

Prudent Practices for Investment Advisors

Step 1: Organize

***Practice 1.1** – The Investment Advisor demonstrates an awareness of fiduciary duties and responsibilities.*

Criteria:

1.1.1 – The Investment Advisor complies with all fiduciary laws and rules that apply to the Advisor’s services.

1.1.2 – The Investment Advisor complies with all applicable Practices and Procedures defined in this Prudent Practices handbook.

1.1.3 – The Investment Advisor adheres to the professional standards of conduct and code(s) of ethics required by law, regulation, their organization or employer, and all other applicable organizations in which they are a member.

***Practice 1.2** – Investments and investment services provided are consistent with applicable governing documents.*

Criteria:

1.2.1 – Investments held in trust are managed in accordance with the documents governing the trust.

1.2.2 – Investments are managed and investment services are provided in accordance with governing documents, including the investment policy statement.

1.2.3 – Documents pertaining to the investment management process, including records of decisions made by the client, are organized and retained in a centralized location.

***Practice 1.3** – The roles and responsibilities of all involved parties (fiduciaries and non-fiduciaries) are defined and documented.*

Criteria:

1.3.1 – The roles and responsibilities of all involved parties are documented in the investment policy statement.

1.3.2 – All involved parties have acknowledged their fiduciary or non-fiduciary status in writing.

1.3.3 – Investment committees have a defined set of by-laws or operating procedures to which they adhere.

1.3.4 – The Investment Advisor has a documented disaster recovery plan that is reviewed and tested periodically.

***Practice 1.4** – The Investment Advisor identifies conflicts of interest and addresses conflicts in a manner consistent with the duty of loyalty.*

Criteria:

1.4.1 – Policies and procedures for overseeing and managing conflicts of interest, including self-dealing, are defined.

1.4.2 – Conflicts of interest are avoided when possible and always when required by law, regulation, and/or governing documents.

1.4.3 – Unavoidable conflicts of interest are disclosed in writing to the client and are managed in the best interest of the client or beneficiaries.

1.4.4 – When an unavoidable conflict of interest exists, the conflict is explained and informed written consent is obtained from the client.

Practice 1.5 – *Agreements, including service provider agreements under the supervision of the Investment Advisor, are in writing and do not contain provisions that conflict with fiduciary standards of care.*

Criteria:

1.5.1 – The Investment Advisor fully discloses in writing all compensation arrangements and affiliations involved in the service agreement between the client and Advisor, as well as the Advisor’s services and fiduciary status.

1.5.2 – If the Investment Advisor is responsible for oversight of other service providers, the service agreements of those providers disclose all compensation, affiliations, and fiduciary status (if fiduciary status is assumed by the service provider).

1.5.3 – Agreements are periodically reviewed to ensure consistency with the needs of the client.

1.5.4 – Comparative reviews of service agreements for which the Investment Advisor is responsible are conducted and documented approximately every three years.

Practice 1.6 – *Client assets are protected from theft and embezzlement.*

Criteria:

1.6.1 – The Investment Advisor has a reasonable basis to believe assets are within the jurisdiction of a viable judicial system.

1.6.2 – ERISA fiduciaries have the required fidelity bond, if applicable.

1.6.3 – If the Investment Advisor’s firm custodies client assets, the firm has appropriate insurance, internal controls, and physical security measures to reasonably protect against theft and embezzlement.

1.6.4 – If within the scope of the Investment Advisor’s engagement, the Investment Advisor verifies that service providers that custody client assets have appropriate insurance.

1.6.5 – Appropriate procedures are in place to secure client or plan data.

Step 2: Formalize

***Practice 2.1** – An investment time horizon has been identified for each investment objective of the client.*

Criteria:

- 2.1.1** – Sources, timing, distribution, and uses of each client’s cash flows are documented.
- 2.1.2** – In the case of a defined benefit retirement plan client, an appropriate asset/liability study has been factored into the time horizon.
- 2.1.3** – In the case of a defined contribution retirement plan client, the investment options provide for a reasonable range of participant time horizons.
- 2.1.4** – In the case of a foundation or endowment, a schedule of expected receipts and disbursements of gifts and grants has been factored into the time horizon to the extent possible and an estimated equilibrium spending rate has been established.
- 2.1.5** – In the case of a retail investor, an appropriate needs-based analysis has been factored into the time horizon.

