STEP JOURNAL



# Peak performance

Kevin Custis on using investment policy statements and benchmarks to get the most out of investment managers.

Under the English and Welsh *Trustee Act 2000* (TA 2000), and the *Trustee Act (Northern Ireland) 2001*, trustees are under a duty to seek advice from an appropriate person regarding investments.[1] Trustees are also empowered under those Acts (and in most modern governing instruments) to delegate the function of holding investments to a suitable nominee.[2] In the modern world of investment management, regulated investment managers are able to undertake both of those functions with their standard discretionary or advisory services for trustees, as they do for individuals.

## Management agreements and policy statements

Under current regulation, if the trustees conclude a professional investment manager is required, a written agreement must be signed with the investment manager.[3] The agreement will be fairly detailed and should be reviewed carefully by both the trustees and the investment manager. Where an investment policy statement is required,[4] this should be prepared at the same time as the investment management agreement, both to discharge the necessary duties and to avoid any conflicts between the two sets of papers, as they will deal with many of the same subjects.

A sample policy statement will be produced by STEP to assist members in drafting. All policy statements are particular to the trust in question, so there are plenty of areas where a bespoke approach is expected. The policy statement flows from the trustees rather than the investment manager, so, although dialogue is important, the final wording is that of the trustees alone.

The policy statement must contain details of the trust, as well as the attitude of the trustees to risk. Case law has much to say about all this, notwithstanding that the modern world of investment management has moved on a great deal from past events. The trustee principles of a prudent man of business,[5] a productive trust fund,[6] and the avoidance of hazard are as salient today as they ever were.[7] A considered approach is expected, and therefore a good reason would be needed to adopt a high-risk, rather than medium- or low-risk, investment strategy for a trust fund.

## Monitoring trust investments

Trustees are obliged to monitor trust investments on a regular basis, and this should be evidenced at least annually, or more frequently if the trust is large or complex. It is a good idea (and cost-effective) for the trustees to meet the investment managers where possible, to review the investments and discuss past performance. The trustees must be satisfied that the duties they have delegated are discharged.

Measuring performance is an essential ingredient of monitoring investments and boils down to a mathematical exercise. The performance of a portfolio needs to be put into context if it is to be assessed fairly, and that is where benchmarks are often employed. The approach to using benchmarks is varied but there are three common types used for trust-style portfolios:

- a benchmark based on a published market index (such as the FTSE 100) or a weighted group of other market published indices;
- an absolute benchmark, such as a bank base or inflation rate plus (or minus) a percentage; or
- a benchmark constructed from the performance of like portfolios.

All have their good and bad points but perhaps the fairest, most relevant approach is the third. STEP has developed the Trustees Managed Portfolio Indices (TMPI) with Enhance MPI Ltd to assist members with monitoring and assessing the performance of the invested trust funds they deal with.

A word of caution about benchmarks, lest they are ever thought to replace the need for independent thought: all trusts are different and the particular needs of a trust fund, such as lifespan, needs for liquidity and other non-invested trust assets, are very relevant to whether a portfolio performance is considered satisfactory. In terms of the risks the trustees are willing to take, those factors will be outside the statistics used to construct most benchmarks.

## TMPI: A STEP member service

The Trustee Managed Portfolio Indices (TMPI) are provided by Enhance MPI Ltd. The Indices show the performance of a peer group of investment portfolios that are managed on a discretionary basis on behalf of persons acting in a fiduciary capacity.

The core aim of TMPI is to bring about transparency and understanding between the trustee and discretionary investment management professions with regard to communicating investment risk and understanding investment returns.

The indices are calculated using data supplied by investment managers specifically for portfolios managed on behalf of persons acting in a fiduciary capacity.

TMPI are available in GBP, USD and EUR, and the risk categories are low, medium and high.

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1. *1Section 5(1) TA 2000; s5(2) Trustee Act (NI) 2001*
2. *2Section 11 of both Acts*
3. *3Section 15(1) TA 2000 and Trustee Act (NI) 2001*
4. *4Section 15(2) TA 2000 and Trustee Act (NI) 2001*
5. *5Speight v Gaunt [1883] UKHL 1*
6. *6Re Wragg Ltd [1897] 1 Ch 796*
7. *7Learoyd v Whiteley [1887] UKHL 1*



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