

White Paper

From Beliefs to Action: Documenting Investment Philosophy, Policy, and Committee Processes

Core purpose: to guide financial professionals in establishing robust, compliant, and effective investment frameworks, with practical tools and governance insights.

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Overview

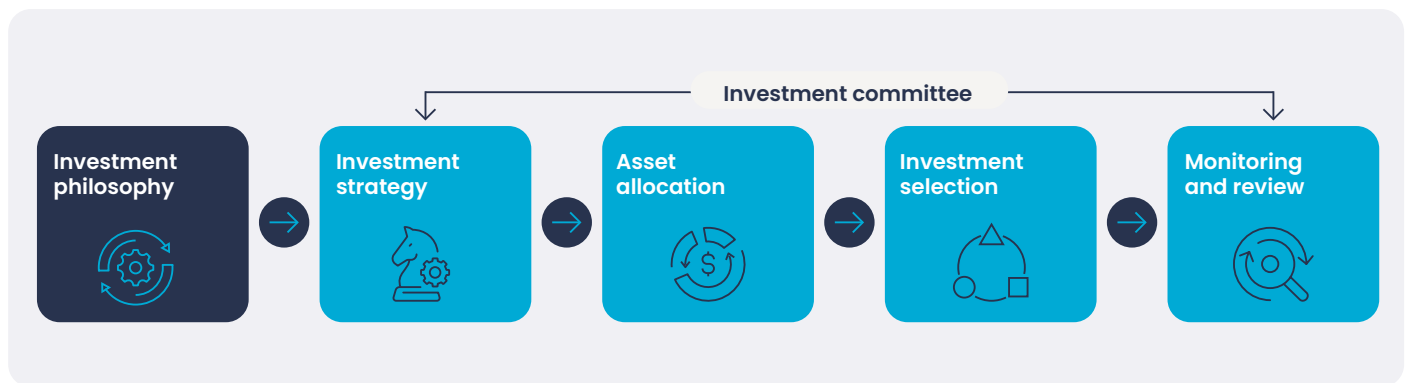
1. Introduction

When making investment decisions and/or managing your own model portfolios, it is considered best practice to have a documented investment philosophy to support your process. Where you operate an investment committee to manage your approved product list and model portfolios, robustness is demonstrated by adopting and documenting an investment policy.

An *investment philosophy* is a set of beliefs and principles that guides your investment strategy and

helps your clients understand how you make critical decisions regarding the investment of assets and what kinds of recommendations they can expect from you.

An *investment policy* outlines the investment strategy, goals and objectives for each investment portfolio offered and can be supplemented with an investment committee that governs matters relating to the strategic oversight and governance of your investment philosophy.



This document provides guidance on what you should consider when documenting your APL and investment framework, detailing some ‘best practice tips’ to assist you.



Important: You must adhere to your AFSs requirements regarding investment selection, including research ratings, investment guidelines, asset allocation guidelines and Approved Product Lists (APLs).

Investment Philosophy

1. What is an investment philosophy?

An *investment philosophy* reflects a broad set of investment beliefs. It is important as it underpins the investment strategy or investment process, that is how a portfolio will be managed and the characteristics the portfolio should exhibit.

It provides transparency and ensures consistency to help mitigate behavioural biases (e.g. chasing last year's winner).



2. How do I get started?

Define your core beliefs

Your philosophy should consist of your core beliefs regarding your investment approach, including (but not limited to):

- Your investment management style:
 - Do you believe in being passive or active or a combination?
- Your asset allocation strategy:
 - Do you believe in being strategic or tactical or a combination of both?
- Risk and return:
 - How do you plan to manage investment risks within a portfolio context? For example, through diversification and quality investment selection
 - Are there any risks not worth taking?
- Partnering with experts:
 - Who do you partner with to build your portfolios or make investment decisions?
 - What is your selection process?
- Research:
 - How important is research to your investment decisions?
 - Do you use independent research to review and select investments?
 - Does your research have a governance framework? For example, an investment committee.
- Costs:
 - How do you keep costs down to increase net returns? For example, by adopting a long-term investment approach or consideration of the tax implications of corporate actions.

Keep it short

Your investment beliefs do not need to be exhaustive and can be listed as a part of your key principles; however, they should highlight the beliefs that are fundamental to the way you construct your investment portfolios and be client friendly.