***Practice 2.2** – An appropriate risk level has been identified for each client.*

Criteria:

- 2.2.1** – The level of volatility the client’s portfolio is exposed to is understood by the Investment Advisor and communicated to the client, and the quantitative and qualitative factors that were considered are documented.
- 2.2.2** – “Large loss” scenarios have been identified and considered in establishing each client’s risk tolerance level.
- 2.2.3** – Expected disbursement obligations and contingency plans have been considered in order to establish liquidity requirements for the portfolio.
- 2.2.4** – In the case of a defined contribution retirement plan client, the investment options provide for a reasonable range of participant risk tolerance levels.

***Practice 2.3** – An expected return to meet each investment objective has been identified.*

Criteria:

- 2.3.1** – The expected return for each portfolio is consistent with the client’s risk level and investment goals and objectives.
- 2.3.2** – The expected return assumptions for each asset class are based on reasonable risk-premium assumptions.
- 2.3.3** – For defined benefit plans, the expected return values used for modeling are reasonable and are also used for actuarial calculations.
- 2.3.4** – For defined contribution plans, the expected return assumptions for pre-diversified options, such as target date funds or model portfolios, are based on reasonable risk/premium assumptions.
- 2.3.5** – For endowments and foundations, the expected return values used for modeling are reasonable and are consistent with distribution requirements or the projected equilibrium spending rate.

Practice 2.4 – Selected asset classes are consistent with the client’s time horizon and risk and return objectives.

Criteria:

2.4.1 – Assets are appropriately diversified to conform to each client's specified time horizon and risk/return profile and to reduce non-systemic risk.

2.4.2 – For participant-directed plans, selected asset classes provide each participant the ability to diversify their portfolio appropriately given their time horizon and risk/return profile.

2.4.3 – The methodology and tools used to establish appropriate portfolio diversification for each client are prudent and consistently applied.

Practices 2.5 – Selected asset classes are consistent with implementation and monitoring constraints.

Criteria:

2.5.1 – The Investment Advisor has the time, resources, and requisite knowledge and skills to implement and monitor all selected asset classes for each client.

2.5.2 – The process and tools used to implement and monitor investments in the selected asset classes are appropriate.

2.5.3 – Appropriate investment products are accessible within each selected asset class.

Practice 2.6 – The investment policy statement contains sufficient detail to define, implement, and monitor the client’s investment strategy.

Criteria:

2.6.1 – The investment policy statement identifies the bodies of law governing the portfolio.

2.6.2 – The investment policy statement defines the duties and responsibilities of all parties involved.

2.6.3 – The investment policy statement specifies risk, return, and time horizon parameters.

2.6.4 – The investment policy statement defines diversification and rebalancing guidelines consistent with risk, return, and time horizon parameters.

2.6.5 – The investment policy statement defines due diligence criteria for selecting investment options.

2.6.6 – The investment policy statement defines procedures for controlling and accounting for investment expenses.

2.6.7 – The investment policy statement defines monitoring criteria for investment options and service vendors.

Practice 2.7 – When socially responsible investment strategies are elected, the strategies are structured appropriately.

Criteria:

2.7.1 – Each client’s goals and objectives are evaluated to determine whether socially responsible investing is appropriate and/or desirable.

2.7.2 – If a client has elected a socially responsible investment strategy, the client’s investment policy statement documents the strategy, including appropriate implementation and monitoring procedures.

Step 3: Implement

Practice 3.1 – *A reasonable due diligence process is followed to select each service provider in a manner consistent with obligations of care.*

Criteria:

- 3.1.1** – Reasonable criteria are identified for each due diligence process used to select service providers.
- 3.1.2** – The due diligence process used to select each service provider is documented.
- 3.1.3** – Each due diligence process used to select service providers is consistently applied.

Practice 3.2 – *When statutory or regulatory investment safe harbors are elected, each client’s investment strategy is implemented in compliance with the applicable provisions.*

Criteria:

- 3.2.1** – Applicable ERISA safe harbor requirements pertaining to the delegation of investment responsibility are implemented in compliance with regulatory requirements, when elected.
- 3.2.2** – For participant-directed qualified retirement plans, applicable 404(c) safe harbor requirements are implemented in compliance with ERISA requirements, when elected.
- 3.2.3** – For participant-directed qualified retirement plans, applicable fiduciary adviser safe harbor requirements are implemented in compliance with ERISA requirements, when elected.
- 3.2.4** – For participant-directed qualified retirement plans, qualified default investment alternatives (QDIA) are implemented in compliance with ERISA requirements, when elected.
- 3.2.5** – For non-ERISA services, safe harbors and exemptions are implemented in compliance with regulatory requirements, when elected.

