? What are their *professional certifications* and designations?
4. **Performance:** Are all of the portfolios managed in the same way? Does the investment management consultant have specialized knowledge about specific types of fiduciary entities? How much experience do they have with these types of fiduciary entities?

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The many various sources of investment advice could be overwhelming as the trustee is looking for a logical way to select a professional investment management consultant. Here are some of the relevant questions to ask in your search for investment advice ([www.Fi360.com](http://www.Fi360.com)):

### Questions a Trustee Should Ask an Investment Management Consultant

1. Are you registered with the appropriate regulators as an investment adviser? If so, have you provided me with all the disclosures required under those laws?
2. Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention? If so, describe those relationships?
3. Do you or a related company receive any payments from money managers you recommend, consider for recommendation, or otherwise mention? If so, what is the extent of these payments in relation to your other income (revenue)?
4. Do you have any policies or procedures to address conflicts of interest or to prevent these payments or relationships from being considered when you provide advice to your clients?
5. If you allow clients to pay your consulting fees using the client's brokerage commissions, do you monitor the amount of commissions paid and alert clients when consulting fees have been paid in full? If not, how can a client make sure that consulting fees are not over-paid ?
6. If you allow clients to pay your consulting fees using the client's brokerage commissions, what steps do you take to ensure that the client receives best execution for its securities trades?
7. Do you have any arrangements with broker-dealers under which you or a related company will benefit if money managers place trades for their clients with such broker-dealers?
8. If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment adviser to the client while providing the consulting services we are seeking?
9. Do you consider yourself a fiduciary with respect to the recommendations you provide the client?
10. What percentage of your clients utilize money managers, investment funds, brokerage services or other service providers from whom you receive fees?

Think of the investment management consultant as a generalist and the investment manager as a specialist. The investment management consultant can help you create an investment policy for your trust. It is important to understand that it is out of the scope of an "investment manager" to help you to develop investment policy. Here are six possible risks in hiring an investment manager directly.

An investment manager *may not*:

1. Provide objective due diligence research on themselves
2. Be objective in the manager selection process
3. Be objective in monitoring their own performance
4. Be objective in evaluating their own performance
5. Not consider the total universe of managers available
6. Not represent all asset categories needed to diversify

It is critical to understand that if you choose to work directly with an investment manager without the guidance of an independent investment management consultant, you may expose yourself to potentially avoidable risks. For example, you might limit yourself to using only the asset classes that are available to this particular investment manager, excluding many other important asset classes. You may also be dependent on the benchmark that the investment manager recommends, which is a little like asking professional Major League baseball players to call the balls and the strikes when they are at bat. Investment managers may not objectively analyze their own investment performance.

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Investment management consultants provide a comprehensive assessment of your financial position, investment policy formulation, asset allocation strategy, risk management, investment manager search and selection, socially responsible investing (SRI), investment performance monitoring, reporting and evaluation and periodic portfolio rebalancing.

### Three reasons to hire an investment management consultant are:

1. To provide expertise and/or understanding that you may not have
2. To provide guidance and help with difficult investment decisions
3. To provide third party endorsement of your investment decisions and actions

To understand this concept better, we return to the analogy of the medical field. We all may be familiar with the healthcare process as we have likely experienced health related issues at some point in our lives. For example, let's say you have chest pains. You research "chest pains" on the internet and find a myriad of possible causes such as heart, lung, gastrointestinal problems as well as potentially bone, muscle or nerve problems. Other causes of chest pain may include anxiety or panic attacks. When in doubt, it is wise to call your family practice doctor (generalist) to diagnose your symptoms and refer you to a specialist. It does not make sense to diagnose yourself and call a heart surgeon to perform a quadruple bypass operation when you may actually have a lung issue. First you call your family practice doctor, then you visit a specialist only if you receive a referral. The investment profession is similar to the medical profession in the use of generalists and specialists. Investment generalists act like family practitioners in the medical field.

## Optimal Investment Structure

As fiduciary investors, trustees often adopt the optimal investment structure to separate the roles and responsibilities of the various investment service providers (investment consultants, investment managers, investment brokers and custodians). They will also define and document an investment policy that includes diversification by both asset class and by individual security. They do not usually select individual securities but instead use asset allocation to develop broadly-diversified portfolios and then retain professional investment managers to implement the specific asset class strategies.

Institutional investors tend to use low-cost, passively-managed investment strategies in the more traditional (and efficient) asset classes of stocks and bonds. Then they may introduce alternative investments to try to lower the portfolio volatility which may improve the risk-adjusted rates of return and may also introduce new sources of expected investment returns. The utilization of alternative investments to provide broader diversification to lower portfolio volatility and include new sources of expected investment returns has frequently been referred to as the "endowment model." The same approach is often also recommended for trusts. The diagram above depicts this model.