The advantage to keeping your philosophy brief is that you can use it in a variety of ways in your marketing or client engagement plans. It can have a prominent place on your website, newsletters and welcome packs for new clients.

3. Sample investment beliefs



Investment Policy

1. Investment strategy

Your investment policy should formulate an investment strategy for each investment portfolio you offer.

Once established, your investment committee will oversee the governance, implementation and management of this strategy.

When formulating an investment strategy, you should consider, amongst other things, the following factors:

- each investment portfolio's objectives
- your portfolio construction strategy
- consideration of Target Market Determinations (TMDs)
- implementing your investment strategy
- maintaining your investment strategy, and
- risk management.

2. Investment objectives

Client characteristics and needs

When formulating an investment strategy, your first step is to define the client characteristics and needs each model will be suited for. This will shape the investment objectives, including the desired risk and return outcome for each portfolio.

Investment objectives should be measurable, formally documented and clearly communicated. A statement of investment objectives would ordinarily include a clear expression of a measurable target investment return and a measurable target level of risk exposure.

Return objective

A return objective provides a point of reference to evaluate investment performance.

This means that your investment return objective must be specific and measurable. It should be expressed with a defined investment horizon and stated as either an absolute or relative term. It can also be specified in nominal or real terms. Nominal returns are not adjusted for inflation, whereas real returns are.

For example:

- a return objective expressed as a rate of return matching, or exceeding by x percentage points, a benchmark index over a period of y years, or
- a return objective to provide real long-term growth, when measured relative to CPI or the cash rate, over at least y years.

Risk objective

You should consider and articulate a measurable investment risk objective when setting an investment strategy for a portfolio. A risk objective aims to assist clients to understand the likelihood that the return objective/s of a portfolio may not be achieved.

To determine your risk objective, you must first specify your measurement of risk. Risk is measured in either absolute or relative terms. Absolute risk measurement will include a specific level of variance or standard deviation of total return. Relative risk measurement will include a specific tracking risk.

Risk objectives should include reference to the variability of returns over the defined investment horizon by your chosen measurement of risk.

For example:

- to have no more than x negative investment returns over a period of y years, and/or
- to maintain a tracking error below x percentage points over a period of y years relative to the risk objective benchmark.

3. Portfolio construction

Portfolio construction is a crucial step in forming your investment strategy that achieves your stated investment objectives.

Asset allocation

Where you formulate an investment strategy for an investment portfolio that involves more than one asset, the investment strategy must follow the AFSL asset allocation targets and ranges appropriate to achieving the investment objectives for the investment portfolio.

Irrespective of which asset allocation technique is used, you should adopt a formal approach to oversee the asset allocation. In doing so, your investment policy should set out:

- the investment horizon and investment objectives of the investment portfolio
- the initial target asset allocation for each asset class
- asset allocation ranges for each asset class
- a list of permissible investment types, and
- any investment restrictions.

Diversification

When formulating an investment strategy, you should consider the composition of investments within that investment strategy. You are also required to ensure that the investment options offered within the portfolio allow for adequate diversification.

A well-diversified investment strategy should be exposed to uncorrelated assets that have different risk and return profiles. This is typically achieved by investing across multiple assets and sub-asset classes, counterparties and geographic regions, and taking into account other factors such as liquidity, credit or macroeconomic risks where relevant.

Costs and tax considerations

When formulating an investment strategy, your policy should consider the costs and tax consequences that might be incurred in relation to the proposed investments.

When formulating the strategy, you should consider:

- the general cost effectiveness and cost efficiency of implementing an investment strategy, such as a minimum transaction amount, and
- factors related to tax efficiency such as turnover of the portfolio.

4. Consideration of Target Market Determinations (TMDs)

Your investment policy should include a process for identifying whether the proposed investment products in a model are in-scope for the Design and Distribution Obligations (DDO) by determining whether a TMD has been made, or is required to be made, for those investments.

You must also ensure you have a process for recording your assessment of the TMDs for each proposed investment, for example, by way of a standing agenda item in each meeting of the committee.

Where an investment is required to have a TMD, you should consider reviewing and recording:

- whether the client characteristics and needs identified in the investment objectives for each model align to those outlined in the TMD
- any investments that require the adviser using the model to consider the TMD in light of each individual client circumstances where they do not align, and
- any distribution restrictions set out in the TMD.