Practice 3.3 – *Decisions regarding investment strategies and types of investments are documented and made in accordance with fiduciary obligations of care.*

Criteria:

- 3.3.1** – A documented due diligence process, consistent with prudent practices and generally accepted investment theories, is used to select investments and third-party Investment Managers.
- 3.3.2** – Decisions regarding the selection of investments consider both qualitative and quantitative criteria.
- 3.3.3** – The documented due diligence process used to select investments and third-party Investment Managers is consistently applied.
- 3.3.4** – Regulated investments are preferred over unregulated investments when all other characteristics are comparable.
- 3.3.5** – Investments that are covered by readily available data sources are preferred over similar investments for which limited coverage is available when all other characteristics are comparable.
- 3.3.6** – Decisions regarding passive and active investment strategies are documented and made in accordance with obligations of care.
- 3.3.7** – Decisions regarding the use of separately managed and commingled accounts, such as mutual funds, unit trusts, exchange-traded products, and limited partnerships, are documented and made in accordance with obligations of care.

3.3.8 – Decisions to use complex investments or strategies, such as alternative investments or strategies involving derivatives, are supported by documentation of specialized due diligence conducted by professionals who possess knowledge and skills needed to satisfy the heightened obligations of care.

3.3.9 – When socially responsible investment strategies are elected, the strategies are implemented appropriately.

Step 4: Monitor

Practice 4.1 – *Periodic reports compare investment performance against appropriate index, peer group, and investment policy statement objectives.*

Criteria:

4.1.1 – The performance of each investment option is periodically compared against an appropriate index, peer group, and any other performance-related due diligence criteria defined in the investment policy statement.

4.1.2 – “Watch list” procedures for underperforming Investment Managers are documented, and consistently applied.

4.1.3 – Rebalancing procedures are reasonable, documented, and consistently applied.

Practice 4.2 – *Periodic reviews are made of qualitative and/or organizational changes of Investment Managers and other service providers.*

Criteria:

4.2.1 – Periodic evaluations of the qualitative factors that may impact the results or reliability of Investment Managers are performed.

4.2.2 – Negative news and other material information regarding an Investment Manager or other service provider are considered and acted on in a timely manner.

4.2.3 – Deliberations and decisions regarding the retention or dismissal of Investment Managers and other service providers are documented.

4.2.4 – Qualitative factors that may impact service providers are considered in the contract review process.

Practice 4.3 – *Control procedures are in place to periodically review policies for trading practices and proxy voting.*

Criteria:

4.3.1 – Control procedures are in place to periodically review each Investment Manager’s policies for best execution.

4.3.2 – Control procedures are in place to periodically review each Investment Manager’s policies for special trading practices such as “soft dollars”, directed brokerage, and commission recapture.

4.3.3 – Control procedures are in place to periodically review each Investment Manager’s policies for proxy voting.

Practice 4.4 – *Periodic reviews are conducted to ensure that investment-related fees, compensation and expenses are fair and reasonable for the services provided.*

Criteria:

4.4.1 – A summary of all parties being compensated from client portfolios or from plan or trust assets and the amount of compensation has been documented.

4.4.2 – Fees, compensation, and expenses paid from client portfolios or from plan or trust assets are periodically reviewed to ensure consistency with all applicable laws, regulations, and service agreements.

4.4.3 – Fees, compensation, and expenses paid from client portfolios or from plan or trust assets are periodically reviewed to ensure such costs are fair and reasonable based upon the services rendered and the size and complexity of the portfolio or plan.

Practice 4.5 – *There is a process to periodically review the organization's effectiveness in meeting its fiduciary responsibilities.*

Criteria:

4.5.1 – Fiduciary assessments are conducted at planned intervals to determine whether (a) appropriate policies and procedures are in place to address all fiduciary obligations, (b) such policies and procedures are effectively implemented and maintained, and (c) the investment policy statement is reviewed at least annually.

4.5.2 – Fiduciary assessments are conducted in a manner that promotes objective analysis and results are documented and reviewed for reasonableness.