FEG INSIGHT

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GOVERNANCE FRAMEWORK: How to Structure for Success

FEG investment advisors

Having the right governance structure is key to an organization's success. Good governance leads to good decision-making across the entire organization, including the investment committee. Conversely, a poor governance structure can lead to underperformance across an organization. The governance framework serves as a foundation upon which an organization builds different roles and processes. Without a sturdy foundation, the overall structure is more likely to deteriorate in times of stress.

The key to creating good governance is to establish clear guidelines for decision-making, delegation, and accountability.

The Role of Investment Committees

To develop the right investment committee for your organization, it is important to first understand members' roles and responsibilities. Investment committee members, or fiduciaries, tend to be concerned with helping an organization achieve its long-term portfolio performance goals. To do this, they need to fully understand their fiduciary responsibilities and how their role fits into the plan to put the organization's governance best practices into action.

Creating the right governance structure can help investment committee members identify their responsibilities so they can be more effective in their positions. An ideal governance structure starts with the "governing" fiduciaries of the investment board. They serve as the first line of decision-making on broader, large impact issues, and they can assign other fiduciary duties downward to the "managing fiduciaries."

The managing fiduciaries are usually staff or consultants that the investment committee selects to oversee the investment program and ensure it is implemented in a way that aligns with the organization's goals. The managing fiduciaries report up to the governing fiduciaries and assign responsibilities down to the "operating fiduciaries."

The operating fiduciaries, who are usually investment managers, custodians, or actuaries, focus more on the day-to-day responsibilities of portfolio management, such as deciding when to buy and sell securities based on daily market movement or events. These operating fiduciaries report to the managing fiduciaries. Typically, the duties of operating fiduciaries have a smaller impact on the overall organization than the actions of the governing or managing fiduciaries.

Developing the Framework

1. SELECT A GOVERNANCE STRUCTURE

First, determine whether you want your governance structure to include all three roles—governing, managing, and operating fiduciaries—or if you would rather combine the governing and managing positions into one role.

FIDUCIARY ROLE	2-TIER	3-TIER
Governing	Board/Investment Committee, Staff, and Consultant (supporting fiduciary)	Board/Investment Committee
Managing		Internal CIO or Outsourced CIO, and Staff
Operating	Investment Managers Custodians Actuaries Vendors	Investment Managers Custodians Actuaries Vendors

Many organizations—especially smaller organizations that do not have a chief investment officer (CIO)—opt for a two-tiered approach in which the governing fiduciary, typically with the guidance of a consultant, retains hire/fire discretion for operating fiduciaries.

The primary benefits of the two-tiered approach is that it is often simpler to implement and can be less expensive than the three-tiered approach. It is generally more affordable to use a consultant than to create an internal CIO or outsourced CIO (OCIO) position. Drawbacks to consider include reduced fiduciary oversight as the consultant is acting as a supporting fiduciary vs. a co-fiduciary, and increased overlap between the roles and responsibilities of those in the two tiers.

With a three-tiered approach, you may consider the "governing fiduciary" to be the investment committee or board, the "managing fiduciary" to be the CIO or other executive staff (or perhaps a consultant), and the "operating fiduciaries" to be the investment managers, custodians, actuaries. In lieu of a CIO, a nonprofit may opt to outsource that position to an OCIO, who would assume the responsibility for hiring or firing investment managers.

The primary benefit of the three-tiered approach is that it offers the clearest delineation of roles and responsibilities An OCIO may provide additional fiduciary oversight because the OCIO is a co-fiduciary. The primary downside of having three tiers is that it is typically more expensive to have an internal CIO or OCIO than a consultant.

2. SPECIFY FIDUCIARY RESPONSIBILITIES

Next, you will want to clearly define the responsibilities for all fiduciaries so they can develop the right strategies to fulfill their obligations. Here are just a few examples.

Governing Fiduciaries

- Establish organization's long-term financial objectives
- Approve investment policy statement
- Develop guidelines to evaluate Investment Committee progress
- Develop clear risk guidelines

Managing Fiduciaries
- Hire investment managers
- Report to governing fiduciaries
- Delegate to operating fiduciaries
- Evaluate investments and/or investment managers

Operating Fiduciaries
- Adjust portfolio according to the organization's goals and risk tolerance
- Rebalance portfolio in response to market conditions
- Report to managing fiduciaries

3. DETERMINE EXPECTATIONS AND ACCOUNTABILITY

Finally, you will want to establish clear expectations for how fiduciaries will carry out their responsibilities. That includes creating clear communication channels and a policy that specifies how the different levels of fiduciaries should communicate with each other. You will also need a system for delegating responsibilities that includes reporting expectations about decision-making priorities and reporting results.

Enforcing accountability is a challenge for organizations across all industries and sizes. Adopting the following practices can encourage stakeholders to take responsibility and address issues in a direct and open manner.

- Put people who take ownership of their results into leadership roles
- Set SMART goals that are specific, measurable, achievable, relevant, and time-based
- Document roles, goals, and reporting expectations – and make it accessible to the entire organization
- Delegate authority to leaders that directly impact results
- Communicate progress updates on a regular basis
- Establish a review cadence and openly address deficiencies

We recommend the following framework to outline your own roles and responsibilities.

FIDUCIARY ROLE	RESPONSIBLE FOR:	DELEGATE TO:	REPORT RESULTS TO:
Governing			
Managing			
Operating			

The Bottom Line

Creating a governance framework for your organization's investing needs is no small task, but it is an essential one. Building a strong governance framework is one of the best ways you can support your organization's investment goals.

An organization's strength and health depend on everyone under the investment committee's purview fully understanding their fiduciary duties—including those serving in a given role and those appointing others. It is critical that you structure your governance framework so that it best supports your organization's initiatives with clearly articulated communication channels, expectations, and accountability standards.

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