You should also consider whether the product issuer has issued a cease distribution notification, that will limit the distribution to the provision of personal advice. If you are providing Managed Discretionary Account (MDA) services, you cannot acquire products on a client's behalf where the product issuer has limited its distribution under personal advice as part of the MDA service.

It is important to document and communicate a summary of the above to your advisers so they can meet their reasonable steps requirements for DDO. Where your APL allows investments in MDAs, you should ensure the record keeping requirements for this service are referenced and complied with. If you have a DDO policy for your AFSL, you may also refer to this policy at this time.

5. Implementing an investment strategy

You should consider the most efficient and cost-effective way to implement your investment strategy for your clients both initially and ongoing.

6. Maintaining an investment strategy

Asset allocation rebalancing

Each investment strategy should include a policy to monitor and maintain the asset allocation within the determined ranges within a reasonable timeframe.

Monitoring investments

Your investment policy should include a monitoring schedule that includes reviewing the performance of each investment in each investment portfolio.

You are expected to have in place systems, structures and processes to measure and report the performance of each investment within the investment portfolio in line with their investment objectives and the overall investment objective of the strategy.

Effective performance monitoring arrangements are to be objective and measurable and exhibit characteristics that are consistent with those of the investment or the style of the investment manager being measured and should be formally documented.

You must also determine measures for under-performance and the process to be undertaken if under-performance continues to occur. This may include steps that will be taken to address under-performance, limit the exposure to these investment options or other actions that are in the best interests of your clients.

7. Investment risk management

Investment risk in portfolio management is the risk of an investment strategy failing to meet its investment objectives.

While investment risk is borne by your client, you and the investment committee are ultimately responsible for measuring and managing investment risk that may arise due to the investment strategy.

Investment risk management arrangements would typically comprise a range of tools for risk measurement and analysis that are commensurate with the size, business mix and complexity of the investments in the portfolio.

Ideally there would be appropriate segregation of duties between those persons responsible for implementing investment decisions and those persons responsible for the investment risk management arrangements, to ensure investment risk objectives are monitored and managed objectively.

Investment Committee Charter

1. Purpose and objectives

To ensure there is an explicit understanding by the committee members of their role, function and whether the portfolios they oversee fulfil their objectives. Your investment policy should set out the purpose of the investment committee, why it has been established and its objectives.

Sample

The purpose of this Investment Committee Charter ("Charter") is to specify the authority delegated to the Investment Committee ("Committee") by XYZ Financial Planning and to set out the role, responsibilities, membership and operation of the Committee.

The Charter specifies how the Committee will govern the matters relating to the strategic oversight and governance of XYZ Financial Planning's investment philosophy and strategy.

The objective of the Committee is to:

- assist in developing the overall investment strategy for XYZ Financial Planning's client portfolios
- oversee the implementation and management of the investment governance framework, and
- consider matters on behalf of XYZ Financial Planning relating to the investment strategy, philosophy, frameworks and policies.

2. Appointments and members

Your committee charter should set out the rules and parameters for the members of the committee and appointment procedures, including the committee chair (and delegate). It should detail:

- the minimum and maximum number of members
- the members (or their role in the practice) of the committee, their role and whether they have voting rights
- any specifics of how the committee is made up (including the use of external parties)
- the selection process, appointment and replacement/removal process of members
- how often the composition of the committee members should be reviewed with reference to a skills matrix, and
- the selection and appointment process for the chair, including delegated authorities in their absence.

Member attributes

Each member of the committee should have the skills and experience necessary to carry out the duties and obligations as determined under the investment policy.

Ideally, the experience and expertise of the members should be complementary. When, for example, one member's strength is in fixed income, another member might be highly experienced in the area of alternative asset classes. You should develop a skills matrix that sets out the skills required to be represented by the committee and map the skills of each committee member against the matrix to ensure full coverage.

Use of external parties

Where an investment committee has decided to utilise an external investment consultant, you should apply a robust due diligence process when selecting and appointing the potential consultant to the committee.

Chairperson appointment

The investment policy should consider nominating an appropriate individual as committee chair, or, in their absence, such other person that the committee may determine for that meeting (delegate).