## Optimal Investment Structure



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### Investment Management Consultant Qualifications

Trustees are encouraged to learn about the relevant qualifications for the investment professionals they will want to hire to assist them with their portfolios. A respected professional designation for a professional investment manager would be the Chartered Financial Analyst (CFA) designation, which is awarded by the Association for Investment Management and Research (AIMR). The equivalent professional designations for professional investment management consultants would be the Certified Investment Management Analyst (CIMA) designation, which is awarded by the Investments & Wealth Institute (formerly IMCA).

One of the fastest growing professional designations for investment management consultants who work with fiduciary investors is the Accredited Investment Fiduciary (AIF<sup>®</sup>) designation awarded by the Center for Fiduciary Studies, a division of Fi360. Accredited Investment Fiduciary<sup>®</sup> (AIF<sup>®</sup>) designation training empowers investment professionals with the fiduciary knowledge and tools they need to serve their clients' best interests. An AIF<sup>®</sup> designee has completed Fi360's course on ethical behavior and fiduciary services. Investment management consultants and advisors who complete the training are eligible to earn the AIF<sup>®</sup> designation and are able to demonstrate the added value they bring to prospective and existing clients.

The recently developed designations from the Center for Fiduciary Studies show the increasing demand for specialized professional investment training for both fiduciary investors and the investment professionals who advise them. Choosing an investment management consultant with a professional designation geared for fiduciary investors will show other interested parties (like beneficiaries, regulators, family members and other interested parties) that you understand your fiduciary responsibilities as a trustee. This will also show that you understand the relevant professional training and designations that a prudent fiduciary investor should be looking for in a professional investment management consultant.

While the tenets of effective fiduciary oversight are well defined, the specific processes advisors must use to achieve them are not. That's why a growing number of advisors are receiving the training they need to employ the fiduciary processes in their business practices by earning the AIF<sup>®</sup> Designation from the Center for Fiduciary Studies™ (*A Matter of Trust: The Benefits of Choosing an AIF Designee*, Fi360).

### Benefits of Choosing an Accredited Investment Fiduciary<sup>®</sup> (AIF<sup>®</sup>) Designee

While the *Practices* are available to all advisors, only those who have earned the AIF<sup>®</sup> Designation are formally recognized by the Center for Fiduciary Studies for demonstrating a full understanding of how to implement those processes to help trustees fulfill their fiduciary obligations. AIF<sup>®</sup> designees are able to use the knowledge and resources they have gained through their training to:

- Evaluate your organization's current fiduciary practices and recommend actions that address risk areas and help ensure compliance with applicable state and federal law
- Create and maintain a comprehensive investment policy statement that documents all of the processes and procedures that will be used to manage your portfolio
- Analyze and optimize your portfolio's asset allocation strategy to better align with the plan or fund's specific investment objective or the demographic needs of plan participants
- Apply objective standards for evaluating and recommending appropriate investment options for your portfolio
- Monitor and report performance of your portfolio and its underlying investments on an ongoing basis and recommending changes when necessary
- Serve as a resource for education and assistance to help you understand and fulfill your fiduciary obligations with greater confidence



## Trustee Intelligence: The Role of the Investment Manager Consultant

In addition to providing fiduciary guidance and assistance, many AIF® designees also take on the fiduciary responsibilities for managing assets in a retirement plan or endowment. This alleviates the burden of day-to-day oversight of those assets from your shoulders.

To maintain the designation, all AIF® designees must complete continuing education training to keep up to date with changes in the industry and the ongoing evolution of legal requirements under the fiduciary standard. Designees must accrue and report six hours of CE annually according to their renewal cycle and four of those hours must be Fi360 accepted courses (<https://www.fi360.com/who-we-are/affiliates/ce-providers>). They also must recognize and formally affirm the principles and obligations stated in the AIF® Designee Code of Ethics, which govern their professional and ethical conduct.

### Benefits of Choosing a CEFEX Certified Firm

In a similar way that investment management consultants with AIF® designations are certified and trained to implement fiduciary best practices, advisory firms are also certified by the Center for Fiduciary Excellence (CEFEX). CEFEX is a global, independent assessment and certification organization that works closely with investment fiduciaries and industry experts. They offer comprehensive assessment programs of investment advisory firms for both institutional and individual investors. CEFEX certification provides independent recognition of the advisory firm's conformity to defined standards of practice found in *The Prudent Practices for Investment Advisors* developed by Fi360. The CEFEX assessment is based on the international standard ISO 19011: Guidelines for quality management auditing.

The independent CEFEX Investment Advisor certification demonstrates that the firm adheres to the “global fiduciary standard of excellence.” This means they strive to act in the best interest of investors. Contrast this with a firm that lacks a fiduciary process or operates according to a “suitability” standard.

