Investment Policy Statement
Guidelines

Elements to consider when drawing up an Investment Policy Statement for individuals or institutional investors
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Introduction

Disclaimer

This document serves as a mere guide and should not be used as the definitive and only source of information for advising a client and implementing any processes in your practice. Your due diligence must be done. The FPI will not accept any liability that may arise out of the use of this document, consultation must be sought from a relevant expert.

Request for comment

This is an evolving document and therefore we do encourage constructive input. The next update is scheduled for 2015. We welcome comments from members and other stakeholders. These comments will be used to assess the Guide’s usefulness and to improve it prior to publishing another version.

Please submit your comments to technical@fpi.co.za

An Investment Policy Statement (IPS) is a document that sets out the framework for setting out an investment program and the implementation thereof for individual and institutional investors.

An IPS is not a legal requirement and there is no standard format for one either. However, drawing up an IPS, would constitute best practice.

The IPS should in essence vary considerably from client to client. Merely making use of a template does not do any justices to a client’s subjective needs. Therefore this guide provides principles that should be taken cognisance of when putting together an IPS.

An IPS provides a constant in a sea of change and will always be your reference source when confronted with investment decisions regarding the ebb and flows in the market and the economy. An IPS should be reviewed occasionally, but, not consistently seeing as this would defeat the objective of the IPS.

The IPS needs to note the investment philosophy and not the implementation or specific investment products.

The overarching theme that should be prevalent throughout the IPS is the best interest of the client. In fulfilling this fiduciary duty, use the Global Fiduciary Precepts as a guide, they are as follows:

- Know standards, laws, and trust provisions.
- Diversify assets
- Prepare investment policy statement
- Use “prudent experts”
- Account for investment expenses
- Monitor the activities of “prudent experts”
- Avoid conflicts of interest

A financial advisor needs to assess the following in the IPS: client’s risk profile; the client’s financial constraint’s (tolerance) and objectives.

The IPS will provide a platform with which to measure the performance of the investments and to ascertain if the client’s objectives have been reached or not.

It is best for the IPS to be as thorough as possible, this is beneficial for both the financial planner and the client.
Principles - that should be included in an IPS

Client Information

1. Define the investor - subjective information
   - Is the investor an individual or juristic person?
   - Where the investor’s assets are held
   - The amount of assets under your management
   - Any other relevant information you deem fit, for example if they have environmental, social or governance (ESG) views, religious (Shariah-compliant investments) obligations etc.
   - For institutional investors, in the retirement funding space, the Code for Responsible investing needs to also be taken cognisance of. There could be restrictions on foreign investments, if the investor is averse to this.

2. Investment specific information - more of a factual analysis
   - Investment objectives - What is the purpose for the assets being invested? Client goals.
   - Time horizons - the objectives would inform this, this would also inform the asset allocation
   - Liquidity requirements - does the client have cash reserves for an unforeseen event, would the assets under management form part of that reserves?
   - Tolerance and capacity - you might be aggressive investor but based on a number of reasons it would not be advisable that you take too much risk with the assets. For example you could be close to retirement or not enough financial security and cannot risk any loss to the capital invested. How much risk do you need to take in order to achieve your goals?
   - Attitude towards risk - As an investor do you understand that in order to achieve greater return greater risk has to be taken and that with less risk you might not achieve the growth you desire?

3. Required investment returns
   - Taking into account time value of money (opportunity cost), inflation, tax and charges what is the required rate of return?
   - Explain relevant constraints - legal or regulatory (For example: If you are an institutional investor that is dealing with retirement funding assets it must be explained that asset allocations are regulated in terms of Regulation 28 of the Pension Funds Act No. 24 of 1956)

Investment framework

1. Investment philosophy:
   - The efficient market hypothesis
   - Portfolio selection and diversification
   - Capital asset pricing model
   - Arbitrage pricing theory etc.
2. Asset Allocation

Explain the different asset classes and specify which asset classes should be included in the investment portfolio and at what percentages based on the information you have gathered from the client. In accordance with behavioural finance we know that past performance is not an indication of future performance and that this should not be the sole factor that is taken cognisance when presenting a recommended portfolio to a client, however, FAIS does mention that historical annual returns, be mentioned to the client. This can also be included in the IPS.

3. Rebalancing of portfolio

Based on the initial decision on the exposure to certain asset classes, it might become necessary to rebalance the portfolio in order to keep on track with the initial objectives as a result of market conditions. This is especially necessary if the purpose of the investment is retirement funding income as an institutional investor. If the policy is not to rebalance, this should be noted.

4. Due diligence

Define your due diligence process, for selecting relevant service providers, to fulfil the investment objectives.

The FPI will be developing a guide on the due diligence process.

Governance

1. Responsibilities

Advisor

This is where the person responsible within your FSP for the IPS is identified. Specify if this person will be responsible for implementation and monitoring of the policy. This person will be accountable to the investor for all stages of the investment policy development.

Specify if the same or another individual would be responsible for monitoring the investment and high light risks and report to the investor. Specify the reporting intervals.

Client

To provide the financial planner with all relevant information on their financial condition, net worth, and risk tolerances and must notify the financial planner promptly of any changes to this information.

2. Reviewing of IPS

Describe the process for reviewing and updating the IPS. Mention the reasons why this would be necessary. It could be to rebalance the portfolio or to make changes based on various risk (market, economic, political, geographic, sector, liquidity etc.). However, it should be noted that the very purpose of having an IPS is to have a solid investment framework, and therefore it should not be to reactive to external stimuli.
3. Risk management and evaluation

There needs to be a consistent method of assessing and evaluating risk measurement and performance. Ultimately the IPS will be judged on whether it meets the objectives set out. Clarifying this would be beneficial for both the financial planner and client.

4. Signatures

ADOPTION OF THE INVESTMENT POLICY STATEMENT

I (we) have reviewed, approved and adopted this Investment Policy Statement prepared with the assistance of……………………………………………..

___________________________________
Client                                                     Date

___________________________________
Financial Planner                                           Date
List of questions:

These are questions that the financial planner needs to be able to answer before drafting the IPS:

- What is the investor’s risk profile?
- What is the investor’s risk capacity?
- What is the investor’s required rate of return?
- What is the investor’s subjective beliefs? [Environmental concerns, religious, etc.]
- Based on the above questions what asset allocation do you believe will best meet the client’s needs?
- Or Based on the above questions what investment product do you believe will best meet the client’s needs?