You should develop a skills matrix that sets out the skills required to be represented by the committee and map the skills of each committee member against the matrix to ensure full coverage.



3. Committee Process

Meetings

The committee charter should set out how often the committee will meet, who can arrange meetings and the procedures for recording the business of the committee. It should describe:

- how often meetings should be held and how long they should be
- how meetings are called and the procedure for ad hoc meetings, and
- how business, minutes and actions are recorded.

Delegating tasks and use of sub-committees

You should describe:

- how any sub-committees will be established
- the functions, decision-making and tasks that are delegated to the sub-committee, including how these responsibilities are reported back to the committee, and
- any escalation procedures.

You should ensure clear contractual arrangements (where necessary) and service level agreements are in place.

Attendance

All committee members are expected to attend each meeting unless they are unavailable, or their absence is approved by the committee chair.

In the event that a member is unable to attend, your committee charter should detail whether members can appoint a delegate and whether any voting instructions or restrictions will apply.

The charter should set out how many absences per calendar year would be acceptable.

Voting and Quorum

The committee charter should detail how decisions by the committee will be decided, including:

- The quorum of the committee, detailing the minimum number of members that must be present at the meetings to make valid decisions (e.g. implementing the recommendations of the committee).
- Appointing a delegate and any instructions or restrictions that will apply.
- The voting procedures where there is a conflict of interest. It is best practice for you to consider the inclusion of an independent voting member and/or committee chair to participate in the decision-making process.
- How the committee will conduct extraordinary meetings outside of the normal meeting frequency.
- Whether the use of circular resolutions are permitted.
- Where there is an equality of votes (e.g. the committee chair having a casting vote).

4. Conflicts of interest

The general duties in connection with your Conflicts of Interest policy should be complied with.

A separate conflicts of interest policy for the committee should be considered for the investment policy with any impacts for the committee reflected in the committee charter. It should detail how the committee will effectively control and manage any conflicts of interest.

The conflicts of interest policy should, for example, address whether a member of the committee will participate in the determination of any matter in which they have a personal interest or any other relevant conflict of interest (such as a client, family member or close friend who works for a fund manager).

All committee members must have the ability to recognise and disclose actual, perceived and potential conflicts and ensure they are appropriately managed or avoided in line with the committee's conflicts of interest policy. Conflicts of interest should be disclosed by committee members when joining the committee and at the outset of each meeting of the committee by way of a standing agenda item.

The conflicts of interest policy must also address how any identified conflicts of interest are recorded, as well as the action taken to avoid or manage the conflict, in accordance with the policy.

If a member has a direct or indirect pecuniary interest or any other conflict of interest or duty not already disclosed that relates to a matter being considered, or about to be considered, by the committee, that member must inform the committee of the existence and substance of the conflict of interest.

Where a decision required at the committee relates to a related party investment, an independent voting member should participate in the decision and provide an independent vote regarding the recommendation.

In the absence of independent investment committee members, you must document how you have managed all identified conflict of interest investment decisions (eg use of external research).

If you need a Conflict of Interest policy in your AFSL, please contact IOOF Alliances for assistance. (This is part of a subscription to an AFSL policy suite).

5. Due diligence

You should have a due diligence process that is effective and commensurate with the nature and characteristics of each proposed investment decision.

An effective assessment would sufficiently address the complexity of that investment decision, with outcomes of the due diligence assessments documented.

In conducting due diligence for each investment decision, you must also give due consideration to any potential or actual conflicts of interest that may be present or may arise in accordance with the committee's conflicts of interest policy.

6. Record keeping

Your investment policy should set out how you will maintain the investment committee records for:

- committee papers and presentations
- management of conflicts of interest
- agendas and minutes of all meetings, and
- minutes of all votes and decisions.

7. Review of the investment policy

The investment policy should also set out when the policy will be reviewed to verify that it remains consistent with the committee's objectives and responsibilities, applicable law and relevant standards of corporate governance.

It is recommended that this review is conducted at least annually.

8. Resources

Consider using the following templates to support your committee:

- Conflicts of interest policy template
- Meeting agenda template
- Register of conflicts template
- Investment committee minutes template.

If you are looking for supporting documents and templates, please contact the Salita Portfolio Services team.

salitaportfolioservices.com.au

Or email support@salitaportfolioservices.com.au

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