#### The Advisory Firm is Verified by Annual Audits

**Independent Audits:** CEFEX advisory firms choose to undertake annual audits by independent fiduciary experts. This verifies their adherence to the fiduciary standard and is supplemental to the oversight performed by most financial regulators, who require advisors to meet a minimum compliance standard. The objective is simple — to protect investors.

**Information Security:** The CEFEX audit includes a review of the security procedures used by the advisor, including procedures for handling (PII) Personally Identifiable Information and a background check on the top fiduciary at the firm.

**Value of Third Party Audits:** Third-party audits help to increase the safety of the investment industry. CEFEX audits add dozens of checks and balances to the investment program with no direct cost to investors. Third party audits provide a new set of eyes which can enhance the awareness of internal compliance standards.

**Avoiding Conflicts of Interest:** High fees or inadequate performance can be a result of conflicts of interest. The CEFEX analyst is trained to watch for conflicts of interest, such as compensation related conflicts, portfolio management related conflicts and affiliations between investment advisers and broker-dealers.

Annual audits increase the advisory firm's professionalism by keeping up to date with regulations and best practices. The CEFEX audit helps foster a culture of improvement within the firm. The assessment process is frequently updated to address changes in regulations and evolving best practices. Investors are requiring a higher level of transparency, loyalty and trust in their relationships with their investment advisors and investment advisory firms. Investment advisory firms that are committed to the fiduciary standard and have achieved the CEFEX certification could help give investors peace of mind as they work together towards achieving the investor's financial goals.

### Summary

The role of trustee is an enormous undertaking, with many critical responsibilities and legal ramifications. The fiduciary standard of loyalty and care is not just an attitude or approach, but a complex set of duties that must be carried out with prudence and objectivity under the law. Many resources are available to the trustee such as hiring seasoned professionals to assist in the decision-making and management of the trust. Other helpful resources include *Prudent Practices for Investment Stewards*, which is a useful reference guide to help complete the four steps and corresponding practices for achieving a fiduciary standard. Other guides and resources can be obtained through the relevant State Attorney General's office.

Hiring an investment management consultant (advisor) can help you through all four steps of the prudent practices. The investment management consultant can help you to organize and evaluate your current practices, make recommendations, understand relevant laws and achieve legal compliance, formalize an Investment Policy Statement (IPS), help you with making and implementing decisions such as asset allocation or risk tolerance of the portfolio to better align with your trust document and IPS, and monitor performance of the portfolio and review service providers on an ongoing basis. The investment management consultant will also be available to answer any questions or address any issues that unexpectedly arise and can also offer continuing fiduciary education and support over time.

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### ***About Allodium Investment Consultants***

Allodium Investment Consultants is a fee-only investment management consulting firm that provides investment management services to both individual and institutional investors. Advisory services include Wealth Management, Fiduciary Management, Investment Management Consulting, Financial Planning and Fiduciary Consulting. The firm is a member of the National Association of Personal Financial Advisors (NAPFA) and provides fee-only financial advice that supports the fiduciary standard of care. Allodium is the first Minneapolis-based investment advisor to be certified by CEFEX to follow the fiduciary best practices in the *Prudent Practices for Investment Advisors*. The firm was established as an independent Registered Investment Advisor in 2005. Learn more at [www.allodium.com](http://www.allodium.com)

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## Appendix A: Common Trustee Questions

One way to be a good steward is to ask the questions:

1. Now that I have been asked to be a trustee, now what do I do?
2. How can I do a good job as a trustee?
3. How can I do a good job?
4. How can I show prudent decision-making to my family members and to the beneficiaries of the trust?
5. I don't know anything about how to be a trustee. Where do I go to get started?
6. What am I supposed to do as the trustee?
7. What are my duties as a trustee?
8. What is my job?
9. What are my fiduciary obligations under the law?
10. What would be a prudent investment decision-making process?
11. How do I know how to be a good trustee?
12. Where can I learn how to be a good trustee?
13. Who can help me to learn how to do a good job as a trustee?
14. What if I fail as a trustee?
15. Can't I do this investment management all by myself?
16. Investment management consultants cost money. Can't I do this all by myself?
17. I don't have any money to hire an investment management consultant. How can I hire for this expertise if I don't have any money?
18. A: The investment advisory fees charged by an investment management consultant are the normal expenses of managing the trust and are paid out of the trust assets.
19. Who should I go to first if I want to develop and document a prudent investment decision-making process?
20. Who can help me to draft an investment policy statement?
21. Can't I just look up how to be a trustee on the internet?
22. Can't I save money by skipping the use of an investment management consultant?
23. How often does a trustee get sued by a State regulator?
24. How often does a trustee get sued by a beneficiary?
25. How often does a trustee get sued by a family member?
26. Can't I just plead ignorance if I make a mistake?